GRAND TOYS INTERNATIONAL INC
Form 10-Q
August 12, 2004

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, 2004**

[ ]

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

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to _______________.

Commission File No. 0-22372.

GRAND TOYS INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Nevada

98-0163743

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization

Identification No.)

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

(Address of principal executive offices)

(514) 685-2180

(Registrant s telephone number, including Area Code)

(Former name, former address and former fiscal year,

if changed since last report)

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

Yes

X

No _____

Indicate the number of shares outstanding of each of the Issuer s classes of common equity, as of August 11, 2004: 5,355,244

GRAND TOYS INTERNATIONAL, INC.

Index to Quarterly Report on Form 10 Q
Filed with the Securities and Exchange Commission
Period ended June 30, 2004

GRAND TOYS INTERNATIONAL, INC.

Part I. Financial Information

Item 1. Consolidated Financial Statements

Consolidated Balance Sheets

	June 30, 2004 (Unaudited)	December 31, 2003
Assets		
Current assets:		
Cash	$ 757,196	$ 1,487,318
Short-term deposit (note 14(c))	500,000	500,000
Accounts receivable (net of allowance for doubtful accounts of $9,441; 2003 - $9,712)	2,093,977	1,598,907
Due from Playwell International Limited	1,744,017	804,252
Due from employees	4,011	771
Current portion of loan receivable (note 2)	302,894	161,447
Note receivable (note 9)	127,802	-
Inventory	2,049,408	1,682,298
Prepaid expenses (note 3)	474,105	367,288
Total current assets	8,053,410	6,602,281
Note receivable (note 9)	-	286,896
Loan receivable (note 2)	-	220,963
Equipment and leasehold improvements, net (note 4)	198,631	219,988
Other assets (note 5)	8,676	13,331

Total assets	$	8,260,717	$	7,343,459

GRAND TOYS INTERNATIONAL, INC.

Consolidated Balance Sheets

	June 30, 2004 (Unaudited)	December 31, 2003
Liabilities and Stockholders' Equity		
Current liabilities:		
Bank indebtedness (note 6)	$ 1,647,808	$ 1,579,458
Trade accounts payable	1,172,734	1,047,390
Other accounts payable and accrued liabilities	363,274	217,567
Accrued compensation	55,654	111,085
Accrued legal expenses	153,362	151,711
Total current liabilities	3,392,832	3,107,211
Minority interest	100	100
Stockholders' equity:		
Capital stock (note 7):		
Voting common stock, $0.001 par value:		
12,500,000 shares authorized,		
5,355,244 shares issued and outstanding	5,355	5,355
Additional paid-in capital	22,749,791	22,750,518
Deficit	(17,249,667)	(17,968,179)
Accumulated other comprehensive income-		
cumulative currency translation adjustment	(637,694)	(551,546)
	4,867,785	4,236,148
Commitments and contingencies (notes 13 and 14)		
Total liabilities and stockholders' equity	$ 8,260,717	$ 7,343,459

See accompanying notes to unaudited consolidated financial statements.

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GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Operations (Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2004	2003	2004	2003
Net sales	$ 2,775,237	$ 2,602,474	$ 5,588,935	$ 5,509,806
Cost of goods sold	1,423,243	1,396,821	3,097,848	3,086,339
Gross profit	1,351,994	1,205,653	2,491,087	2,423,467
Operating costs and expenses:				
General and administrative	508,656	692,264	1,008,077	1,221,357
Salaries and fringe benefits	296,001	378,927	633,890	673,629
Royalties	21,361	57,871	44,235	127,766
Bad debt expense	11,537	18,848	24,476	29,449
Depreciation and amortization	13,436	17,514	26,863	33,933
	850,991	1,165,424	1,737,541	2,086,134
Non-operating expense (income):				
Interest expense	21,194	26,471	40,640	47,208
Interest revenue	(9,446)	(13,431)	(23,576)	(28,325)
Foreign exchange loss (gain)	6,971	(31,577)	17,970	(90,720)
	869,710	1,146,887	1,772,575	2,014,297
Earnings before income taxes	482,284	58,766	718,512	409,170
Income tax expense	-	-	-	325
Earnings from continuing operations	482,284	58,766	718,512	408,845
Gain on sale of discontinued operations	-	129,725	-	232,727
Net earnings applicable to common stockholders	$ 482,284	$ 188,491	$ 718,512	$ 641,572

Earnings per share (note 10):

Continuing operations:				
Basic	$ 0.09	$ 0.02	$ 0.13	$ 0.15
Diluted	0.08	0.01	0.12	0.04
Discontinued operations:				
Basic	-	0.05	-	0.08
Diluted	-	0.02	-	0.04
Net earnings:				
Basic	0.09	0.07	0.13	0.23
Diluted	0.08	0.03	0.12	0.11

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GRAND TOYS INTERNATIONAL, INC.

