YP CORP
Form 10QSB/A
December 29, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB/A

Amendment No. 1

(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

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act

For the transition period from _____________ to _______________

Commission File Number 0-24217

YP CORP.
(Exact name of small business issuer as specified in its charter)

Nevada	**85-0206668**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

4840 East Jasmine St. Suite 105
Mesa, Arizona 85205
(Address of principal executive offices)

(480) 654-9646
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 o

APPLICABLE ONLY TO CORPORATE ISSUERS

The number of shares of the issuer's common equity outstanding as of August 1, 2004 was 50,336,802 shares of common stock, par value $.001.

Transitional Small Business Disclosure Format (check one):

Yes o No x

EXPLANATORY NOTE

This Amendment on Form 10-QSB/A (this "Amendment") amends the Company's Quarterly Report on Form 10-QSB for the three-month period ended June 30, 2004, originally filed on August 19, 2004 ("Original Filing"), solely for the purpose of making the amendments set forth herein, which include (i) deletion of language concerning certain parties' relationship to American Business Funding Corp. to make it consistent with the Company's disclosure in a Current Report on Form 8-K filed subsequent to the Original Filing to clarify the statements made and these relationships; (ii) additional disclosure concerning the Company's Stockholder Rights Plan; (iii) a reconciliation of the amounts disclosed under Results of Operations with the Company's unaudited financial statements to correct inconsistencies; (iv) the refiling of certain exhibits to include a conformed signature to demonstrate that these agreements had been validly executed; and (v) refiling the Exhibit 32 certification listing the CEO as the acting CFO at the time of the filing. In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, the Company is including with this Amendment certain currently dated certifications.

Except as described above, no other changes have been made to the Original Filing. This Amendment continues to speak as of the date of the Original Filing, and the registrant has not updated the disclosures contained therein to reflect any events that occurred at a date subsequent to the filing of the Original Filing. The filing of this Form 10-KSB/A is not a representation that any statements contained in items of the Original Filing other than that information being amended are true or complete as of any date subsequent to the date of the Original Filing. The filing of this Form 10-KSB/A shall not be deemed an admission that the original filing or the amendments made thereto, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

For a description of our significant accounting policies and an understanding of the significant factors that influenced our performance during the three and nine months ended June 30, 2004, this "Management's Discussion and Analysis" should be read in conjunction with the Consolidated Financial Statements, including the related notes, appearing in Item 1 of this Quarterly Report.

Forward-Looking Statements

This portion of this Quarterly Report on Form 10-QSB, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates," and do not reflect historical facts. Specific forward-looking statements contained in this portion of the Annual Report include, but are not limited to the Company's: (i) belief that the new methodology of counting IAP advertisers is more accurate and can be more consistently applied to each period; (ii) belief that tracking and disclosing the numbers of its activated customers provides greater clarity into its business; (iii) belief that its ability to bill customers on their local telephone bill enables it to realize a greater average rate of collections than direct invoice-billing; (iv) expectation that the trend of increasing ACH as a billing method relative to LEC billing will continue and escalate; (v) expectation that LEC billing will become a smaller component of the Company's overall billing methodology; (vi) expectation that the dilution and costs to implement its new billing method will be reduced to more normal levels over the next few quarters; (vii) belief that its recent attempts at addressing corporate governance issues will help it to preserve the financial and operational integrity that the Company and its stockholders have experienced in the past; (viii) belief that Mr. Bergmann's background in the management of advertising businesses and marketing will be helpful to the Company; (ix) expectation that management will focus significant attention on dealing with the issue of increased dilution; (x) expectation that sales and marketing costs will continue to increase; (xi) expectation that capital expenditures will not grow at the same rate in future fiscal periods.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in the section below titled "Risk Factors," as well as other factors that we are currently unable to identify or quantify, but may exist in the future.

In addition, the foregoing factors may affect generally our business, results of operations and financial position. Forward-looking statements speak only as of the date the statement was made. We do not undertake and specifically decline any obligation to update any forward-looking statements.

Executive Overview

Business Summary

We use a business model similar to print Yellow Page publishers. We publish basic directory listings, free of charge, exclusively on the Internet. Like Yellow Page publishers, we generate virtually all of our revenues from those advertisers that desire increased exposure for their businesses by purchasing our Internet Advertising Package , or IAP. Our basic listings contain the business name, address and phone number for almost 18 million U.S. businesses. We strive to maintain a listing for almost every business in America in this format.

To generate revenues, certain advertisers pay us a monthly fee for our IAP in the same manner that advertisers pay additional fees to traditional print Yellow Page providers for enhanced advertisement font, location or display. The IAP includes, Mini-Webpage , map directions, a toll-free calling feature, a link to the advertiser's own webpage and, at no additional charge, a priority or preferred placement on our website. The users of our website(s) are prospective IAP advertisers for our advertisers.

We also offer other ancillary services and products that currently account for less than 5% of our revenue. These ancillary services and products include website design and hosting, and dial-up Internet access.

Sales and Marketing

We employ a direct mail marketing program to solicit our IAP advertisers. Currently, our direct mail marketing program includes a promotional incentive currently in the form of a $3.25 activation check that a solicited business simply deposits with its bank to activate the service and become an IAP advertiser on a monthly basis. As a method of third-party verification, the potential IAP advertiser's bank verifies that the depositing party is in fact the solicited business. Upon notice of activation by the IAP advertiser's bank, we contact the business to confirm the order. Within 30 days of activation, we also send a confirmation card to the business. We offer a cancellation period of 120 days with a full refund. Our direct mail marketing program complies with and, in many instances, exceeds the United States Federal Trade Commission, or FTC, requirements as established by an agreement between our company and the FTC.

In June 2004, we implemented our National Accounts Program. Unlike other IAP advertisers, these accounts are not obtained through our direct mail program. These accounts represent large national organizations that purchase their advertising in "bulk" for their many locations. These are sophisticated advertisers for whom a "per click" revenue model is effective, desired and expected. We have built a software model that allows us to implement and bill these customers on a per click basis. We host their information on a separate spot on our search results page (beside the standard IAP listings) to give them high priority while allowing our smaller advertisers to compete directly when consumers are searching for products.

IAP advertisers

In September 2003, we revised the method by which we count our IAP advertisers. We now differentiate between "paying IAP advertisers" and "activated IAP advertisers." Paying IAP advertisers, as the name implies, are those advertisers that are actually currently paying for the IAP service. The terms activated IAP advertisers or activated advertisers are broader and more inclusive terms. They include those advertisers that are currently paying for the IAP service, as well as those advertisers that either have signed-up for the IAP service but have not yet been billed or have been billed but have not yet remitted to us their fees. We include National Accounts as paying IAP advertisers.

We believe that the new methodology is more accurate and can be more consistently applied to each period. We also believe that tracking and disclosing the numbers of our activated IAP advertisers, in addition to our paying IAP advertisers, provides greater clarity into our business by providing an indication or forecast of how many activated IAP advertisers may eventually become paying IAP advertisers. Our average retention rate for paying IAP advertisers is approximately 29 months, which, in turn, approaches the average operating life expectancy of 36 months for a small business in the U.S., according to the U.S. Small Business Administration.

Methods of Billing

We bill most of our IAP advertisers on their local telephone bill through their Local Exchange Carrier, or "LEC." We are one of only a few independent Internet advertisers that are permitted to utilize this unique and cost-efficient method of billing. By billing our IAP advertisers on their local telephone bill, we believe we are able to realize a greater average rate of collection than direct invoice-billing. The amount and frequency of collections on invoice-billed IAP advertisers historically has been significantly lower than for IAP advertisers billed on their monthly telephone bill. Accordingly, our revenues can be negatively impacted if the billing method used to bill an IAP advertiser converts from monthly telephone bill invoicing to direct invoicing.

We are not permitted to bill our IAP advertisers through Competitive Local Exchange Carriers, or CLECs. Recently, the CLECs have been participating in providing local telephone services to IAP advertisers at an increasing rate. We have begun to address this problem and we are implementing data filters to reduce the effects of the CLECs. We have also sought other billing methods to reduce the adverse effects of the CLEC billings, including credit cards and Automated Clearing House, or ACH, which is direct debit from the IAP advertiser's bank account. ACH billing now accounts for approximately 12% of our total billings and is our second highest billing method. ACH billing has reduced some of our dependency on LEC billing. We expect this trend to continue and escalate.

Accounting Policies and Procedures

We bill our services monthly and recognize revenue for services billed in that month. We utilize outside billing companies, or billing aggregators, to transmit billing data, much of which is forwarded to the LECs for inclusion on the IAP advertiser's monthly local telephone bill. Because we have a 120-day cancellation policy on new advertiser sign-ups, we accrue for such refunds as a liability and net such anticipated refunds against revenue to report a net revenue number in our financial statements.

The billing aggregators and, subsequently, the LECs, filter all billings that we submit to them. We recognize as revenue and accounts receivable the net billings accepted by the LECs. The billing aggregators remit payments to us on the basis of cash that the billing aggregators ultimately receive from the LECs. The billing aggregators and LECs charge fees for their services, which generally are 3% to 7% each on a monthly basis. These fees, in turn, are netted against the gross accounts receivable balance. The billing aggregators and LECs also apply holdbacks to the remittances for potentially uncollectible accounts due to bad telephone numbers and other indications of uncollectibility. We account for these holdbacks and fees as a dilution expense on our financial statements because they significantly "dilute" or reduce our gross billings and, therefore, may significantly affect our cash flow.

Due to the periods of time for which adjustments may be reported by the LECs and the billing aggregators, we estimate and accrue for dilution of our gross billings and fees reported subsequent to year-end for initial billings related to services provided for periods within the fiscal year. The amounts attributable to the dilution of our gross billings will vary due to numerous factors. Accordingly, we may not be certain as to the actual amounts of dilution on any specific billing submittal until several months after that submittal. We estimate the amount of these fees and holdbacks based on historical experience and subsequent information received from the billing aggregators. We also estimate uncollectible account balances and provide an allowance for such estimates.

We process our billings through two primary billing aggregators PaymentOne, Inc. and ACI Communications, Inc. PaymentOne provides the majority of our billings, collections, and related services. The receivable due from PaymentOne at June 30, 2004 was $10,249,831, net of an allowance for doubtful accounts of $3,581,737. The net receivable from PaymentOne for billing at June 30, 2004 represented approximately 73% of our total net accounts receivable.

With respect to our alternative billing methods, we recognize revenue for ACH billings when they are accepted. We recognize revenue for direct-invoice billings based on estimated future collections on such billings. We continuously review these estimates for reasonableness based on our collection experience. At June 30, 2004, the receivable due from PaymentOne for ACH revenue was $614,825

Our cost of services increased dramatically during the period ended June 30, 2004. Specifically, our cost of services increased 344% for the three-month period ended June 30, 2004 compared to the same period in the prior fiscal year, 236% for the nine-month period ended June 30, 2004 compared to the same period in the prior fiscal year, and 38% compared to our prior quarterly fiscal period ended March 31, 2004. While our net revenues have also increased significantly in the corresponding periods, our cost of services as a percentage of our net revenues in each period have also increased significantly.

The increase in our cost of services is directly attributable to an increase in our dilution expense. This dilution expense has escalated from $2,573,490 for our first fiscal quarter ended November 30, 2003, and $3,826,875 for our second fiscal quarter ended March 31, 2004, to $6,154,908 in our third fiscal quarter ended June 30, 2004.

The telephony industry as a whole is changing with more and more competition being experienced by the local exchange carriers, or LECs, also known as the Regional Bell Operating Companies. We bill most of our customers through the LECs. However, the LECs are losing market share at a substantial rate due to the existence of competitive Local Exchange Carriers, or CLECs, which, in turn, has an adverse effect on our business. When one of our IPA customers changes their telephone carrier to a CLEC, we do not count this customer as a paying subscriber until we receive direct payment. When that phone number is returned by the LEC because they are no longer customers of that LEC we count it as dilution. Recent large price increases by the LECs have caused business customers to look for alternative telephony suppliers. This has resulted in significant short-term dilution for us. Recent management changes at the Company have reduced our ability, in the short-run, to address these matters. However, as we emerge from our recent challenges we expect to focus significant attention in this area. This dilution is also a direct result of our attempt to modify and enhance our LEC billing processes so that more accounts would be accepted by the LECs. Many accounts have been accepted. However, this has reached its culmination during the quarter ended June 30, 2004 and these dilution costs have begun to drop in the fiscal fourth quarter beginning July 1, 2004.