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

	Capital Stock	Additional Paid in Capital	Deficit	Accumulated other comprehensive income	Total
January 1, 2004	$ 5,355	$ 22,750,518	$ (17,968,179)	$ (551,546)	$ 4,236,148
Net earnings for the period	-	-	718,512	-	718,512
Foreign currency adjustment	-	-	-	(86,148)	(86,148)
Total comprehensive income					632,364
Compensation expense	-	(727)	-	-	(727)
June 30, 2004	$ 5,355	$ 22,749,791	$ (17,249,667)	$ (637,694)	$ 4,867,785

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GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Cash Flows (Unaudited)

	For the six months ended June 30, 2004		2003	
Cash flows from operating activities:				
Net earnings from continuing operations	$	718,512	$	408,845
Adjustments for:				
Depreciation and amortization		26,863		33,933
Amortization of product development costs		4,265		1,584
Compensation expense		(727)		1,615
Net change in non-cash operating working capital				
items (note 11)		(1,757,360)		(55,778)
Net cash (used for) provided by operating activities		(1,008,447)		390,199
from continuing operations				
Net cash used for operating activities from		-		(113,331)
discontinuing operations				
Net cash (used for) provided by operating activities		(1,008,447)		276,868
Cash flows from financing activities:				
Increase (decrease) in bank indebtedness		54,479		(267,360)
Repurchase of shares		-		(12,982)
Decrease in loan payable to a director		-		(32,169)
(Decrease) increase in due from employees		(3,248)		4,121
Other		82		1,512
Net cash provided by (used for) financing activities		51,313		(306,878)
Cash flows from investing activities:				
Proceeds from loan receivable		79,516		89,138
Proceeds from note receivable		159,094		370,694
Decrease in other assets		-		19,965
		(11,598)		(2,993)

Additions to equipment and leasehold improvements				
Net cash provided by investing activities		227,012		476,804
Net decrease in cash and cash equivalents		(730,122)		446,794
Cash and cash equivalents, beginning of period		1,487,318		540,896
Cash and cash equivalents, end of period	$	757,196	$	987,690

Supplemental disclosure of cash flow information (note 12)

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GRAND TOYS INTERNATIONAL, INC.

Notes to Unaudited Consolidated Financial Statements

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

1.

Significant accounting policies:

(a)

Principles of consolidation:

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

(b)

Revenue recognition:

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

Net sales include gross revenues, freight charged to customers and FOB commissions, net of allowances and discounts such as defectives, returns, volume rebates, cooperative advertising, cash discounts, customer fines, new store allowance, markdowns, freight and warehouse allowance.

(c)

Cost of Goods Sold:

Cost of Goods Sold includes cost of merchandise, duties, brokerage fees, inbound freight, packaging, product development and provision on slow-moving inventory.

(d)

General and Administrative Costs:

General and Administrative costs include advertising expense, royalties, rent, insurance costs, travel and entertainment, utilities, courier, repairs and maintenance, communications expense, office supplies, professional fees, dues and membership, bank charges and property taxes expense.

Outbound shipping and handling costs incurred by the company are included in general and administrative expenses. For the six-month periods ended June 30, 2004 and June 30, 2003, freight out was $35,588 and $27,788 respectively.

(e)

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.

(f)

Prepaid expenses:

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

Prepaid royalties relate to licensing agreements for character properties. These contracts can extend for up to three years. Total expense for the six-month periods ended June 30, 2004 was $44,235 (2003 - $127,767) and is shown as royalty expense in the statements of operations.

Prepaid taxes are amortized on a straight-line basis over the period to which they relate. The amount expected to be recognized in the statement of operations in 2004 is $55,593.

(g)

Other assets:

Prepaid royalties are capitalized and amortized as earned in relation to product sales, over a period not to exceed the term of the related agreements. The amounts expected to be recognized in the statement of operations during the remainder of 2004 and the year 2005 are $1,583 and $1,772, respectively.

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

(h)

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	Annual rates/periods

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

(i)

Incomes taxes:

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

(j)

Foreign currency translation:

i)

Grand Toys Ltd., a wholly-owned Canadian subsidiary of the Company, uses the Canadian dollar as its functional currency. Financial statements of the self-sustaining foreign operation are translated into US dollars using the exchange rate prevailing at the balance sheet date for assets and liabilities and the average exchange rate for the year for revenues, expenses and cash flows. The resulting currency translation adjustments are accumulated and reported in other comprehensive income.

ii)

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

(k)

Guarantees:

In November 2002, the Financial Accounting Standards Board (FASB) Interpretation No.45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, was issued. This Interpretation enhances the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation were applicable to guarantees issued or modified after December 31, 2002 and the disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002. The Company was not a party to any guarantees as at June 30, 2004 and June 30, 2003.

(l)

Earnings per Share:

i)

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

ii)

Diluted earnings per share give effect to all potentially dilutive common shares that existed at June 30, 2004.

(m)

Advertising and Promotion:

All costs associated with advertising and promoting products are included in the statement of operations in the period incurred. Media advertising expense for the six-month periods ended June 30, 2004 and 2003 were $39,415 and $198,005, respectively, and are shown as part of general and administrative expenses in the financial statements. Cooperative adverting expense for the period ended June 30, 2004 and 2003 were $30,144 and $96,697, respectively, and are shown as a reduction of revenues in the financial statements

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

(n)

Employee stock option plan:

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

(o)

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.

(p)

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.

(q)

Cash and cash equivalents:

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

2.

Loan receivable:

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

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

Details are as follows:

		June 30, 2004		December 31, 2003
Amount due repayable in monthly payments of principal and interest of $7,500 until November 30, 2001, $21,124 until March 31, 2003 and $15,000 until April 2005, with a final payment of $165,789 in May 2005	$	302,894	$	382,410
Less current portion		302,894		161,447
	$	-	$	220,963

3.

Prepaid expenses:

		June 30, 2004		December 31, 2003
Prepaid inventory	$	56,936	$	66,555
Royalties		3,355		14,821
Insurance		274,607		192,699
Other		139,207		93,213
	$	474,105	$	367,288

4.

Equipment and leasehold improvements:

	June 30, 2004		December 31, 2003	
		Accumulated		Accumulated
	Cost	depreciation	Cost	depreciation
Computer equipment	$ 1,456,959	$ 1,326,603	$ 1,486,846	$ 1,342,114
Machinery and equipment	497,779	486,658	512,100	499,387
Furniture and fixtures	542,042	523,979	557,376	536,840
Trucks and automobiles	91,620	91,248	94,256	93,806
Telephone equipment	50,630	45,217	52,086	45,900
Leasehold improvements	282,810	249,504	290,945	255,574
	$ 2,921,840	$ 2,723,209	$ 2,993,609	$ 2,773,621
Net book value		$ 198,631		$ 219,988

5.

Other assets:

	June 30, 2004	December 31, 2003
Prepaid royalties	$ 3,355	$ 14,821
Product development costs	8,676	13,331
	12,031	28,152
Less current portion of prepaid royalties, included in prepaid expenses	3,335	14,821
	$ 8,676	$ 13,331

6.

Bank indebtedness:

The Company has a line of credit to finance its inventory and accounts receivable for advances of up to $2,624,082 (CA$3,500,000). The receivable loan has a discount fee of 2.0% and the inventory loan bears interest at Canadian prime plus 7.5%. The agreement is for a period of one year and is renewed automatically, unless prior notice is given by either party.

The loan is secured by a first lien in the principal amount of $2,999,000 (CA$4,000,000) on the universality of all present and future assets of the Company and the assignment of insurance. There are no debt covenants or cross-default provisions.

As at June 30, 2004, the Company had approximately $976,274 (December 2003 - $1,120,000) of credit available under this facility, subject to the availability of eligible inventory and accounts receivable.

7.

Capital stock

(a)

Authorized capital also includes 5,000,000, $0.001 par value preferred shares, issuable in series with such designation, rights and preferences as may be determined from time to time by the Board of Directors. There are no preferred shares issued and outstanding at June 30, 2004.

(b)

Share transactions:

i)

April 2003:

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

ii)

August 2003:

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

iii)

November 2003:

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

(c)

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

There were no transactions in the six-month period presented.

	June 30, 2004	December 31, 2003
Common Stock	5,355,244	5,355,244

8.

Stock options and warrants:

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

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

Changes in options and warrants are as follows:

	Option Plan	Other stock options	Warrants	Total		Weighted-average exercise price per share
January 1, 2004	213,464	196,000	637,143	1,046,607	$	1.74
Granted	1,750	-	-	1,750		2.89
Options outstanding and exercisable at June 30, 2004	215,214	196,000	637,143	1,048,357	$	1.74

The following table summarizes information about options and warrants outstanding and exercisable at June 30, 2004:

		Options and warrants outstanding and exercisable		
Range of exercise prices	Number		Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
$0.01 - $1.96	554,214	$	0.59	4.60
$2.12 - $3.07	477,643		2.21	2.96
$5.62 - $11.00	1,000		7.78	6.07

$16.00 - $87.60	15,500		28.13	3.87
	1,048,357	$	1.74	3.84

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

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

		June 30, 2004		June 30, 2003
Earnings from continuing operations, as reported	$	718,512	$	408,845
Add compensation cost resulting from:				
Application of variable accounting to modified awards (APB Opinion No. 25)		(727)		1,615
Application of fair value method (FASB Statement No. 123)		(3,623)		(4,967)
Pro-forma earnings from continuing operations		714,162		405,493
Earnings from discontinued operations		-		232,727
Pro-forma net earnings applicable to common stockholders	$	714,162	$	638,220
<u>Basic EPS</u>				
Earnings from continuing operations	$	0.14	$	0.15
Earnings from discontinued operations		-		0.08
Net earnings applicable to common stockholders		0.14		0.23
<u>Diluted EPS</u>				
Earnings from continuing operations	$	0.12	$	0.07
Earnings from discontinued operations		-		0.04
Net earnings applicable to common stockholders		0.12		0.11

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

	June 30, 2004	June 30, 2003
Weighted average expected life (years)	3	3
Risk-free interest rate	3.16%	4.92%
Volatility factor of expected market price of Company s common stock	124%	149%
Dividend rate	-	-
Weighted average grant date fair value of options and warrants	$ 2.00	$ 1.91

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

Compensation (income) expense of $(727) and $1,615 was recorded for the six-month periods ended June 30, 2004 and 2003, respectively, as a result of the application of variable accounting to modified awards.

9.