For those accounts that could not be billed though the LEC during the above process we have expanded our ACH billing. This means we have taken significant steps to reduce our dependence on LEC billing during the most recent quarter and will continue to do so in future quarters. We have purchased new software that more quickly identifies the phone numbers that are active with the LECs so that we are able to more efficiently bill our clients by omitting accounts that have switched to a CLEC. We have begun to acquire direct debit information from at least 40% of new accounts as we acquire them so that if they switch phone companies we are able to seamlessly switch billing methods. We are processing all of our invoice customers to obtain more direct billing information in an effort to switch them to ACH billing. This process will take most of the fourth quarter. While LEC billing will remain our dominant billing method for the foreseeable future, it will eventually become a smaller component because our advertisers do not expect to pay for yellow page advertising on their phone bill. ACH billing has higher initial dilution but the dilution drops to insignificant levels after two months and then is less expensive to process than LEC billing.

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However, while we expect this dilution and the costs to implement our new billing method to be reduced to more normal levels over the next few quarters as this process runs its course through the billing system it has significantly increased our costs in the near term.

Subscription receivables that result from direct-invoice billing are valued and reported at the estimated future collection amount. Generally these receivables are what we expect to collect (based on prior experience) in one to two months. Determining the expected collections requires an estimation of both uncollectible accounts and refunds. The net subscriptions receivable at June 30, 2004 was $157,299.

Our cost of services is comprised, primarily, of variable costs, including the following:

- allowances for bad debt, which are based upon historical experience and reevaluated monthly;
- billing fees, such as the fees charged by our billing aggregators and the Local Exchange Carriers;
- billing aggregator inquiry fees, which generally are 1% on a monthly basis;
- dilution resulting from fees and holdbacks due to items such as wrong telephone numbers and other indications of uncollectibility;
- Internet expenses, such as dial-up expenses; and
- direct mailer marketing costs and the amortization of such costs.

Our general and administrative expenses are comprised, primarily, of fixed costs, including compensation expenses, which generally equate to 5% to 10% of net. We recognize revenue for direct-invoice billings based on estimated future collections on such billings. We continuously review these estimates for reasonableness based on our collection experience. revenue, as well as other expenses, such as lease payments, telephone, professional fees, and office supplies.

Recent Developments

Challenges and Solutions

We have faced a number of significant challenges over the past few months and have recently experienced substantial turnover in our management and Board of Directors. However, we believe that the progress the Company has made in addressing these challenges and adopting enhanced corporate governance practices will help us to preserve the financial and operational integrity that the Company and our stockholders have experienced in the past. This progress is marked by the following examples:

- In keeping with our goal to end all related party transactions, we have terminated the Company's Executive Consulting Agreements pursuant to which the offices of Chief Executive Officer, Chief Financial Officer and other executive positions were provided through consulting companies.

- We have revamped our management team and have filled the positions of Chief Executive Officer and Chief Financial Officer with highly qualified individuals, as described in greater detail below.

- We have recomposed our Board of Directors to include more independent directors, as described in greater detail below, and we continue to seek qualified independent candidates.

- We have formed an audit committee, adopted its charter and appointed its chairman.

- We have adopted a comprehensive code of ethics.

- We have revisited and updated our insider trading policies.

- We have identified and designated the Board of Directors' qualified financial expert.

- We have terminated our previous loan obligations to our two largest stockholders, Morris & Miller, Ltd. and Mathew and Markson, Ltd., which came about as a byproduct of the acquisition of our wholly-owned subsidiary (Telco Billing) and operating unit through which virtually all our revenue is generated. Moreover, we have negotiated the acceleration of three repayments, totaling an aggregate of $1,600,000, from these stockholders on their existing debt to the Company, which is well ahead of their scheduled repayment dates.

- We have obtained and publicly shared the beneficial ownership of Morris & Miller, Ltd. and Mathew and Markson, Ltd. as provided to us in sworn affidavits by their managing director, the Swiss Consul to Antigua.

- We have recently paid our second consecutive quarterly cash dividend to our stockholders.

- We have established a new credit facility.
- We have adopted a Stockholder Rights Plan, which is described in greater detail below, to protect the Company from unsolicited offers and to provide the Board with the leverage and ample opportunity to negotiate the greatest value for the stockholders if another person wishes to acquire the Company.

- We have begun paying dividends to our common shareholders.

Management and Board Changes
On May 28, 2004, our Chief Executive Officer, Angelo Tullo, resigned as an officer and director of our company. Our board of directors appointed Peter J. Bergmann to succeed Mr. Tullo as Chairman, President and Chief Executive Officer. Mr. Bergmann had previously been an independent director of our company since May 2002. Mr. Tullo's resignation was prompted by the fact that on May 27, 2004, federal indictments were handed down alleging that the former management of American Business Funding Corp., including Mr. Tullo, had engaged in fraud and conspiracy in connection with the factoring of receivables. American Business Funding Corp. is not and has never been affiliated with or related to our company.

Our board of directors believed that even though the indictments against Mr. Tullo were not related to our company or its business, so long as Mr. Tullo remained an officer and director of our company the indictments against him would adversely impact our business reputation and perception in the public markets and detract from our ability to expand our business. Accordingly, Mr. Tullo and the board of directors determined that it was in the best interests of our stockholders for Mr. Tullo to resign as an officer and director of our company. As described below under *Termination Agreements*, we also later terminated the executive consulting agreement with Mr. Tullo's company, Sunbelt Financial Concepts, Inc., or Sunbelt.

Upon Mr. Tullo's resignation as Chairman and CEO, the board of directors determined that Mr. Bergmann was the most qualified candidate to replace him because of Mr. Bergmann's familiarity with our business, his business expertise, and his public company experience. We believe that Mr. Bergmann's background in the management of advertising and marketing companies will be helpful to our company, given our advertising focus.

Since January 1999, Mr. Bergmann has served as the President of Perfect Timing Media, Inc., a television development and production company that he founded. Mr. Bergmann received his PhD from New York University and has served as head of a number of companies and divisions, including:

- principal of Century Media Inc, a Santa Monica, California, based direct-response advertising agency and media buying company;
- head of the television division of Major Arts, Inc.;
- president of Coast Productions, where he engineered the merger of Coast Productions, Inc., with Odyssey Entertainment, Inc., which subsequently became Odyssey Filmmakers, Inc.;
- president of The Film Company, Inc.; and
- various capacities with the American Broadcasting Company (ABC), including Executive Vice President and Special Assistant to the Chairman of the Board.

On June 9, 2004, Gregory Crane, Vice President of Marketing, resigned as an officer and director in an effort to assist the Company in recomposing management and the Board. As described under "Termination Agreements," below, we also later terminated the Executive Consulting Agreement with Mr. Crane's company, Advertising Management & Consulting Services, Inc., or AMCS.

The Company also recently concluded its relationship with MAR & Associates, Inc., or MAR, the entity that provided us with services associated with the position of Chief Financial Officer through MAR's President, David Iannini. The Company originally decided to transition MAR into an investment banking or strategic advisory role. Ultimately, however, in keeping with the goal of eliminating all related party transactions, the Board determined that this was not in the best interests of the stockholders. As described under "Termination Agreements," below, we also terminated the Executive Consulting Agreement with MAR.

On August 3, 2004, we hired W. Chris Broquist as our new Chief Financial Officer. Mr. Broquist brings 23 years of business experience including 14 years of a business banking background to YP Corp. Most recently, he served as Vice President & CFO of Gold Graphics Manufacturing Co., a medium-sized, Los Angeles-based manufacturer. Prior to Gold Graphics, Mr. Broquist held the senior financial position at Century Media Group where he was a key member of the team that successfully negotiated its acquisition to a public entity. Mr. Broquist was also with The Summit Group for five years, where he lead the Businesses Services Group, which was responsible for providing business and financial planning services as well as developing access to capital for small and medium sized businesses. He holds a BA in Business Administration with a concentration in finance from California State University, Fullerton. He completed his graduate work at The University of Washington, Pacific Coast Banking School in 1990.

On July 30, 2004, John Langdon stepped down as a director of the Company. Mr. Langdon cited the growing demands as a director of the Company resulting from the many changes we are undertaking and his inability to meet those time commitments.

As part of our continuing effort to recompose our Board of Directors, however, John T. Kurtzweil and Paul Gottlieb have been appointed as independent members of the Board. Messrs. Kurtzweil and Gottlieb have also accepted appointment to the Audit and Compensation Committees. Mr. Kurtzweil has agreed to serve as the Chairman of the Audit Committee and its qualified financial expert.

Mr. Kurtzweil brings more than 25 years of high-level corporate management background to our Board. Mr. Kurtzweil currently serves as the Senior Vice-President and Chief Financial Officer of Cirrus Logic, Inc., a publicly-held corporation that is a premier supplier of high-performance analog, mixed-signal and digital processing solutions for consumer entertainment electronics, automotive entertainment and industrial product applications. He possesses a strong financial background, including public company experience with such industry leaders as ON Semiconductor and Honeywell, Inc. Mr. Kurtzweil maintains active CPA and CMA licenses and earned his MBA from the University of St. Thomas in St. Paul, MN and his Accounting Degree from Arizona State University in Tempe, AZ.

Mr. Gottlieb is an attorney with Pomeranz, Gottlieb & Mushkin in New York City. His practice involves estate planning, tax, corporate and securities matters. Mr. Gottlieb received his undergraduate degree from Queens College of City University of New York, after which he served as a journalist in the United States Army. Upon completion of his military service, Mr. Gottlieb attended New York Law School, where he received his law degree. Mr. Gottlieb worked as a senior attorney with the Internal Revenue Service before entering private practice.

Termination Agreements

After Messrs. Tullo's and Crane's personal resignations, the Company entered into Termination Agreements with respect to (i) the termination of the Executive Consulting Agreement between the Company and Sunbelt, of which Mr. Tullo is President, and (ii) the Executive Consulting Agreement between the Company and AMCS, of which Mr. Crane is President. Each of these Termination Agreements provide for payments payable over two years in amounts that are well below the amounts that the Company otherwise would have been required to pay under the Executive Consulting Agreements. The required amounts that would have been payable under the Executive Consulting Agreement with Sunbelt and AMCS were approximately $2.6 million and $1.9 million, respectively. However, under the Termination Agreements, these payouts were reduced to $960,000 and $697,010, respectively.

Specifically, the amounts owed under the Termination Agreement with Sunbelt are payable as follows:

a. $150,000 upon signing of the Termination Agreement with Sunbelt;

b. $17,500 payable at the beginning of each month for 24 months commencing August 1, 2004;

c. $120,000 on October 1, 2004;

d. $150,000 on the one-year anniversary of the signing of the agreement; and

e. $120,000 no later than October 1, 2005. This payment must be made upon Sunbelt's written request at any time between the July 1, 2005 and the October 1, 2005 payment. The Company will be obligated to make such early payment so long as it retains 30 days operating capital after making the payment, which is defined as a current ratio of 1-to-1.

The amounts owed under the Termination Agreement with AMCS are payable as follows:

a. $130,000 upon signing of Termination Agreement with AMCS;

b. $10,709 payable at the beginning of each month for 24 months commencing August 1, 2004;

c. $110,000 on October 1, 2004;

d. $110,000 on the one-year anniversary of the signing of the agreement; and

e. $90,000 no later than October 1, 2005. This payment must be made upon AMCS' written request at any time between the July 1, 2005 and the October 1, 2005 payment. Company will be obligated to make such early payment so long as it retains 30 days operating capital after making said payment, which is defined as a current ratio of 1-to-1.

Upon a change of control or the sale of all or substantially all of the assets of the Company, all the foregoing payments to Sunbelt and AMCS will be immediately due and payable.

Additionally, pursuant to the Termination Agreements, each of Sunbelt and AMCS, and their respective officers, directors and affiliates have agreed not to compete with or solicit customers or employees of the Company for a period of six years. Finally, the Termination Agreements require Messrs. Tullo, Crane, and other officers and employees of Sunbelt and AMCS to make themselves available to the Company and our officers, directors and employees for consultation as needed.

In connection with the conclusion of our relationship with MAR, we entered into a Separation and Settlement Agreement with MAR, whereby the Executive Consulting Agreement between the Company and MAR was terminated. Under the arrangement, we will pay MAR $120,000 in equal monthly payments over the six months commencing August 1, 2004. This amount is well below the approximately $750,000 that would have been payable under the Executive Consulting Agreement with MAR. Despite the conclusion of our relationship with MAR, we will continue to explore various strategic alternatives, including the possible sale of the Company.

Termination of M&M Credit Facility

As of April 9, 2004, we terminated certain loan obligations that we owed to Morris & Miller, Ltd. and Mathew and Markson, Ltd., our two largest stockholders. Under this termination agreement, we made final advances to these stockholders totaling an aggregate of $1,050,000 at an annual interest rate of 8%. The stockholders agreed to forego the final advance of $250,000. The aggregate of all advances made by the Company to these stockholders is to be repaid to the Company at the end of three years, along with accrued interest. To date, however, we have received $1,600,000 in negotiated accelerated repayments.