Discontinued operations:

On June 14, 2002, the Company sold its investment in its wholly-owned subsidiary, Sababa Toys Inc. ("Sababa"), to the subsidiary's management for $1,065,716. Consideration received by the Company was a promissory note secured by the shares of Sababa.

The promissory note is being repaid using cash collected on accounts receivable and inventories, net of liabilities existing as at June 14, 2002, and 10% of net sales of inventories acquired after that date. Any balance owing will be due on June 30, 2005. At June 30, 2004, the balance owing on the note receivable was $127,802 and it was classified under current asset.

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

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

	Deferred Gain	Note receivable
Balance, January 01, 2003	$ 497,800	$ 884,877
Recorded in 2003	(497,800)	(597,981)
Balance, December 31, 2003	-	286,896
Recorded in 2004	-	159,094
Balance, June 30, 2004	$ -	$ 127,802

10.

Earnings per share:

		Income (numerator)	Shares (denominator)		Per Share Amount
Quarter ended June 30, 2004					
Basic EPS					
Earnings from continuing operations	$	482,284	5,355,244	$	0.09
Earnings applicable to common stockholders and assumed conversions		482,284	5,355,244		0.09
Diluted EPS					
Earnings from continuing operations	$	482,284	5,909,480	$	0.08
Earnings applicable to common stockholders and assumed conversions		482,284	5,909,480		0.08

		Income (numerator)	Shares (denominator)		Per Share Amount
Six months ended June 30, 2004					
Basic EPS					
Earnings from continuing operations	$	718,512	5,355,244	$	0.13
Earnings applicable to common stockholders and assumed conversions		718,512	5,355,244		0.13
Diluted EPS					
Earnings from continuing operations	$	718,512	5,945,619	$	0.12
Earnings applicable to common stockholders and assumed conversions		718,512	5,945,619		0.12

For the six-month period ended June 30, 2004, options and warrants to purchase 16,500 shares (June 2003 93,375) of the Company s common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

For the quarter ended June 30, 2004, options and warrants to purchase 18,750 shares (June 2003- 93,375) of the company s common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

11.

Net change in non-cash operating working capital items:

		For the six months ended June 30, 2004		2003
Continuing operations:				
(Increase) decrease in accounts receivable	$	(537,147)	$	782,655
Increase in amount due from Playwell International Limited		(939,765)		-
(Increase) in inventory		(412,498)		(765,937)
(Increase) in income taxes recoverable		-		(3,723)
(Increase) in prepaid expenses		(113,323)		(77,209)
Increase (decrease) in trade accounts payable		145,628		(137,925)
Increase (decrease) in other accounts payable and accrued liabilities		149,964		(23,787)
(Decrease) increase in accrued compensation		(52,115)		59,600
Increase in accrued legal expenses		1,896		110,548
	$	(1,757,360)	$	(55,778)

12.

Supplemental disclosure of cash flow information:

		For the six months ended June 30, 2004		2003
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	$	40,640	$	47,208
Income taxes		-		325

13.

Commitments:

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

2004	$	167,000
2005		343,000
2006		343,000
2007		338,000
2008		334,000
Thereafter		240,000

Rent expense for the six month periods ended June 30, 2004, and 2003 amounted to approximately $79,135 and $61,197, respectively.

The Company has entered into a long-term agreement to sub-lease a portion of its warehouse, resulting in a reduction of the minimum annual rental payments presented above of approximately $47,845 for the remainder of 2004 and $116,000 annually from 2005 to 2007 and $ 73,000 for 2008.

14.

Contingencies:

(a)

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

(b)

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

(c)

The Company s Canadian subsidiary is contingently liable for an outstanding letter of credit of $500,000 as at June 30, 2004. The short-term deposit has been pledged as collateral for this letter of credit.

(d)

On April 15, 2004, the Company was named in a lawsuit for alleged non-payment of commissions. In the opinion of management, it is difficult to ascertain or estimate the value of a settlement if any.

15.

Segment information:

(a)

Operating and geographic information:

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

(b)

Other information:

		June 30, 2004			June 30, 2003	
		Revenue	%		Revenue	%
Customer A	$	1,285,455	23	$	1,157,059	21

B		1,006,008	18		936,667	17
C		670,672	12		550,981	10
All others		2,626,800	47		2,865,099	52
	$	5,588,935	100	$	5,509,806	100

Sales of toys purchased from the Company's two largest manufacturers and suppliers of toys in aggregate accounted for 80% of gross sales for the six-month periods ended June 30, 2004. The Company s two largest suppliers accounted for 77% of gross sales for the six-months periods ended June 30, 2003.

16.

Related party transactions:

During the six-month period, the Company paid $46,241 (June 2003 - $42,743) in consulting fees to two directors/stockholders**.**

11

17.

Financial instruments:

(a)

Fair values:

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

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

(b)

Credit risk and economic dependence:

For the six-month periods ended June 30, 2004, approximately 65% (June 30, 2003 - 58%) of the Company s sales were made to five unrelated companies. Three customers representing approximately 53% (June 30, 2003 - 48%) of total sales, individually accounted for 12% or more (June 30, 2003 - 10%) of total sales. The Company regularly monitors its credit risk exposure to these and other customers and takes steps to mitigate the risk of loss.