Cash Dividends

In connection with our termination of the loan obligations to Morris & Miller and Mathew and Markson, we have begun paying a $0.01 per share dividend each quarter, subject to compliance with applicable laws. We paid the first dividend on April 30, 2004 and the second dividend on August 6, 2004.

Disclosure of M&M Beneficial Ownership

On May 27, 2004, we issued a press release disclosing the beneficial ownership of Morris & Miller and Mathew and Markson, as provided to us in sworn affidavits by Ms. Ilse Cooper, the Managing Director of these entities. Ms. Cooper also serves as the Swiss Consul to Antigua. She has recently been promoted by the Swiss Ambassador to the role of General Consul and is awaiting confirmation of that appointment from the Queen of England as Antigua is part of the Commonwealth. Specifically, it was disclosed that Ms. Cooper herself, as well as her sister, are the beneficial owners of these entities. It was further disclosed that both Ms. Cooper and her sister are cancer survivors and that any assets of Morris & Miller and Mathew and Markson remaining after their deaths will be bequeathed to the Swiss Institute for Experimental Cancer Research, a large not-profit-organization partially funded by the Swiss government.

New Credit Facility

On April 13, 2004, we entered into a one year, renewable revolving credit facility agreement with Merrill Lynch Business Financial Services, Inc. for a maximum principal amount of $1,000,000. We may request advances under the credit facility up to the full amount of the line. Interest on outstanding advances is payable monthly in arrears at the per annum rate of the one-month LIBOR as published in The Wall Street Journal, plus 3.0%. Outstanding advances are secured by all of our existing and after-acquired tangible and intangible assets located in the United States.

We paid Merrill Lynch a $10,000 fee in connection with the initiation of the credit facility. A $10,000 line maintenance fee is payable to Merrill Lynch upon each annual renewal. At this time, we do not have any current plans or need to draw down any funds under the credit facility.

The credit facility requires us to maintain a "Leverage Ratio" (total liabilities to tangible net worth) that does not exceed 1.5-to-1 and a "Fixed Charge Ratio" (earnings before interest, taxes, depreciation, amortization and other non-cash charges minus any internally financed capital expenditures divided by the sum of debt service, rent under capital leases, income taxes and dividends) that is not less that 1.5-to-1 as determined quarterly on a 12-month trailing basis. The credit facility includes additional covenants governing permitted indebtedness, liens, and protection of collateral.

Stockholder Rights Plan

In May 2004, our board of directors declared a dividend distribution of one right on each outstanding share of our common stock. Each right will entitle stockholders to buy one one-thousandth of a share of our newly created Series A Junior Participating Preferred Stock at an initial exercise price of $36.50 per one one-thousandth share.

The rights will enable our board of directors to control the terms and timing of its response if a third party makes an unsolicited bid to acquire control of the Company. The rights are designed to protect the interests of our stockholders, to ensure that all stockholders of the Company receive fair and equal treatment in the event of any proposed takeover of the Company, and to guard against partial tender offers, open market accumulations and other tactics designed to gain control of the Company without paying all stockholders a fair price. The rights accomplish these goals by creating the potential for an unacceptable level of dilution if an acquirer takes certain actions without the board of directors' approval. The bidder will therefore be more likely to negotiate with the board of directors, which has the ability to redeem the rights or exempt the bidder from the rights' dilutive effect if the bidder's proposal is acceptable to the board. The rights were not distributed in response to any specific effort to acquire the Company.

In general, the rights become exercisable if a person or group becomes an "Acquiring Person," or commences or announces a tender or exchange offer to acquire 15% or more of the outstanding Common Stock, at which time each right will entitle its holder to purchase, at the right's exercise price, a number of shares of common stock having a market value at that time of twice the right's exercise price. Rights held by an Acquiring Person will become void. In general, a person will become an Acquiring Person by acquiring 15% or more of the Company's outstanding Common Stock. Certain other shareholders that already own in excess of 15% will be come an Acquiring Person if they exceed higher thresholds.

Results of Operations

Net revenue for the three-month period ended June 30, 2004, was $16,917,361 compared to $8,013,845 for the three-month period ended June 30, 2003, an increase of approximately 111%. For the nine-month period ended June 30, 2004, net revenue was $47,179,181 compared to $20,604,344 for the nine-month period ended June 30, 2003, an increase of approximately 129%. This increase in net revenue is primarily the result of two factors: (1) an increase in the number of our IAP advertisers and (2) an increase in our monthly pricing. These two factors are discussed further below

Our activated IAP advertiser count increased to approximately 320,296 at June 30, 2004 compared to approximately 235,162 at June 30, 2003, an increase of approximately 36%. Our paying IAP advertiser count increased to approximately 224,474 at June 30, 2004 compared to approximately 161,000 at June 30, 2003, an increase of approximately 39%.
Our paying subscriber base actually declined in the three month period ended June 30, 2004 from the period ended March 31, 2004. This is due in large part to the increased competition in the telephony market and the targeting by CLEC's of small and mid-sized companies (our primary market) to switch their services from the long-established LEC's to themselves. When that switch occurs the company is unable immediately bill that customer and so deducts their number as a paying subscriber while retaining them as a customer until they pay an invoice or an alternative billing method is found. To combat this the company is transferring many of these CLEC customers to alternative billing methods such as ACH billing. While subsequent to the quarters end, the company has seen a decline in CLEC conversions, the company is progressing strongly with its ACH conversion that will take at least another 90 days.

The increase in activated IAP advertisers described above equates to average monthly growth of 5,100 activated IAP advertisers for the three-month period ended June 30, 2004. This remains within our targeted net growth of 5,000 to 10,000 new activated IAP advertisers per month.

Relating to our price increases, in March 2003 we increased our monthly fees for the IAP product from $17.95 to $21.95 for new customers. At the same time, for existing customers, the monthly fee for the IAP product was increased to $24.95 upon their first twelve-month anniversary of paying the $17.95 service fee. In January 2004, we began charging new customers monthly fees of $29.95 for the IAP product. In addition, in March 2004, the monthly fee on the IAP product for existing customers was increased to $29.95 upon their first six-month anniversary of paying the previous fee.

Regarding our cost of services, between August 2003 and June 30, 2004, we converted approximately 45,000 direct-invoice IAP advertisers, out of an approximate target of 70,000, to telephone billing. However, in the fiscal quarter ended June 30, 2004, we continued to experience short-term dilution of our gross billings and chargebacks resulting from those direct-invoice IAP advertisers that we were unable to convert to LEC billing. Dilution is generally attributable to IAP advertiser credits and other receivable write-downs, such as unbillable telephone numbers. It does not necessarily mean that we have lost a customer. We merely seek alternative billing methods for these customers. This level of dilution has been higher in the quarter ended June 30, 2004 than in the prior quarter ended June 30, 2003 resulting in higher cost of services. During July 2004 we have seen a marked drop in this dilution as it relates to "unbills." Unbills are phone numbers, or BTNs, that due to any number of variables can not be billed to a customer's phone bill. We expect this downward trend to continue and more customers to pay us as more invoice customers are converted to ACH billing. This increase in dilution accounts for virtually all of the change in our cost of services.

Cost of services for the three-month periods ended June 30, 2004 and June 30, 2003 was $8,195,264 and $2,061,229, respectively, an increase of approximately 298%. Cost of services for the nine-month periods ended June 30, 2004 and June 30, 2003 was $19,696,203 and $5,732,345, respectively, an increase of approximately 244%.

Our cost of services as a percentage of net revenue was approximately 48% for the three months ended June 30, 2004 compared to approximately 26% for the same period in the prior fiscal year. Our cost of services as a percentage of net revenue was approximately 42% for the nine months ended June 30, 2004 compared to approximately 28% for the same period in the prior fiscal year.

As explained in greater detail above under "Executive Overview - *Accounting Policies and Procedures*," these increased costs of services resulted, primarily, from increased dilution expense, as well as increased IAP advertiser counts.

Amortization of direct marketing costs included in sales and marketing costs is $1,336,927 for the three months ended June 30, 2004 and $829,405 for the prior-year period. Amortization of direct marketing costs included in cost of sales is $3,566,122 for the nine months ended June 30, 2004 and $1,953,457 for the prior-year period.

Gross profits increased to $8,722,097 for the three months ended June 30, 2004 from $5,952,616 for the prior-year period, an increase of approximately 47%. Gross margins decreased to approximately 52% of net revenues in the three months ended June 30, 2004 compared to approximately 74% of net revenues in the prior-year period. Gross profits increased to $27,482,978 for the nine months ended June 30, 2004 from $14,771,999 for the prior-year period, an increase of approximately 86%. Gross margins decreased to approximately 58% of net revenues in the nine months ended June 30, 2004 compared to approximately 72% of net revenues in the prior-year period. The increase in our gross profits was due to increased revenues resulting from the previously mentioned increased IAP advertiser counts and price increases, offset by increased dilution discussed above.

Our general and administrative expense for the three-month periods ended June 30, 2004 and June 30, 2003 were $3,298,624 and $2,561,499, respectively, an increase of approximately 29%. Our general and administrative expense for the nine-month periods ended June 30, 2004 and June 30, 2003 were $9,223,889 and $5,603,685, respectively, an increase of approximately 65%. These general and administrative expenses increased due to an increase in employees and other expenses relating to our growth in IAP advertisers, our Quality Assurance and Outbound marketing initiatives, as well as an increase in certain officers' compensation relating to employment contracts with such officers.

As a percentage of net revenue, general and administrative expenses were approximately 20% for the three months ended June 30, 2004 compared to 32% for the same period in 2003. As a percentage of net revenue, general and administrative expenses were approximately 20% for the nine months ended June 30, 2004 compared to 27% for the same period in 2003. The reduction in general and administrative expenses as a percentage of net revenue is the result of increasing revenue associated with the leveraging of our fixed cost infrastructure over a larger IAP advertiser base.

Sales and marketing expenses for the three-month periods ended June 30, 2004 and June 30, 2003 were $1,667,040 and $1,069,576, respectively, an increase of approximately 56%. Sales and marketing expenses for the nine-month periods ended June 30, 2004 and June 30, 2003 were $4,385,430 and $2,564,950, respectively, an increase of approximately 71%. The primary reason for the increase in sales and marketing is due to the re-institution of our marketing solicitation program and the implementation of new market strategies and modification of direct mail marketing pieces. Such marketing has resulted in the increase in IAP advertisers cited previously. We expect these sales and marketing costs to continue to increase as our marketing efforts increase and as we continue to roll out our branding campaign. We capitalize certain direct marketing expenses and amortize those costs over an 18-month period based on the analyzed IAP advertiser attrition rates.

As a percentage of net revenues, sales and marketing expenses were approximately 10% and 13% for the three-month periods ended June 30, 2004 and 2003, respectively. As a percentage of net revenues, sales and marketing expenses were approximately 9% and 12% for the nine-month periods ended June 30, 2004 and 2003, respectively.

Depreciation and amortization primarily relates to the amortization of our intellectual property and depreciation of equipment. Amortization relating to the capitalization of our direct mail marketing costs is included in cost of sales, as discussed previously.

Our depreciation and amortization expense was $243,261 in the three months ended June 30, 2004 compared to $166,523 for the three months ended June 30, 2003. Our depreciation and amortization expense was $639,173 in the nine months ended June 30, 2004 compared to $464,761 for the nine months ended June 30, 2003. Depreciation and amortization increased in the current periods compared to the comparable periods in 2003 due to additional purchases of equipment relating to our upgrade in infrastructure in the information technology department, hardware purchased relating to our Quality Assurance and Outbound Marketing initiatives, as well as our agreement to license the "YP.Com" Uniform Resource Locator, or URL, from OnRamp Access, Inc.

Regarding our other intellectual property, the cost of our "Yellow-Page.net" URL license was capitalized at $5,000,000. This URL is amortized on an accelerated basis over the twenty-year term of the agreement. Amortization expense on this URL was $79,276 and $90,369 for the three-month periods ended June 30, 2004 and June 30, 2003, respectively. Amortization expense on this URL was $243,276 and $76,808 for the nine-month periods ended June 30, 2004 and June 30, 2003, respectively. As a result of the significant equipment purchases relating to the previously-mentioned infrastructure additions, depreciation expense is expected to be greater in the fourth quarter of fiscal 2004 compared to the prior-year periods. However, we do not anticipate capital expenditures to grow at the same rate in future fiscal periods compared to the prior fiscal year.

Operating income for the three-month period ended June 30, 2004 was $3,513,172 compared to $2,155,018 in the prior-year period, an increase of approximately 63%. Operating margins decreased to approximately 21% of net revenue from approximately 27% in the prior-year period. Operating income for the nine-month period ended June 30, 2004 was $13,234,486 compared to $6,238,603 in the prior-year period, an increase of approximately 112%. Operating margins decreased to approximately 28% of net revenue from approximately 30% in the prior-year period. The increase in operating income is the result of the increased revenue discussed above. Operating margins decreased slightly due to the significant increase in our cost of services resulting from increased dilution expense, partially offset by increased revenues and the leveraging of certain fixed expenses over a larger IAP advertiser base.

Interest income, net of interest expense, for the three-month period ended June 30, 2004 was $103,897. This compares to interest income, net of interest expense, of $27,994 for the three months ended June 30, 2003. Interest income, net of interest expense, for the nine-month periods ended June 30, 2004 was $253,595. This compares to interest income, net of interest expense, of $40,783 for the nine months ended June 30, 2003. The increase in interest income, net of interest expense, primarily results from our increased average cash position resulting, in turn, from our increased profitability, as well as increased interest income resulting from the increase in advances to affiliates.

Net income before taxes for the three-month periods ended June 30, 2004 and June 30, 2003 was $4,048,533 and $2,352,869, respectively, an increase of approximately 72%. Pre-tax margins decreased to approximately 24% of net revenue in the current period compared to approximately 29% of net revenue in the prior-year period. Net income before taxes for the nine-month periods ended June 30, 2004 and June 30, 2003 were $14,265,698 and $6,679,038, respectively, an increase of approximately 114%. Pre-tax margins decreased to approximately 30% of net revenues in the current period compared to approximately 32% of nest revenues in the prior-year period. The increase in pre-tax income is a result of those factors that resulted in the increase in operating income in addition to the increased interest income and other income discussed above.

The income tax provision was $1,416,986 in the three months ended June 30, 2004 compared to $676,039 in the prior-year period. The income tax provision was $4,992,994 in the nine months ended June 30, 2004 compared to $2,404,486 in the prior-year period. The increase in the income tax provision is the result of our increased profitability in current-year periods compared to the previous year periods, as well as the fact that we were able to utilize our net operating loss carry-forwards for the prior-year periods that were unavailable in the three- and nine-month periods ended June 30, 2004.

Net income for the three-month periods ended June 30, 2004 and June 30, 2003 was $2,631,547, or $.05 per diluted share, and $1,676,830, or $.04 per diluted share, respectively, an increase in net income of approximately 57%. Net income as a percentage of net revenues for the three months ended June 30, 2004 was approximately 16%, compared to approximately 21% for the same prior-year period. Net income for the nine-month periods ended June 30, 2004 and June 30, 2003 was $9,272,704, or $.19 per diluted share, and $4,274,552, or $.10 per diluted share, respectively, an increase in net income of approximately 117%. Net income as a percentage of net revenues for the nine months ended June 30, 2004 was approximately 20% compared to approximately 21% for the same prior-year period.

Liquidity And Capital Resources

Net cash provided by operating activities for the nine-month period ended June 30, 2004, was $2,870,002 compared to $3,513,826 for the nine-month period ended June 30, 2003. The increase in cash generated from operations is primarily due to a significant increase in net income resulting from an increase in IAP advertisers, as well as an increase in income tax payable, offset by an increase in the accounts receivable balance from such growth and funds expended for mailings related to our direct marketing efforts.

Cash used in investing activities was $2,202,736 for the nine-month period ended June 30, 2004. The primary component of cash used in investing activities was advances to affiliates of $2,725,000 All advances to affiliates have ceased as of April 9, 2004 and these affiliates have begun early repayment of those advances. In the nine-month period ended June 30, 2003, cash used in investing activities was $1,544,673 which consisted primarily of purchases of equipment of $537,912 and lower advances to affiliates of $1,000,000.

Cash used or provided by financing activities for the nine-month period ended June 30, 2004 was $499,983 of dividends paid, compared to cash used in financing activities of $307,000 for the nine-month period ended June 30, 2003. The cash used in financing activities represents total payments of $585,167 to reduce the principal balances of our outstanding debt, offset by financing of $278,167 under our trade acceptance draft program with AcTrade Financial Technologies, Ltd., or AcTrade.

We had working capital of $12,645,133 as of June 30, 2004, compared to $4,684,466 as of June 30, 2003. The increase is due primarily to increases in cash to $2,546,130, and accounts receivable to $13,926,934 offset by increases in accrued liabilities and income taxes payable.

In the past, we had borrowed under two credit facilities. These credit facilities were maintained primarily for safety and security back-up purposes as our cash flow generally is more than sufficient to maintain and grow our business. In April 2004, we established a $1,000,000 credit facility with Merrill Lynch Business Financial Services, Inc. This facility is for one year and is renewable. The applicable interest rate on borrowings, if any, will be a variable rate of the one-month LIBOR rate (as published in the *Wall Street Journal*), plus 3%. The facility required an annual line fee of $10,000, payable whether or not we have drawn any funds on the line. We have terminated our previous credit facilities with the Bank of the Southwest and AcTrade Financial Technologies, Ltd. We utilized our new credit facility with Merrill Lynch and repaid the balance during the quarter ended June 30, 2004 in order to test its functioning and reporting requirements. There was no balance outstanding on June 30, 2004.

The new credit facility requires us to maintain a "Leverage Ratio" (total liabilities to tangible net worth) that does not exceed 1.5-to-1 and a "Fixed Charge Ratio" (earnings before interest, taxes, depreciation, amortization and other non-cash charges minus any internally financed capital expenditures divided by the sum of debt service, rent under capital leases, income taxes and dividends) that is not less that 1.5-to-1 as determined quarterly on a 12-month trailing basis. The credit facility includes additional covenants governing permitted indebtedness, liens, and protection of collateral.

We owed $115,868 to Mathew & Markson Ltd. on a note related to the original acquisition of the "Yellow Page.net" URL.

As previously described, collections on accounts receivable are received primarily through the billing service aggregators under contracts to administer this billing and collection process. The billing service aggregators generally do not remit funds until they are collected. The billing companies maintain holdbacks for refunds and other uncertainties. Generally, cash is collected and remitted to us over a 60 to 120 day period subsequent to the billing dates. Under our current agreement with our primary billing service provider, PaymentOne, cash is remitted to us on a sixty day timetable.

Effective as of April 9, 2004, per the December 22, 2003 agreement, we terminated certain loan agreements whereby we were obligated to loan or advance money to Morris & Miller, Ltd. and Mathew and Markson, Ltd., our two largest stockholders, secured by Company stock held by these stockholders. Under this termination agreement, we made final advancements to these stockholders of approximately $1,050,000. An additional final advance of $250,000 was not paid as the stockholders decided to forego this payment. The aggregate of all advances made by the Company to these stockholders is to be repaid to the Company at the end of three years, along with accrued interest. During the quarter ended June 30, 2004, however, these stockholders began advanced repayments of those loans. The stockholders were not obligated to begin repayments until April 2007 but during this quarter they repaid $1,600,000.

In connection with our termination of the loan obligations, we have begun paying a $0.01 per share dividend each quarter, subject to available cash and compliance with applicable laws. The first dividend was paid on April 30, 2004 to holders of record on March 20, 2004. The second dividend of $0.01 per common share was paid on August 6, 2004 to holders of record on June 21, 2004.

Risk Factors

An investment in our common stock involves a substantial degree of risk. Before making an investment decision, you should give careful consideration to the following risk factors in addition to the other information contained in this report. The following risk factors, however, may not reflect all of the risks associated with our business or an investment in our common stock only if you can afford to lose your entire investment.

Risks Related to Our Business

We have a relatively limited operating history upon which investors can evaluate the likelihood of our success.

We have been engaged in the Internet-based Yellow Pages industry through our subsidiary, Telco Billing, since 1997. As a result, an investor in our securities must consider the uncertainties, expenses, and difficulties frequently encountered by companies such as ours that are in the early stages of development. Investors should consider the likelihood of our future success to be highly speculative in light of our relatively limited operating history, as well as the challenges, limited resources, expenses, risks, and complications frequently encountered by similarly situated companies in the early stages of development, particularly companies in new and rapidly evolving markets such as Internet Yellow Pages. To address these risks and to sustain profitability, we must, among other things:

- maintain and increase our base of advertisers;
- increase the number of users who visit our web sites for online directory services;
- implement and successfully execute our business and marketing strategy;
- continue to develop and upgrade our technology;
- continually update and improve our service offerings and features;
- provide superior IAP advertiser service;
- respond to industry and competitive developments;
- successfully manage our growth while controlling expenses; and
- attract, retain, and motivate qualified personnel.

We may not be successful in addressing these risks. If we are unable to do so, our business, prospects, financial condition, and results of operations would be materially and adversely affected.

Our success depends upon our ability to establish and maintain relationships with our advertisers.

Our ability to generate revenue depends upon our ability to maintain relationships with our existing advertisers, to attract new advertisers to sign up for revenue-generating services, and to generate traffic to our advertisers' websites. We primarily use direct marketing efforts to attract new advertisers. These direct marketing efforts may not produce satisfactory results in the future. We attempt to maintain relationships with our advertisers through IAP advertiser service and delivery of traffic to their businesses. An inability to either attract additional advertisers to use our service or to maintain relationships with our advertisers could have a material adverse effect on our business, prospects, financial condition, and results of operations.

If we do not introduce new or enhanced offerings to our advertisers and users, we may be unable to attract and retain those advertisers and users, which would significantly impede our ability to generate revenue.

We will need to introduce new or enhanced products and services in order to attract and retain advertisers and users and remain competitive. Our industry has been characterized by rapid technological change, changes in advertiser and user requirements and preferences, and frequent new product and service introductions embodying new technologies. These changes could render our technology, systems, and website obsolete. We may experience difficulties that could delay or prevent us from introducing new products and services. If we do not periodically enhance our existing products and services, develop new technologies that address our advertisers' and users' needs and preferences, or respond to emerging technological advances and industry standards and practices on a timely and cost-effective basis, our products and services may not be attractive to advertisers and users, which would significantly impede our revenue growth. In addition, our reputation and our brand could be damaged if any new product or service introduction is not favorably received.

Our revenue may decline over time.

We have experienced a decrease in revenue from the Local Exchange Carriers (LEC) from the effects of the Competitive Local Exchange Carriers (CLEC) that are participating in providing local telephone services to IAP advertisers. We have begun to address this problem and we are implementing data filters to reduce the effects of the CLECs. We have also sought other billing methods to reduce the adverse effects of the CLEC billings. These other billing methods may be cheaper or more expensive than our current LEC billing and we have not yet determined if they will be less or more effective. We cannot provide any assurances that our efforts will be successful and may experience future decreases in revenue.

We may continue to experience dilution of LEC billable customers because of changes in the telephony industry.

We have experienced dilution of advertisers that we are able to successfully bill on their business phone bills. Because we only count revenue from customers whose billings are accepted by the Local Exchange Carriers, or LECs, or from those customers that have paid their direct invoice we can experience substantial changes in revenue when a customer's billing is not accepted by the LEC and we wait for payment of the direct billing invoice, which can take as long as 90 days or more. With the competition in the telephony industry, many business customers are finding alternative telephony suppliers, such as Competitive Local Exchange Carriers, or CLECs, that offer less expensive alternatives to the LECs. This shrinking of the LECs business affects us because we are unable to bill these customers on their phone bills. When the LECs effectuate a price increase this causes a rush of LEC customers looking for an alternative phone company, which may be a CLEC.

Our quarterly results of operations could fluctuate due to factors outside of our control, which may cause corresponding fluctuations in the price of our securities.

Our net sales may grow at a slower rate on a quarter-to-quarter basis than we have experienced in recent periods. Factors that could cause our results of operations to fluctuate in the future include the following:

- fluctuating demand for our services, which may depend on a number of factors including
  - changes in economic conditions and our IAP advertisers' profitability,
  - varying IAP advertiser response rates to our direct marketing efforts,
  - our ability to complete direct mailing solicitations on a timely basis each month,
  - changes in our direct marketing efforts,
  - IAP advertiser refunds or cancellations, and
  - our ability to continue to bill IAP advertisers on their monthly telephone bills, ACH or credit card rather than through direct invoicing;
- timing of new service or product introductions and market acceptance of new or enhanced versions of our services or products;
- our ability to develop and implement new services and technologies in a timely fashion to meet market demand;
- price competition or pricing changes by us or our competitors;
- new product offerings or other actions by our competitors;
- month-to-month variations in the billing and receipt of amounts from Local Exchange Carriers (LECs), such that billing and revenues may fall into the subsequent fiscal quarter;
- the ability of our check processing service providers to continue to process and provide billing information regarding our solicitation checks;
- the amount and timing of expenditures for expansion of our operations, including the hiring of new employees, capital expenditures, and related costs;
- technical difficulties or failures affecting our systems or the Internet in general;
- a decline in Internet traffic at our website;

- the cost of acquiring, and the availability of, information for our database of potential advertisers; and
- the fact that our expenses are only partially based on our expectations regarding future revenue and are largely fixed in nature, particularly in the short term.