(c)

Interest rate risk:

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

18.

Shareholder s reorganization:

On November 14, 2003, Grand, Grand Toys International Limited, a Hong Kong limited company and a wholly-owned subsidiary of the Company (Grand HK), and Centralink Investments Limited, a British Virgin Islands company (Centralink), entered into a Subscription and Exchange Agreement which was subsequently amended on March 6, 2004, March 31, 2004, May 31, 2004 and July 26, 2004 (as so amended, the Subscription and Exchange Agreement) pursuant to which, among other matters:

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

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

Centralink will also subscribe for 5,000,000 Grand HK ADRs for cash and other consideration totaling $11,000,000.

For accounting purposes Playwell is considered to be the acquirer. As part of the transaction Playwell has agreed to reimburse the Company for its direct costs related to the transaction which amounted to $804,252 at December 31, 2003, and $1,744,017 at June 30, 2004

A proxy statement/prospectus concerning these transactions was declared effective by the Securities and Exchange Commission on July 29, 2004 and on August 13, 2004, a Special Meeting of Shareholders will be held to vote on the reorganization merger and the issuance of the 10,000,000 Grand HK ADSs to Playwell.

19.

Subsequent event related party transactions

On July 19, 2004, 225,000 shares were issued upon the exercise of 225,000 warrants held by Mr Ian Bradley, who was an executive of the Company between 2001 and 2002.

GRAND TOYS INTERNATIONAL, INC.

Item 2. Management s Discussion and Analysis:

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

Overview

Forward-looking statements.

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

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

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

March 6, 2004, March 31, 2004, May 31, 2004 and July 26, 2004 (as so amended, the Subscription and Exchange Agreement) pursuant to which, among other matters:

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

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

Centralink will also subscribe for 5,000,000 Grand HK ADRs for cash and other consideration totaling $11,000,000.

Net sales include gross revenues, freight charged to clients and FOB commissions, net of allowances and discounts such as defectives, returns, volume rebates, cooperative advertising, cash discounts, customer fines, new store allowance, markdowns, freight and warehouse allowance.

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

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

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

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

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, the Company may make exceptions to this policy on a case-by-case negotiated basis. Inventory is comprised of finished goods at landed cost.

Critical Accounting Policy

Management s Discussion and Analysis of Financial Condition and Results of Operations discuss the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires the Company s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, the Company s management evaluates its estimates and judgments, including those related to sales reserve for returns and allowances and inventory obsolescence. The Company s management bases its estimates and judgments on the customer term agreements, historical experience, retail performance of the products sold and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The Company s management believes that its critical accounting policy on sales reserves for returns and allowances and inventory obsolescence, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

The Company establishes sales reserves at the time of sale based on the terms indicated in the customer term agreements, historical experience of discounts and returns on related products. The return of non-defective product occurs infrequently in Canada and the United States, and such returns are usually covered by customer terms agreements, thereby reducing the risk of additional expense. If the defective issue is pervasive to the whole product line, the supplier of the product would be responsible for the excess defective claim over the amount allowed per the term agreement. The financial statement line that would be impacted is net sales as these charges offset gross sales.

Inventory obsolescence is reviewed on a monthly basis. The factors considered include current market prices, the demand for and the seasonality of its products. The Company tailors its purchase of inventory to the rate of sell-through at retail of each item. In addition, the Company does not have purchase commitments to its current vendors. For these reasons, the Company s management believes that the inventory is fairly stated. If circumstances should change (i.e. unexpected shift in market demand, pricing, trends etc.), there could be a material impact on the net realizable value of inventory that would impact the results of Grand. The financial statement line that would be impacted is cost of goods sold.

These risks are not specific to the Company and are considered normal business risks.

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 Ended June 30,		For the Six months ended June 30,	
	2004	2003	2004	2003
	%	%	%	%
Net sales	100.00	100.00	100.00	100.00
Cost of goods sold	51.28	53.67	55.43	56.01
Gross profit	48.72	46.33	44.57	43.99
Operating costs and expenses:				
General and administrative	18.33	26.60	18.04	22.17
Salaries and fringe benefits	10.67	14.56	11.34	12.23
Royalties	0.77	2.22	0.79	2.32
Bad debt expense	0.42	0.72	0.44	0.53
Depreciation and amortization	0.48	0.67	0.48	0.62
	30.67	44.77	31.09	37.87
Non-operating expense (income)				
Interest expense	0.77	1.02	0.73	0.86
Interest revenue	(0.34)	(0.51)	(0.42)	(0.51)
Foreign exchange (gain) loss	0.26	(1.21)	0.32	(1.65)
	31.34	44.07	31.72	36.57
Earnings before income taxes	17.38	2.26	12.85	7.42
Earnings from continuing operations	17.38	2.26	12.85	7.42
Gain on sale of discontinued operations	-	4.98	-	4.22
Net earnings applicable to common stockholders	17.38	7.24	12.85	11.64

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

Comparison of the three months ended June 30, 2004 to the three months ended June 30, 2003:

Net Earnings:

Net earnings for the second quarter of 2004 were $482,284, or $0.09 per share, as compared to a net earnings of $188,491, or $0.07 per share, for the second quarter of 2003. Without the gain on discontinued operations in the second quarter of 2003, net earnings would have been $58,766, or $ 0.02 per share.