The fluctuation of our quarterly operating results, as well as other factors, could cause the market price of our securities to fluctuate significantly in the future. Some of these factors include the following:

- the announcement of new IAP advertisers or strategic alliances or the loss of significant IAP advertisers or strategic alliances;
- announcements by our competitors;
- sales or purchases of our securities by officers, directors and insiders;
- government regulation;
- announcements regarding restructuring, borrowing arrangements, technological innovations, departures of key officers, directors or employees, or the introduction of new products;
- political or economic events and governmental actions affecting Internet operations or businesses; and
- general market conditions and other factors, including factors unrelated to our operating performance or that of our competitors.

Investors in our securities should be willing to incur the risk of such price fluctuations.

Our ability to efficiently process new advertiser sign-ups and to bill our advertisers monthly depends upon our check processing service providers and billing aggregators, respectively.

We currently use three check processing companies to provide us with advertiser information at the point of sign-up for our Internet Advertising Package. One of these processors has indicated that it will be outsourcing this function in the future. Therefore, we have refrained from sending new business to this check processor. Our ability to gather information to bill our advertisers at the point of sign-up could be adversely affected if one or more of these providers experiences a disruption in its operations or ceases to do business with us.

We also depend upon our billing aggregators to efficiently bill and collect monies from the Local Exchange Carriers, or LECs, relating to the LECs' billing and collection of our monthly charges from advertisers. We currently have agreements with two billing aggregators. Any disruption in our billing aggregators' ability to perform these functions could adversely affect our financial condition and results of operations.

The loss of our ability to bill IAP advertisers through Local Exchange Carriers on the IAP advertisers' telephone bills would adversely impact our results of operations.

Our business model depends heavily upon our ability to bill advertisers on their telephone bills through their respective Local Exchange Carriers (LEC). The existence of the LECs is the result of Federal legislation. In the same manner, Congress could pass future legislation that obviates the existence of or the need for the LECs. Additionally, regulatory agencies could limit or prevent our ability to use the LECs to bill our advertisers. Finally, the introduction of and advancement of new technologies, such as WiFi technology or other wireless-related technologies, could render unnecessary the existence of fixed telecommunication lines, which also could obviate the need for and access to the LECs. Our inability to use the LECs to bill our advertisers through their monthly telephone bills would have a material adverse impact on our results of operations.

We depend upon third parties to provide certain services and software, and our business may suffer if the relationships upon which we depend fail to produce the expected benefits or are terminated.

We currently outsource to third parties certain of the services that we provide, including the work of producing usable templates for and hosting of the QuickSites, website templates known as Ezsites, and wholesale Internet access. These relationships may not provide us benefits that outweigh the costs of the relationships. If any strategic supplier demands a greater portion of revenue derived from the services it provides or increases charges for its services, we may decide to terminate or refuse to renew that relationship, even if it previously had been profitable or otherwise beneficial. If we lose a significant strategic supplier, we may be unable to replace that relationship with other strategic relationships with comparable revenue potential. The loss or termination of any strategic relationship with one of these third-party suppliers could significantly impair our ability to provide services to our advertisers and users.

We depend upon third-party software to operate certain of our services. The failure of this software to perform as expected would have a material adverse effect on our business. Additionally, although we believe that several alternative sources for this software are available, any failure to obtain and maintain the rights to use such software would have a material adverse effect on our business, prospects, financial condition, and results of operations. We also depend upon third parties to provide services that allow us to connect to the Internet with sufficient capacity and bandwidth so that our business can function properly and our websites can handle current and anticipated traffic. Any restrictions or interruption in our connection to the Internet would have a material adverse effect on our business, prospects, financial condition, and results of operations.

The market for our services is uncertain and is still evolving.

Internet Yellow Pages services are evolving rapidly and are characterized by an increasing number of market entrants. Our future revenues and profits will depend substantially upon the widespread acceptance and the use of the Internet and other online services as an effective medium of commerce by merchants and consumers. Rapid growth in the use of and interest in the Internet may not continue on a lasting basis, which may negatively impact Internet-based businesses such as ours. In addition, advertisers and users may not adopt or continue to use Internet-base Yellow Pages services and other online services that we may offer in the future. The demand and market acceptance for recently introduced services generally is subject to a high level of uncertainty.

Most potential advertisers have only limited, if any, experience advertising on the Internet and have not devoted a significant portion of their advertising expenditures to Internet advertising. Advertisers may find Internet Yellow Pages advertising to be less effective for meeting their business needs than traditional methods of Yellow Pages or other advertising and marketing. Our business, prospects, financial condition or results of operations will be materially and adversely affected if potential advertisers do not adopt Internet Yellow Pages as an important component of their advertising expenditures.

We may not be able to secure additional capital to expand our operations.

Although we currently have no material long-term needs for capital expenditures, we will likely be required to make increased capital expenditures to fund our anticipated growth of operations, infrastructure, and personnel. We currently anticipate that our cash on hand as of August 1, 2004, together with cash flows from operations, will be sufficient to meet our anticipated liquidity needs for working capital and capital expenditures over the next 12 months. In the future, however, we may seek additional capital through the issuance of debt or equity depending upon our results of operations, market conditions or unforeseen needs or opportunities. Our future liquidity and capital requirements will depend on numerous factors, including the following:

- the pace of expansion of our operations;
- our need to respond to competitive pressures; and
- future acquisitions of complementary products, technologies or businesses.

Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties and actual results could vary materially as a result of the factors described above. As we require additional capital resources, we may seek to sell additional equity or debt securities or draw on our existing bank line of credit. Debt financing must be repaid at maturity, regardless of whether or not we have sufficient cash resources available at that time to repay the debt. The sale of additional equity or convertible debt securities could result in additional dilution to existing stockholders. We cannot provide assurance that any financing arrangements will be available in amounts or on terms acceptable to us, if at all.

We must manage our growth and maintain procedures and controls on our business.

We have rapidly and significantly expanded our operations and we anticipate further significant expansion to accommodate the expected growth in our IAP advertiser base and market opportunities. We have increased the number of our personnel from the inception of our operations to the present. This expansion has placed, and is expected to continue to place, a significant strain on our management and operational resources. As a result, we may not be able to effectively manage our resources, coordinate our efforts, supervise our personnel or otherwise successfully manage our resources. We have recently added a number of key managerial, technical, and operations personnel and we expect to add additional key personnel in the future. We also plan to continue to increase our personnel base. These additional personnel may further strain our management resources.

The rapid growth of our business could in the future strain our ability to meet IAP advertiser demands and manage our IAP advertiser relationships. This could result in the loss of IAP advertisers and harm our business reputation.

In order to manage the expected growth of our operations and personnel, we must continue maintaining and improving or replacing existing operational, accounting, and information systems, procedures, and controls. Further, we must manage effectively our relationships with our IAP advertisers, as well as other third parties necessary to our business. Our business could be adversely affected if we are unable to manage growth effectively.

We depend upon our executive officers and key personnel.

Our performance depends substantially on the performance of our executive officers and other key personnel. The success of our business in the future will depend on our ability to attract, train, retain and motivate high quality personnel, especially highly qualified technical and managerial personnel. The loss of services of any executive officers or key personnel could have a material adverse effect on our business, results of operations or financial condition. We do not maintain key person life insurance on the lives of any of our executive officers or key personnel.

Competition for talented personnel is intense, and there is no assurance that we will be able to continue to attract, train, retain or motivate other highly qualified technical and managerial personnel in the future. In addition, market conditions may require us to pay higher compensation to qualified management and technical personnel than we currently anticipate. Any inability to attract and retain qualified management and technical personnel in the future could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Our business is subject to a strict regulatory environment.

Existing laws and regulations and any future regulation may have a material adverse effect on our business. For example, we believe that our direct marketing programs meet or exceed existing requirements of the United States Federal Trade Commission (FTC). Any changes to FTC requirements or changes in our direct or other marketing practices, however, could result in our marketing practices failing to comply with FTC regulations. As a result, we could be subject to substantial liability in the future, including fines and criminal penalties, preclusion from offering certain products or services, and the prevention or limitation of certain marketing practices.

We face intense competition, including from companies with greater resources, which could adversely affect our growth and could lead to decreased revenues.

Several companies, including Verizon, Yahoo and Microsoft, currently market Internet Yellow Pages services that directly compete with our services and products. We may not compete effectively with existing and potential competitors for several reasons, including the following:

- some competitors have longer operating histories and greater financial and other resources than we have and are in better financial condition than we are;

- some competitors have better name recognition, as well as larger, more established, and more extensive marketing, IAP advertiser service, and IAP advertiser support capabilities than we have;

- some competitors may supply a broader range of services, enabling them to serve more or all of their IAP advertisers' needs. This could limit our sales and strengthen our competitors' existing relationships with their IAP advertisers, including our current and potential IAP advertisers;

- some competitors may be able to better adapt to changing market conditions and IAP advertiser demand; and

- barriers to entry are not significant. As a result, other companies that are not currently involved in the Internet-based Yellow Pages advertising business may enter the market or develop technology that reduces the need for our services.

Increased competitive pressure could lead to reduced market share, as well as lower prices and reduced margins for our services. If we experience reductions in our revenue for any reason, our margins may continue to decline, which would adversely affect our results of operations. We cannot assure you that we will be able to compete successfully in the future.

We may face risks as we expand our business into international markets.

We currently are exploring opportunities to offer our services in other English-speaking countries. We have limited experience in developing and marketing our services internationally, and we may not be able to successfully execute our business model in markets outside the United States. We will face a number of risks inherent in doing business in international markets, including the following:

- international markets typically experience lower levels of Internet usage and Internet advertising than the United States, which could result in lower-than-expected demand for our services;

- unexpected changes in regulatory requirements;

- potentially adverse tax consequences;

- difficulties in staffing and managing foreign operations;

- changing economic conditions;
- exposure to different legal standards, particularly with respect to intellectual property and distribution of information over the Internet;
- burdens of complying with a variety of foreign laws; and
- fluctuations in currency exchange rates.

To the extent that international operations represent a significant portion of our business in the future, our business could suffer if any of these risks occur.

We may be unable to promote and maintain our brands.

We believe that establishing and maintaining the brand identities of our Internet Yellow Pages services is a critical aspect of attracting and expanding a base of advertisers and users. Promotion and enhancement of our brands will depend largely on our success in continuing to provide high quality service. If advertisers and users do not perceive our existing services to be of high quality, or if we introduce new services or enter into new business ventures that are not favorably received by advertisers and users, we will risk diluting our brand identities and decreasing their attractiveness to existing and potential IAP advertisers.

We may not be able to adequately protect our intellectual property rights.

Our success depends both on our internally developed technology and our third party technology. We rely on a variety of trademarks, service marks, and designs to promote our brand names and identity. We also rely on a combination of contractual provisions, confidentiality procedures, and trademark, copyright, trade secrecy, unfair competition, and other intellectual property laws to protect the proprietary aspects of our products and services. Legal standards relating to the validity, enforceability, and scope of the protection of certain intellectual property rights in Internet-related industries are uncertain and still evolving. The steps we take to protect our intellectual property rights may not be adequate to protect our intellectual property and may not prevent our competitors from gaining access to our intellectual property and proprietary information. In addition, we cannot provide assurance that courts will always uphold our intellectual property rights or enforce the contractual arrangements that we have entered into to protect our proprietary technology.

Third parties may infringe or misappropriate our copyrights, trademarks, service marks, trade dress, and other proprietary rights. Any such infringement or misappropriation could have a material adverse effect on our business, prospects, financial condition, and results of operations. In addition, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights, which may result in the dilution of the brand identity of our services.

We may decide to initiate litigation in order to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of our proprietary rights. Any such litigation could result in substantial expense, may reduce our profits, and may not adequately protect our intellectual property rights. In addition, we may be exposed to future litigation by third parties based on claims that our products or services infringe their intellectual property rights. Any such claim or litigation against us, whether or not successful, could result in substantial costs and harm our reputation. In addition, such claims or litigation could force us to do one or more of the following:

- cease selling or using any of our products that incorporate the challenged intellectual property, which would adversely affect our revenue;

- obtain a license from the holder of the intellectual property right alleged to have been infringed, which license may not be available on reasonable terms, if at all; and

- redesign or, in the case of trademark claims, rename our products or services to avoid infringing the intellectual property rights of third parties, which may not be possible and in any event could be costly and time-consuming.