Net earnings increased during the quarter ended June 30, 2004 by $293,793, from $188,491 to $482,284 as a result of increases in FOB commissions and reduction in expenses which were offset by reduced margins as a result of the decrease in sales of the Astrojax product line.

Net Sales:

Net sales increased during the second quarter of 2004 by $172,763, or by 6.64%, to $2,775,237 from $2,602,474 for the second quarter of 2003. Domestic sales decreased due to the leveling off of certain product lines. This decrease was more than offset by increases in sales of Spiderman and the Art X-press product lines and the increase in commissions on FOB sales.

Gross Profit:

Gross profit for the Company increased during the second quarter of 2004 by $146,341 from $1,205,653 to $1,351,994. As a percentage of sales, gross profit increased from 46.33% in the second quarter of 2003 to 48.72% in the second quarter of 2004.

Gross profit increased as a result of the increase in FOB commissions in the second quarter of 2004, which is partially offset by the decrease in sales in the second quarter of 2004 of higher margin product lines.

General and Administrative Expenses:

General and administrative expenses decreased by $183,608 to $508,656, in the second quarter of 2004, from $692,264 in the second quarter, of 2003 as a result of a decrease in media advertising and insurance premiums. The decrease is consistent with management s emphasis on controlling costs.

During the second quarter of 2004, total advertising expense decreased by $158,890 as a result of a decrease in media advertising compared to the second quarter of 2003.

Salaries and Fringe benefits:

Salaries and fringe benefits expenses decreased by 21.88%, from $378,927 for the quarter ended June 30, 2003 to $296,001 for the quarter ended June 30, 2004.

The decrease was a result of a reduction in commission payments to the Company s sales representatives and also there was no provision for bonus payment in the second quarter of 2004 as compared to the second quarter of 2003.

Royalties Expense:

Royalties expense decreased by 63.09%, from $57,871 for the quarter ended June 30, 2003 to $21,361 for the quarter ended June 30, 2004, as a result of the decrease in the sales of the Astrojax licensed product line.

Bad Debts Expense:

Bad debts expense decreased by $7,311, from $18,848 for the quarter ended June 30, 2003 to $11,537 in the quarter ended June 30, 2004. The decrease in bad debts expense for the quarter ended June 30, 2004 is explained by the absence of customer bankruptcy costs which were included in the bad debts expense for the quarter ended June 30, 2003.

Foreign Exchange (gain) loss:

As a result of the decline of the Canadian dollar in the second quarter of 2004, the Company reported a foreign exchange loss of $6,971 as compared to a gain of $31,577 in the second quarter of 2003.

Gain on Discontinued Operation:

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

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

For the second quarter of 2003, the Company recorded a gain of $129,725. As of December 31, 2003 the balance of the gain has been fully recorded in income.

Comparison of the six months ended June 30, 2004 to the six months ended June 30, 2003

Net Earnings:

Net earnings for the first six months of 2004 were $718,512, or $0.13 per share, as compared to a net earnings of $641,572, or $0.23 per share, for the first six months of 2003. Without the gain on discontinued operations in the first six months of 2003, net earnings would have been $ 408,845 or $0.15 per share.

Net earnings from continuing operations increased by $309,667, from $408,845 to $718,512, as a result of increases in FOB commissions and reduction in expenses, which were offset by reduced margins as a result of the decrease in sales of the Astrojax product line.

Net Sales:

Net sales increased for the first six months of 2004 by $79,129, or by 1.4%, to $5,588,935 from $5,509,806 for the first six months of 2003 due to an increase in commissions received by the Company.

For the six month period ended June 30, 2004, sales increased slightly as a result of the decreased domestic sales due to the leveling off of certain product lines. These decreases were offset by increases in sales of Spiderman and the Art X-press product line and the receipt of commissions on FOB sales.

Gross Profit:

Gross profit for the Company increased during the first six months of 2004 by $67,620 compared to the first six months of 2003. As a percentage of sales, gross profit increased from 43.99% in the first six months of 2003 to 44.57% in the first six months of 2004.

During the first six months of 2004, the decrease in the sales of higher margin product lines offset the increase in FOB commissions, resulting in a slight increase in gross profit for the six months ended June 30, 2004 as compared to the first six months of 2003.

General and Administrative Expenses:

The decrease of 17% in general and administrative expenses of $213,280 to $1,008,077 in the first six months of 2004 from $1,221,357 in the first six months of 2003, was due to an overall decrease in overhead accounts as a result of management s emphasis on controlling costs.

Expense reductions were realized in advertising and insurance expenses. During the first six months of 2004, there was less media advertising and the Company benefited from a reduction in insurance premiums.

Salaries and Fringe benefits:

Salaries and fringe benefits expenses were reduced by 5.9%, from $673,629 for the six months ended June 30, 2003 to $633,890 for the current period.

The reduction of $39,739 is due to the absence of a provision for bonus payment in 2004.

Royalties Expense:

Royalties expense decreased by 65.38%, from $127,766 for the six months ended June 30, 2003 to $44,235 for the six months ended June 30, 2004, as a result of the decrease in the sales of the Astrojax licensed product.

Bad Debts Expense:

Bad debts expense decreased by $4,973 from $29,449 for the six months ended June 30, 2003 to $24,476 for the six months ended June 30, 2004. The decrease in bad debts expense for the six months ended June 30, 2004 is explained by the absence of customer bankruptcy costs which were included in the bad debts expense for the six months ended June 30, 2003.

Foreign Exchange (gain) loss:

As a result of the decline of the Canadian dollar in the first six months of 2004, the Company reported a loss of $17,970 as compared to a gain of $90,720 in the first six months of 2003.

Gain on Discontinued Operation:

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

As of June 14, 2002 the Company recognized a gain on the sale of $761,584. As of December 31, 2002, $263,784 was recorded in the Statement of Operations.

For the six-month period ended June 30, 2003, the Company recorded a gain of $232,727. The balance of the gain has been deferred and will be recorded in income on a proportionate basis as the proceeds from the note receivable are received

Liquidity and Capital Resources

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

The Company has a line of credit to finance its inventory and accounts receivable for advances of up to $2,624,082 (CA$3,500,000).The receivable loan has a discount fee of 2.0% and the inventory loan bears interest at Canadian prime plus 7.5%.The agreement is for a period of one year and is renewed automatically, unless prior notice is given by either party.

The loan is secured by a first ranking movable hypothec in the principal amount of $2,999,000 (CA$4,000,000) on the universality of all present and future assets of the Company and the assignment of insurance. There are no debt covenants or cross-default provisions.

Accounts receivable at June 30, 2004 were $2,093,977 compared to $1,598,907 at December 31, 2003. The sales were mainly to mass retailers. Inventory at June 30, 2004 increased to $2,049,408 from $1,682,298 at December 31, 2003.

Working capital increased from $3,495,070 at December 31, 2003 to $4,660,578 at June 30, 2004. Net cash used for operating activities was $1,008,447 in 2004 compared to net cash provided by operating activities of $276,868 in 2003. Cash for additions to equipment and leasehold improvements was $11,598 in 2004 compared to $2,993 for 2003.

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

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

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

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

Contractual Obligations

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

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

Contractual Obligations		Less than 1 year		1-3 years		3-5 years		More than 5 years
Operating lease obligations	$	167,000	$	1,024,000	$	574,000	$	-

Risk Factors

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

The Company s three largest customers accounted for approximately 53% and 49% of its net sales in the six-month period ended June 30, 2004 and for the year ended December 31, 2003, respectively. Except for outstanding purchase orders for specific products, the Company does not have written contracts with or commitments from any of its customers. A substantial reduction in or termination of orders from any of its largest customers could adversely affect its business, financial condition and results of operations. In addition, pressure by large customers seeking a reduction in prices, financial incentives, a change in other terms of sale or on the Company to bear the risks and the cost of carrying inventory could also adversely affect the Company s business, financial condition and results of operations.

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

The Company has operated without a written distribution agreement with Toy Biz Worldwide Ltd. (Toy Biz) since 2001. However, it has continued to distribute the product lines carried by Toy Biz during 2002 and 2003 and has accepted orders from Toy Biz in 2004. Because Toy Biz is affiliated with Playwell, the Company s management believes that its relationship with Toy Biz will continue past 2004 if the Playwell acquisition is consummated. However, if the Playwell acquisition is consummated, or even if it is not, there can be no assurance that the Company will be able to retain the right to distribute the Toy Biz product line or, even if the Company does retain this right, that any of the products in this branded product line will retain their current popularity. The loss of the Company s distribution rights for any of these product lines or the decrease in the popularity of any one of these branded product lines would adversely affect its business, financial condition and results of operations.

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

Although the Company had net earnings of $718,512 and $1,112,577 for the six-month period ended June 30, 2004 and for the year ended December 31, 2003, it incurred a net loss of $826,848 for the year ended December 31, 2002 and prior to the fiscal year ended December 31, 2003, and had not reported an annual profit since the year ended December 31, 1997. The Company believes that its return to profitability in 2003 resulted form its recent focus on the distribution of products with higher profit margins and the reduction in expenses. Although these efforts were successful in the first and second quarter of 2004 and for the year ended December 31, 2003, the Company cannot be sure that its efforts will result in continued profitability on an annual basis in the future.

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

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

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

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

The Company s management exercises substantial control over its business

As of July 15, 2004, the Company s directors and executive officers and their affiliates beneficially owned, in the aggregate, 2,087,312 shares of the Company s common stock, representing approximately 39% of the common stock outstanding. Accordingly, if these persons act together, they exercise significant control over matters requiring approval of our stockholders, including the election of the Company s board of directors.