Even if we were to prevail, such claims or litigation could be time-consuming and expensive to prosecute or defend, and could result in the diversion of our management's time and attention. These expenses and diversion of managerial resources could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Current capacity constraints may require us to expand our infrastructure and IAP advertiser support capabilities.

Our ability to provide high-quality Internet Yellow Pages services largely depends upon the efficient and uninterrupted operation of our computer and communications systems. We may be required to expand our technology, infrastructure, and IAP advertiser support capabilities in order to accommodate any significant increases in the numbers of advertisers and users of our web sites. We may not be able to project accurately the rate or timing of increases, if any, in the use of our services or expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner. If we do not expand and upgrade our infrastructure in a timely manner, we could experience temporary capacity constraints that may cause unanticipated system disruptions, slower response times, and lower levels of IAP advertiser service. Our inability to upgrade and expand our infrastructure and IAP advertiser support capabilities as required could impair the reputation of our brand and our services, reduce the volume of users able to access our website, and diminish the attractiveness of our service offerings to our advertisers.

Any expansion of our infrastructure may require us to make significant upfront expenditures for servers, routers, computer equipment, and additional Internet and intranet equipment, as well as to increase bandwidth for Internet connectivity. Any such expansion or enhancement will need to be completed and integrated without system disruptions. An inability to expand our infrastructure or IAP advertiser service capabilities either internally or through third parties, if and when necessary, would materially and adversely affect our business, prospects, financial condition, and results of operations.

Risks Related to the Internet

We may not be able to adapt as the Internet, Internet Yellow Pages services, and IAP advertiser demands continue to evolve.

Our failure to respond in a timely manner to changing market conditions or client requirements could have a material adverse effect on our business, prospects, financial condition, and results of operations. The Internet, e-commerce, and the Internet Yellow Pages industry are characterized by:

- rapid technological change;
- changes in advertiser and user requirements and preferences;
- frequent new product and service introductions embodying new technologies; and
- the emergence of new industry standards and practices that could render our existing service offerings, technology, and hardware and software infrastructure obsolete.

In order to compete successfully in the future, we must

- enhance our existing services and develop new services and technology that address the increasingly sophisticated and varied needs of our prospective or current IAP advertisers;
- license, develop or acquire technologies useful in our business on a timely basis; and
- respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

Our future success may depend on continued growth in the use of the Internet.

Because Internet Yellow Pages is a new and rapidly evolving industry, the ultimate demand and market acceptance for our services will be subject to a high level of uncertainty. Significant issues concerning the commercial use of the Internet and online service technologies, including security, reliability, cost, ease of use, and quality of service, remain unresolved and may inhibit the growth of Internet business solutions that use these technologies. In addition, the Internet or other online services could lose their viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity, or due to increased governmental regulation. Our business, prospects, financial condition, and results of operations would be materially and adversely affected if the use of Internet Yellow Pages and other online services does not continue to grow or grows more slowly than we expect.

We may be required to keep pace with rapid technological change in the Internet industry.

In order to remain competitive, we will be required continually to enhance and improve the functionality and features of our existing services, which could require us to invest significant capital. If our competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing services, technologies, and systems may become obsolete. We may not have the funds or technical know-how to upgrade our services, technology, and systems. If we face material delays in introducing new services, products, and enhancements, our advertisers and users, may forego the use of our services and select those of our competitors, in which event our business, prospects, financial condition and results of operations could be materially and adversely affected.

Regulation of the Internet may adversely affect our business.

Due to the increasing popularity and use of the Internet and online services such as online Yellow Pages, federal, state, local, and foreign governments may adopt laws and regulations, or amend existing laws and regulations, with respect to the Internet and other online services. These laws and regulations may affect issues such as user privacy, pricing, content, taxation, copyrights, distribution, and quality of products and services. The laws governing the Internet remain largely unsettled, even in areas where legislation has been enacted. It may take years to determine whether and how existing laws, such as those governing intellectual property, privacy, libel, and taxation, apply to the Internet and Internet advertising and directory services. In addition, the growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business over the Internet. Any new legislation could hinder the growth in use of the Internet generally or in our industry and could impose additional burdens on companies conducting business online, which could, in turn, decrease the demand for our services, increase our cost of doing business, or otherwise have a material adverse effect on our business, prospects, financial condition, and results of operations.

We may not be able to obtain Internet domain names that we would like to have.

We believe that our existing Internet domain names are an extremely important part of our business. We may desire, or it may be necessary in the future, to use these or other domain names in the United States and abroad. Various Internet regulatory bodies regulate the acquisition and maintenance of domain names in the United States and other countries. These regulations are subject to change. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in all countries in which we plan to conduct business in the future.

The extent to which laws protecting trademarks and similar proprietary rights will be extended to protect domain names currently is not clear. We therefore may be unable to prevent competitors from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our domain names, trademarks, trade names, and other proprietary rights. We cannot provide assurance that potential users and advertisers will not confuse our domain names, trademarks, and trade names with other similar names and marks. If that confusion occurs, we may lose business to a competitor and some advertisers and users may have negative experiences with other companies that those advertisers and users erroneously associate with us. The inability to acquire and maintain domain names that we desire to use in our business, and the use of confusingly similar domain names by our competitors, could have a material adverse affect on our business, prospects, financial conditions, and results of operations in the future.

Our business could be negatively impacted if the security of the Internet becomes compromised.

To the extent that our activities involve the storage and transmission of proprietary information about our advertisers or users, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. We may be required to expend significant capital and other resources to protect against security breaches or to minimize problems caused by security breaches. Our security measures may not prevent security breaches. Our failure to prevent these security breaches or a misappropriation of proprietary information may have a material adverse effect on our business, prospects, financial condition, and results of operations.

Our technical systems could be vulnerable to online security risks, service interruptions or damage to our systems.

Our systems and operations may be vulnerable to damage or interruption from fire, floods, power loss, telecommunications failures, break-ins, sabotage, computer viruses, penetration of our network by unauthorized computer users and "hackers," natural disaster, and similar events. Preventing, alleviating, or eliminating computer viruses and other service-related or security problems may require interruptions, delays or cessation of service. We may need to expend significant resources protecting against the threat of security breaches or alleviating potential or actual service interruptions. The occurrence of such unanticipated problems or security breaches could cause material interruptions or delays in our business, loss of data, or misappropriation of proprietary or IAP advertiser-related information or could render us unable to provide services to our IAP advertisers for an indeterminate length of time. The occurrence of any or all of these events could materially and adversely affect our business, prospects, financial condition, and results of operations.

If we are sued for content distributed through, or linked to by, our website or those of our advertisers, we may be required to spend substantial resources to defend ourselves and could be required to pay monetary damages.

We aggregate and distribute third-party data and other content over the Internet. In addition, third-party websites are accessible through our website or those of our advertisers. As a result, we could be subject to legal claims for defamation, negligence, intellectual property infringement, and product or service liability. Other claims may be based on errors or false or misleading information provided on or through our website or websites of our directory licensees. Other claims may be based on links to sexually explicit websites and sexually explicit advertisements. We may need to expend substantial resources to investigate and defend these claims, regardless of whether we successfully defend against them. While we carry general business insurance, the amount of coverage we maintain may not be adequate. In addition, implementing measures to reduce our exposure to this liability may require us to spend substantial resources and limit the attractiveness of our content to users.

Risks Related to Our Securities

Stock prices of technology companies have declined precipitously at times in the past and the trading price of our common stock is likely to be volatile, which could result in substantial losses to investors.

The trading price of our common stock has risen and fallen significantly over the past twelve months and could continue to be volatile in response to factors including the following, many of which are beyond our control:

- decreased demand in the Internet services sector;
- variations in our operating results;
- announcements of technological innovations or new services by us or our competitors;
- changes in expectations of our future financial performance, including financial estimates by securities analysts and investors;
- our failure to meet analysts' expectations;
- changes in operating and stock price performance of other technology companies similar to us;

·	2005	2004	2005	2004
US	$ 8,895,274	$ 1,122,048	$ 17,562,218	$ 1,749,963
Asia	1,859,642	3,180,367	4,167,582	15,247,347
Europe	2,809,703	1,655,510	5,999,212	3,557,433
Canada	3,708,162	1,574,156	7,833,337	1,668,680
Other	48,549	384,100	261,644	488,072
Total net sales	$ 17,321,330	$ 7,916,181	$ 35,823,993	$ 22,711,495

(c) Long-lived assets principally include fixed assets and intangibles, based on their location are as follows:

	September 30, 2005	December 31, 2004
US	$ 4,846,667	$ 2,771,454
Canada	3,464,454	3,808,332
Hong Kong	1,913,948	2,299,222
Total long-lived assets	$ 10,225,069	$ 8,879,008

d) Revenue from external customers by product category are summarized as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
OEM	$ 2,414,665	$ 2,292,330	$ 5,220,940	$ 14,262,440
Playwell plastic	1,088,380	1,983,429	1,962,354	3,309,983
Distributed lines	10,670,624	1,302,966	21,876,974	1,302,996
Playwell wood	461,339	1,050,436	724,810	1,510,548
Proprietary lines	1,745,066	276,825	3,215,792	276,825
Other	941,256	1,010,195	2,823,123	2,048,703
Total net revenues	$ 17,321,330	$ 7,916,181	$ 35,823,993	$ 22,711,495

(e) Customer and vendor concentration:

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	%	2005	%
Customer A	$ 900,709	5.20	$ 2,901,743	8.10
B	568,139	3.28	1,196,521	3.34
C	514,443	2.97	1,182,192	3.30
All others	15,338,039	88.55	30,543,537	85.26
Total net sales	$ 17,321,330	100	$ 35,823,993	100

	For the three months ended September 30,		For the nine months Ended September 30,	
	2004	%	2004	%
Customer A	$ 2,332,107	29.46	$ 13,256,700	58.37
B	376,019	4.75	933,442	4.11
C	321,397	4.06	451,959	1.99
All others	4,886,658	61.73	8,069,394	35.53
Total net sales	$ 7,916,181	100%	$ 22,711,495	100%

Sales of toys purchased from the Company's two largest suppliers of toys in aggregate accounted for 19% and 51% of gross sales for the three months ended September 30, 2005 and 2004, respectively.

Sales of toys purchased from the Company's two largest suppliers of toys in aggregate accounted for 20% and 60% of gross sales for the nine months ended September 30, 2005 and 2004, respectively.

3.

Other prepaid expenses and current assets:

		September 30, 2005		December 31, 2004
Prepaid inventory	$	33,797	$	171,266
Insurance		487,020		477,569
Other current assets		164,874		598,843
Other prepaid expenses		725,178		267,108
Total other prepaid expenses and current assets	$	1,410,869	$	1,514,786

4.

Fixed assets:

				September 30, 2005 Accumulated				December 31, 2004 Accumulated
		Cost		**Depreciation**		**Cost**		**depreciation**
Leasehold improvements	$	392,580	$	354,754	$	349,540	$	315,489
Plant & machinery		674,553		336,924		548,901		270,814
Furniture, fixtures & equipment		699,318		391,194		511,877		273,690
Mould & loose tools		2,155,158		718,745		2,178,814		477,315
Total fixed assets	$	3,921,609	$	1,801,617	$	3,589,132	$	1,337,308
Net book value			$	2,119,992		$		2,251,824

Depreciation of $18,166 and $9,993 has been charged to cost of goods sold for the three months ended September 30, 2005 and 2004, respectively and $57,274 and $29,788 for the nine months ended September 30, 2005 and 2004.

5.

Intangibles:

				September 30, 2005 Accumulated				December 31, 2004 Accumulated
		Cost		**Amortization**		**Cost**		**amortization**
License	$	2,549,217	$	335,238	$	2,545,974	$	97,288
Distribution network		2,590,000		248,042		1,790,000		67,125
Customer relationship		1,085,000		107,220		811,000		30,412
Trade name		1,396,000		48,708		786,000		-
Trademark		1,247,345		809,964		1,246,173		664,169
Other acquired rights		1,070,000		283,313		372,000		64,969
Total intangibles	$	9,937,562	$	1,832,485	$	7,551,147	$	923,963
Net book value			$	8,105,077		$		6,627,184

Amortization expense for the three months ended September 30, 2005 and 2004 was $316,433 and $172,386, respectively, and $908,045 and $220,776 for the nine months ended September 30, 2005 and 2004, respectively. Based on current balances and estimated useful lives, the Company expects amortization expense to be $252,254, $979,250, $1,009,017, $984,173 and $766,100 in the remainder of 2005 and the fiscal years ended 2006, 2007, 2008 and 2009, respectively. This would be calculated using the current balances for intangibles and the useful lives for each classification within the intangibles group.

6.