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

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

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

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

(a)

215,214 shares are issuable upon the exercise of currently outstanding options granted under the Company s Amended and Restated 1993 Stock Option Plan the sale of a portion of which have been registered on a registration statement on Form S-8;

(b)

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

(c)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Company faces substantial competition in the toy distribution industry

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

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

The Company s business is seasonal and, therefore, its annual operating results will depend, in large part, on its sales during the relatively brief holiday season from September through December when the majority of its sales take place. Further, the impact of seasonality is increasing as large retailers become more efficient in their control of inventory levels through quick response management techniques. Rather than maintaining large on-hand inventories throughout the year to meet consumer demand, these customers are timing reorders so that they are being filled by suppliers closer to the time of purchase by retail customers, which to a large extent occur during September through December. While these techniques reduce a retailer's investment in inventory, they increase pressure on suppliers like the Company to fill orders promptly and shift a significant portion of inventory risk and carrying costs to the supplier. The limited inventory carried by retailers may also reduce or delay retail sales. Additionally, the logistics of supplying more and more product within shorter time periods will increase the risk that the Company may fail to achieve tight and compressed shipping schedules. This seasonal pattern requires significant use of working capital mainly to manufacture inventory during the year, prior to the holiday season, and requires accurate forecasting of demand for products during the holiday season. The Company s failure to accurately predict and respond to consumer demand could result in its under-producing popular items and overproducing less popular items.

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

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

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

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

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

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

The Company does not expect to pay dividends on its stock

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

Effects of Inflation

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

New Accounting Pronouncements

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

The FASB's issued are as follows :

FAS No.148 *Accounting for Stock Based Compensation* . This provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock based employee compensation and the effect of the method used on reported results. The standard also improves the prominence and clarity of the pro forma disclosures required by FAS No.123 by prescribing a specific tabular format and by requiring disclosure in the Summary of Significant Accounting Policies . In addition it improves the timeliness of those disclosures by requiring them in our quarterly reports.

The Company has not voluntarily changed to the fair value based method of accounting. The improved disclosure was adopted in the Company s 10-K 2003 and subsequent periods. The impact of adopting the standard would be what is disclosed under FAS No.123 in the notes to the Company s Financial Statements.

FAS No.149 Amendment to FAS No. 133 on Derivative Instruments and Hedging Activities .This standard amends FAS No.133 for a variety of issues. This is effective for any contracts entered into after June 30 , 2003.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

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

FOREIGN CURRENCY RISK

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

Item 4.

Controls and Procedures.

In accordance with Exchange Act Rules 13a-15(e) and 15d-15(e), the Company carried out an evaluation, with the participation of the Chief Executive Officer and Chief Financial Officer, as well as other key members of the

Company s management, of the effectiveness of the Company s disclosure and procedures as of the end of the period covered by this report. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that information required to be disclosed in the Company s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

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

Part II: Other Information

Item 1. Legal proceedings

During the quarter ended June 30, 2004, there were no other material developments to any legal proceedings which have been previously reported by the Company.

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

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

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a)

Exhibits.

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

(b)

Reports on Form 8-K.

One report on Form 8-K was filed on May 14, 2004, reporting under item 12, the issuance of a press release announcing the Company s results for the first quarter of fiscal 2004.

GRAND TOYS INTERNATIONAL, INC.

Signatures

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

Dated: August 11, 2004

GRAND TOYS INTERNATIONAL, INC.

By: /s/ Stephen Altro
Stephen Altro
Interim President and Chief Executive Officer

By: /s/ Tania M. Clarke
Tania M. Clarke
Executive Vice President and CFO
(Principal Financial and Accounting Officer)

GRAND TOYS INTERNATIONAL, INC.

Signatures

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

Dated: August 11, 2004

GRAND TOYS INTERNATIONAL, INC.

By: /s/ Stephen Altro
Stephen Altro
Interim President and Chief Executive Officer

By: /s/ Tania M. Clarke
Tania M. Clarke
Executive Vice President and CFO
(Principal Financial and Accounting Officer)

Exhibit 31.1

Certification of Principal Executive Officer

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

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

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

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

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant s internal control over financial reporting that occurred during the registrant s most recent fiscal quarter [the registrant s fourth fiscal quarter in the case of an annual report], that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting; and;

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

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal control over financial reporting.

/s/ Stephen Altro

Stephen Altro

Date: August 11, 2004

Exhibit 31.2

Certification of Principal Financial Officer

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

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

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

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

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant s internal control over financial reporting that occurred during the registrant s most recent fiscal quarter [the registrant s fourth fiscal quarter in the case of an annual report], that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting; and;

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

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal control over financial reporting.

/s/ Tania M. Clarke

Tania M. Clarke

Date: August 11 , 2004

Exhibit 32.1

Certification of Principal Executive Officer

Pursuant to 18 U.S.C. 1350

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

I, Stephen Altro, Acting President and Chief Executive Officer (principal executive officer) of Grand Toys International, Inc. (the Registrant), certify that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended June 30, 2004 of the Registrant (the Report):

(1)

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

(2)

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

/s/ Stephen Altro

Name: Stephen Altro
Date: August 11, 2004

Exhibit 32.2

Certification of Principal Financial Officer

Pursuant to 18 U.S.C. 1350

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

I, Tania M. Clarke, Chief Financial Officer (principal financial officer) of Grand Toys International, Inc. (the Registrant), certify that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended June 30, 2004 of the Registrant (the Report):

(1)

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

(2)

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

/s/ Tania M. Clarke

Name: Tania M. Clarke
Date: August 11, 2004

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