Bank indebtedness:

The Company s indirect wholly-owned US subsidiary, IPI, maintains a $10.0 million revolving credit facility agreement with Citibank N.A., expiring on June 30, 2006, although the facility is uncommitted and Citibank has the right to refuse to make advances in its sole discretion. The interest rate on the revolving loan payable is LIBOR + 175 basis points or prime ½%, at the Company s election. The loan is collateralized by all of IPI s assets and there are covenants and cross defaults attached to the facility. Borrowing is limited based on a borrowing base formula consisting of eligible receivables and inventory. As of September 30, 2005, the amount outstanding was $8.0 million.

The Company s indirect wholly-owned Canadian subsidiary, Grand Toys Ltd., has a line of credit with Montcap Financial to finance its inventory and accounts receivable for advances of up to $3.01 million (CA$3.5 million). The receivable line has a discount fee of 2.0% of invoice amount purchased and the inventory line bears interest at Canadian prime plus

7.5%. The line of credit is for a period of one year and is renewed automatically, unless prior notice is given by either the lender or Grand Toys Ltd.

The line of credit is secured by a lien on the assets of Grand Toys Ltd. There are no debt covenants or cross-default provisions.

As of September 30, 2005, Grand Toys Ltd. had $2,325,587 (December 31, 2004 - $2,560,000) of credit available under the Montcap Financial facility, subject to the existence of eligible inventory and accounts receivable. At September 30, 2005, Grand Toys Ltd. had bank indebtedness of $684,648 (December 31, 2004 - $351,562), which represents receivable advances on $955,861 (December 31, 2004 - $1,747,589).

As of September 30, 2005, Playwell had $nil (December 31, 2004 - $434,480) of discounted bills. The amounts are payable by customers banks. The recourse provisions provide that if such banks do not make the required payments, Playwell s bank would have recourse to Playwell for the full amount. In the opinion of management, the likelihood of such occurrence is remote.

In October 2005, the Company amended IPI s existing Citibank facility by increasing the line to $15.0 million which includes a $2.0 million sub-limit for Grand Toys Ltd. $4.3 million (CA 5.0 million) of the amended credit has been guaranteed by Grand Toys Ltd. In conjunction with this, the Montcap credit facility was terminated.

7.

Capital stock

a) On August 16, 2004, Grand US and Centralink Investments Limited completed the transactions contemplated by a Subscription and Exchange Agreement dated as November 14, 2003, which Subscription and Exchange Agreement 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 following transactions were completed:

.

Grand US undertook a corporate reorganization pursuant to which Grand US and its operating subsidiaries became subsidiaries of the Company, with each issued and outstanding share of Common Stock of Grand US being converted into one ADS, evidenced by one American depositary receipt (ADR), representing beneficial ownership of one ordinary share of the Company, and each outstanding option and warrant to purchase Grand US s Common Stock being converted into one option or warrant to purchase the Company s ADSs;

.

The Company acquired from Centralink all of the issued and outstanding capital stock of Playwell in exchange for the issuance to Centralink of 5,000,000 ADSs. 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 primarily for related parties; Great Wall Alliance Limited, the holder of Playwell trademarks; and Asian World Enterprises Co. Limited, the holder of licenses for Walt Disney Company and Crayola branded products; and

.

Centralink subscribed for 5,000,000 ADSs for cash and other consideration in a total amount of $11,000,000.

b)

As of September 30, 2005, there were 16,234,937 ordinary shares of the Company issued and outstanding. These ordinary shares are traded in the US on Nasdaq in the form of ADSs, and are evidenced by ADRs.

c)

ADS transactions:

August 2004:

5,580,244 ADSs representing beneficial ownership of 5,580,244 ordinary shares were issued as a result of the reorganization merger of Grand US and the Company.

10,000,000 ADSs representing 10,000,000 ordinary shares were issued to Centralink, of which 5,000,000 were issued in exchange for the shares of Playwell International Limited.

December 2004:

7,038 ADSs representing 7,038 ordinary shares were issued upon exercise of stock options.

January 2005:

2,000 ADSs representing 2,000 ordinary shares were issued upon exercise of stock options.

March 2005:

250 ADSs representing 250 ordinary shares were issued upon exercise of stock options.

582,730 ADSs representing beneficial ownership of 582,730 ordinary shares were issued in partial consideration for the Company s acquisition of IPI.

April 2005:

52,175 ADSs representing beneficial ownership of 52,175 ordinary shares were issued in lieu of a cash payment of accrued interest on the Company s Exchangeable Note in the principal amount of $7,675,000 (the Exchangeable Note).

10,500 ADSs representing beneficial ownership of 10,500 ordinary shares were issued upon exercise of stock options.

d)

Preferred shares

2,000,000 Series A Convertible Preference shares were issued in exchange for the Exchangeable Note .

e)

Deferred non-voting shares

2 Deferred non-voting shares were issued to Rich Asia Consultants Limited as a result of the reorganization merger of Grand US and the Company.

f)

The number of ordinary shares/ADSs, Preference Shares and Deferred non-voting shares is as follows:

	Common Stock	**Preferred Stock**	**Deferred Non-voting Stock**
January 1, 2004			
Playwell , historical	101	-	-
Conversion factor	99,010	-	-
Ordinary Shares	10,000,000	-	-
ADSs issuance on reorganization merger	5,580,244	-	-

Deferred non-voting shares	-	-	2
Option exercise	7,038	-	-
December 31, 2004	15,587,284	-	2
ADS issuance in consideration for IPI acquisition	582,730	-	-
ADS issuance on settlement of interest on Exchangeable Note	52,175	-	-
Option exercise	12,750	-	-
Preference share issuance in exchange for Exchangeable Note	-	2,000,000	-
September 30, 2005	16,234,937	2,000,000	2

g)

Dividends:

Deemed dividends of $991,426 (note 16) are based on the difference between the effective conversion price of the Series A Convertible Preference shares and the market price of the ADSs at the March 1, 2005 issuance date of the Exchangeable Note.

Actual dividends of $369,729 on the Preference Shares of which $168,260 have been satisfied in full by the issuance of 73,030 ADSs in October 2005, and $201,469 which have been accrued at September 30 2005 and will be settled at the year end.

8.

Stock options and warrants:

Grand US maintained an amended and restated employee stock option plan (the "Old Option Plan") which provided for the issuance of up to 300,000 options to acquire common stock of Grand US. As part of the reorganization merger, the Company agreed to issue ADSs in satisfaction of Grand US s obligations to issue shares upon exercise of options granted under the Grand US Option Plan.

On August 13, 2004, the Company adopted the Grand Toys International Limited 2004 Stock Option Plan (the "New Option Plan") which provides for the issuance of options to purchase up to 1,558,024 ADSs.

Stock options granted under the Old Option Plan and New Option Plan may be incentive stock options under the requirements of the US Internal Revenue Code, or may be non-statutory stock options, which do not meet such requirements. Options may be granted under the Old Option Plan or the New 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 Old Option Plan and the New Option Plan, the exercise price of each option granted was equal to the market price of the common stock of Grand US on the grant date and an option s maximum term is ten years.

The options granted in 2004 were granted outside the Old Option Plan and the New Option Plan, except for options to purchase 46,875 ADSs, which were automatically granted to directors under the New Option Plan.

Changes in options and warrants are as follows:

	Option Plan	Other stock options	Warrants	Total	Weighted-average exercise price per share

January 1, 2005	208,176	1,290,375	412,143	1,910,694	$	2.28
Granted	39,000	270,907	357,143	667,050		2.19
Exercised	(10,750)	(2,000)	-	(12,750)		1.16
Cancelled	(1,000)	-	(357,143)	(358,143)		2.12
Options and warrants outstanding at September 30, 2005	235,426	1,559,282	412,143	2,206,851	$	2.28
Options and warrants exercisable at September 30, 2005	235,426	672,455	412,143	1,320,024	$	2.18

The following tables summarize information about options and warrants outstanding and exercisable at September 30, 2005:

Options and warrants outstanding :

Range of exercise prices	Number		Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
$0.01 - $2.00	357,458	$	1.12	5.73
$2.12 - $3.07	1,835,393		2.41	7.39
$5.62 - $11.00	1,000		7.78	4.82
$16.00 - $87.60	13,000		16.69	3.29
	2,206,851	$	2.28	7.10

Options and warrants exercisable :

Range of exercise prices	Number		Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
$0.01 - $2.00	315,840	$	1.01	5.70
$2.12 - $3.07	990,184		2.35	6.28
$5.62 - $11.00	1,000		7.78	4.82
$16.00 - $87.60	13,000		16.69	3.29
	1,320,024	$	2.18	6.11

The weighted average fair value of options granted in 2005 was $1.04, which is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used:

For the three months ended September 30, 2005:

Weighted average expected life (years)	3
Risk-free interest rate, average of grant dates	3.84%
Volatility factor of expected market price of Company s ADSs	64.6%

Dividend rate	-

Pro-forma information regarding net earnings and earnings per ADS is required by SFAS 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 (note 1).

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 of $2,891 and $3,151 was recorded for the nine months ended September 30, 2005 and 2004, respectively, as a result of the application of variable accounting to modified awards.

9.

Earnings per ADS:

For the quarter ended September 30, 2005, options and warrants to purchase 2,206,851 ADSs (September 2004 - 1,087,375) were not included in the diluted earnings per ADS calculation as their effect is anti-dilutive.

For the nine months ended September 30, 2005, options and warrants to purchase 2,206,851 ADSs (September 30, 2004   16,500) and the 2,804,600 ADSs issuable upon conversion of the Company s Series A Convertible Preference Shares have not been included in the diluted earnings per ADS calculation as their effect is anti-dilutive.

10.

Net change in non-cash operating working capital items:

	For the nine months ended September 30,			
		2005		**2004**
Continuing operations:				
Increase in accounts receivable	$	(6,278,118)	$	(164,988)
(Increase) decrease in receivable from related companies		(1,407,297)		86,524
Increase in inventory		(2,681,330)		(595,616)
Decrease (increase) in other prepaid expenses and current				
assets		1,451		(2,067,407)
Increase in trade accounts payable		2,978,244		(50,576)
Decrease in payable to related companies		2,107,611		279,724
Increase in other accounts payable and				
accrued liabilities		(1,591,302)		(20,926)
Decrease in amount due to director		-		(4,322)
Decrease in income taxes payable		-		(5,003)
Total net change in non-cash operating working capital items	$	(6,870,741)	$	(2,542,590)

11.

Supplemental disclosure of cash flow information:

	For the nine months ended September 30,	
	2005	2004
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 154,707	$ 19,522
Income taxes	847	5,003

12.

Commitments:

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

2005	$ 270,141
2006	1,495,657
2007	1,531,841
2008	1,060,858
2009	946,203
2010	656,513

Rent expense for the three months ended September 30, 2005 and 2004 amounted to approximately $116,880 and $27,777, respectively, and $580,720 and $132,403 for the nine months ended September 30, 2005 and 2004, respectively.

Grand Toys Ltd., the Company s Canadian subsidiary, 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 $34,000, $138,000, $142,000 and $84,000 for the remainder of 2005 and the years 2006, 2007 and 2008, respectively.

(b) As at September 30, 2005, the Company has license agreements that include the minimum guarantees of royalties for 2005 through 2012. The amounts are $2,803,402, $1,593,496, $1,838,142, $1,930,000 and $2,262,500 for the remainder of 2005, 2006 through 2009, respectively, and $2,250,000 annually from 2010 to 2012.

13.

Contingencies:

Grand Toys Ltd. was named in two lawsuits by former sales agents, dated June 12, 2000 and April 15, 2004. In January 2005, the Company settled the latter claim for $291,181. The settlement was recorded in the December 31, 2004 results. In the opinion of management, it is difficult to ascertain or estimate the value of a settlement if any of the remaining claim.

On May 21, 2003, Grand US was named in a lawsuit for an alleged defective product causing personal injury. Grand US was acting as an agent for the vendor of the alleged defective product. This case was settled in February 2005 and the settlement is covered by insurance.

The Company believes that the ultimate resolution of the one unresolved claim will not have a material adverse effect on the Company s liquidity, financial condition or results of operations.

14.

Related party transactions:

The Company has defined a related party as a company that is owned or controlled by the majority shareholder of the Company.

Name of related party		September 30, 2005		December 31, 2004
a) Amount due from related party:				
Toy Biz Worldwide Limited	$	2,748,075	$	551,934
Playwell Toy (China) Ltd.		1,008,085		1,005,687
Sunny Smile International Ltd.		999,924		997,917
Cornerstone Overseas Investments, Limited		678,817		1,293,273
Playwell Industry Limited		537,770		497,398
Centralink Investments Limited		443,452		-
Guangzhou Playwell Trading Co. Ltd.		320,345		155,238
Dongguan Bailiwei Plaything Co. Ltd.		275,305		351,293
Kord Gifts		14,950		-
Hua Yang Printing Holdings Co. Ltd.		4,402		3,776
Long Sure Industries Ltd.		853		1,042
Brand Management Ltd.		-		164,438
China Retail Management		-		3,570
New Adventures Corporation		-		31,945
Great Asian Development Inc.		-		1,271
Dongguan Playwell Products Co. Ltd.		-		156
Total due from related party	**$**	**7,031,978**	**$**	**5,058,938**
b) Amount due to related party:				
Zhejiang Playwell Toy Co Ltd.	$	1,597,380	$	1,008,705
Playwell Industry Ltd.		1,584,527		380,928
Centralink Investments Limited		305,378		304,765
China Retail Management		208,732		-
Toy Biz Worldwide Ltd.		115,490		147,341
Directors/Shareholders		4,349		155,911
Hong Kong Toy USA		-		115,289
Grand Toys Ltd.		-		4,896
Total due to related party	**$**	**3,815,856**	**$**	**2,117,835**

The amounts are unsecured, interest-free and have no fixed term of repayment or with normal trading terms for the trading balances.

Playwell International Limited	For the three months ended September 30, 2005	2004	For the nine months ended September 30, 2005	2004
Sales				
Toy Biz Worldwide Ltd.	$ 200	$ 1,572,446	$ 197,146	$ 12,077,054
Dongguan Bailiwei Plaything Co. Ltd	-	14,624	-	108,492
Playwell Industry Ltd.	39,128	47,164	130,326	342,090
	39,328	1,634,234	327,472	12,527,636
Purchases				
Playwell Industry Ltd.	1,330,911	2,884,241	2,599,104	11,315,851
Zhejiang Playwell Toy Co., Ltd.	1,732,635	1,384,773	3,634,477	2,732,115
Dongguan Bailiwei Plaything Co. Ltd	-	23,398	-	23,398
	3,063,546	4,292,412	6,233,581	14,071,364
Mould income				
Toy Biz Worldwide Ltd.	893,033	909,963	2,666,951	1,478,046
Playwell Industry Ltd.	(35)	(3)	(34,179)	8,981
	892,998	909,960	2,632,772	1,487,027
Commission income				
Playwell Industry Ltd	-	(39)	-	115,129
	-	(39)	-	115,129
Royalty income				
Guangzhou Playwell Trading Co. Ltd.	38,584	-	151,397	65,351
	38,584	-	151,397	65,351
Other income				
Toy Biz Worldwide Ltd.	8,526	41,555	35,033	84,551
Playwell Industry Ltd	-	1,617	-	1,617
	8,526	43,172	35,033	86,168
Other expenses				
Playwell Industry Ltd.	1,648	(608)	4,998	34,642
	1,648	(608)	4,998	34,642

Grand US		For the three months ended September 30, 2005	For the three months ended September 30, 2004		For the nine months ended September 30, 2005		For the nine months ended September 30, 2004
Purchases							
Toy Biz Worldwide Ltd.	$	623,376	219,264	$	1,419,416	$	219,264
Commissions							
Toy Biz Worldwide Ltd.		10,448	8,846		13,017		8,846

15.

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 three months ended September 30, 2005, approximately 14% (September 30, 2004 19%) of the Company s sales were made to five unrelated companies. Three unrelated customers representing approximately 9% (September 30, 2004 - 13%) of total sales, individually accounted for 3% or more (September 30, 2004 - 3%) of total sales.

For the nine months ended September 30, 2005, approximately 15% (September 30, 2004 12%) of the Company s sales were made to five unrelated companies. Three unrelated customers representing approximately 9% (September 30, 2004 - 8%) of total sales, individually accounted for 3% or more (September 30, 2004 - 2%) 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.

16.

Acquisition:

On March 1, 2005, the Company acquired the assets of New Jersey based IPI, a distributor of a broad range of toys primarily to the consumer specialty markets in the US and Canada.

Pursuant to the asset purchase agreement, the purchase price for the assets was $8,862,000, of which $7,262,000 was paid in cash and $1,600,000 was paid by the delivery of 582,730 ADSs. Acquisition costs relating to the acquisition of IPI were approximately $853,000. In order to finance the cash portion of the purchase price and to provide ongoing working capital for IPI, the Company sold to Centralink the Exchangeable Note in the principal amount of US$7,675,000 for proceeds of US$7,400,000. The Exchangeable Note was sold at a US$275,000 discount in order to compensate the ultimate beneficial owner of Centralink, who is also the controlling shareholder of the Company, for providing the sellers of IPI with the option to require Centralink to purchase the portion of the purchase price paid in ADSs after the first anniversary of the closing of the IPI acquisition. The Exchangeable Note bore interest at 15% per annum and was exchanged for 2,000,000 Series A Convertible Preference shares of the Company when the issuance of the Series A Convertible Preference Shares was approved by the Company s shareholders at the Company s 2005 Annual General Meeting on April 15, 2005.

The Series A Convertible Preference Shares accrue preferential dividends at a rate of 10.5% per annum and are convertible into an aggregate of 2,804,600 ADSs based upon a current conversion price of $2.7365 per share. Centralink has voting rights for the Series A Convertible Preference Shares equal to the number of votes that Centralink would have if the Series A Convertible Preference Shares were converted into ordinary shares/ADSs.

The September 30, 2005 balance sheet reflects the exchange of the Exchangeable Note into Series A Convertible Preference Shares. The conversion feature relating to the preferential conversion price of the Series A Convertible Preference shares has been valued at $991,426, based on the difference between the effective conversion price and the market price of the ADSs at the March 1, 2005 issuance date of the Exchangeable Note. This value is considered to be deemed dividends to the holder of the Series A Convertible Preference Shares and reduces earnings available to the ADS holders.

The total amount recorded in additional paid in capital as of September 30, 2005 was as follows:

		(Amounts reported in thousands)
Exchangeable Note	$	7,415
ADSs issued to IPI sellers on		
Acquisition		1,542
Exchangeable Note features:		
Beneficial conversion feature		991
Fair value of put option		434
Total	$	10,382

The following table summarizes the fair value of the assets acquired and liabilities assumed in partial satisfaction of Centralink s subscription for the Company s ADS.

		(Amounts reported in thousands)
Current assets	$	8,973
Long term assets		328

Intangible assets		2,382
Goodwill		2,709
Current liabilities		(3,525)
Deferred tax liabilities		(550)
Net assets acquired	$	10,317

The acquired intangible assets consist of:

			(Amounts reported in thousands)
Distribution network	$		800
Trade name			610
Customer relationship			274
Other acquired rights			698
Total intangible assets		$	2,382

The Company engaged Empire Valuation Consultants, an independent valuator, to perform a purchase price allocation review of this transaction.

17.

Pro Forma presentation:

The following unaudited pro forma combined statement of operations gives effect to the business combination of the Company, Grand US and IPI. The IPI acquisition, which occurred on March 1, 2005, is being accounted for under the purchase method of accounting, as required by SFAS No. 141 Business Combinations. Under this method of accounting, the purchase price has been allocated to the fair value of the net assets acquired, including goodwill.

The unaudited pro forma consolidated statements of operations for the nine months ended September 30, 2004 combine the consolidated statements of operations of the Company, Grand US and IPI as if the acquisition had taken place on January 1, 2004.

The unaudited pro forma combined statement of operations is not necessarily indicative of the actual operating results that would have occurred or the future operating results that will occur as a consequence of such transactions.

The accounting policies used in the preparation of the pro forma combined statement of operations are disclosed in Note 1 to the audited consolidated financial statements for the year ended December 31, 2004. The pro forma combined statement of operation for the nine months ended September 30, 2004 give effect to the amortization of intangibles.

Pro Forma Combined Information:

		(In thousands, except share and per share data)			
		For the three months ended September 30,			
		2005		2004	
Net Sales		$	17,321	$	16,715
Gross profit			5,410		5,775
Net (loss) earnings from operations		$	(314)	$	1,288
Net (loss) earnings available to ADS		$	(516)	$	1,288
Net (loss) earnings per ADS:					
	Basic	$	(0.03)	$	0.10
	Diluted		N/A		0.10

Weighted average number of ADS:			
	Basic	16,234,937	12,729,467
	Diluted	19,039,537	12,942,989

		(In thousands, except share and per share data) For the nine months ended September 30, 2005		2004
Net Sales		$ 39,321		$ 47,080
Gross profit		13,647		16,332
Net (loss) earnings from operations		$ (3,238)		$ 3,422
Net (loss) earnings available to ADS		$ (4,599)		$ 3,422
Net (loss) earnings per ADS:				
	Basic	$ (0.28)		$ 0.31
	Diluted	N/A		0.29
Weighted average number of ADS:				
	Basic	16,209,567		10,930,041
	Diluted	17,935,474		11,806,200

18. Subsequent event:

.

In October 2005, the Company issued 73,030 ADS in full satisfaction of the $168,260 semiannual dividend to Centralink payable on June 30, 2005.

.

In October 2005, the Company amended IPI s existing Citibank facility by increasing the line to $15.0 million which includes a $2.0 million sub-limit for Grand Toys Ltd.. $4.3 million (CA 5.0 million) of the amended credit has been guaranteed by Grand Toys Ltd. In conjunction with this, the Montcap credit facility was terminated.

Item 2. Management s Discussion and Analysis:

The following should be read in conjunction with the unaudited consolidated financial statements included in this Report on Form 6-K, the Company s Audited Financial Statements for the fiscal year ended December 31, 2004, the Company s Registration Statement on Form F-4 which was declared effective by the Securities and Exchange Commission on July 29, 2004 and Playwell s audited financial statements for the fiscal year ended December 31, 2003, which were included in the Company s Form F-4.

Overview

On November 14, 2003, Grand US and Centralink entered into the Subscription and Exchange Agreement pursuant to which, among other matters:

.

Grand US undertook a corporate reorganization pursuant to which Grand US and its operating subsidiaries became subsidiaries of the Company, with each issued and outstanding share of Common Stock of Grand US being converted into one ADS, evidenced by one ADR, representing beneficial ownership of one ordinary share of the Company, and each outstanding option and warrant to purchase Grand US s Common Stock being converted into one option or warrant to purchase the Company s ADSs representing beneficial ownership of one ordinary share of the Company.

.

The Company acquired from Centralink all of the issued and outstanding capital stock of Playwell in exchange for the issuance to Centralink of 5,000,000 ADSs; and

.

Centralink subscribed for 5,000,000 of the Company s ADSs for cash and other consideration in a total amount of $11,000,000.

For accounting purposes, Playwell was deemed to be the acquirer, therefore the results of Grand US are only included for the period of January 1, 2005 to September 30, 2005, and the 2004 comparative numbers reflect Playwell s results only.

On March 1, 2005, the Company acquired the assets of IPI. IPI s results from March 1, 2005 are included in the Company s 2005 results.

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 allowances.

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. Royalties include payments by the Company s subsidiaries 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.

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, distribution, warehouse and freight expenses.

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 include 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 Policies

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 US. 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 policies 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 products occurs infrequently in Canada and the US, 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 the Company s 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 the Company. 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.

Comparison of the three months ended September 30, 2005 to the three months ended September 30, 2004:

	For the Three Months ended September 30,			
	2005		2004	
	$	%	$	%
Net sales	$ 17,321,330	100.00	7,916,181	100.00
Cost of goods sold	11,911,347	68.77	5,552,831	70.15
Gross profit	5,409,983	31.23	2,363,350	29.85
Other operating income	(245,188)	(1.42)	(26,441)	(0.33)
Operating costs and expenses:				
General and administrative	3,644,711	21.04	1,117,501	14.11
Selling and distribution	1,740,199	10.05	216,518	2.74
Depreciation and amortization	470,950	2.72	219,439	2.77
Total operating costs and expenses	5,855,860	33.81	1,553,458	19.62
Non-operating expense (income):				
Interest expense	102,211	0.59	14,853	0.19
Interest revenue	(7,109)	(0.04)	(17,522)	(0.22)
Total non-operating (income) expense	95,102	0.55	(2,669)	(0.03)
(Loss) earnings before income taxes	(295,791)	(1.71)	839,002	10.59
Net (loss) earnings from operations	$ (314,127)	(1.81)	638,142	8.06
Dividends	(201,469)	(1.16)	-	-
Net (loss) earnings applicable to ADS holders	**$ (515,596)**	**(2.98)**	**$ 638,142**	**8.06**

Net (loss) earnings from operations:

Net loss from operations for the third quarter of 2005 was $516,000 as compared to net earnings of $638,000 for the third quarter of 2004. Gross margins increased from 30% to 31%. Increased general and administrative expenses at the corporate group and a reduction in sales for the Playwell group, offset by the full quarter activity of the distribution unit of IPI and Grand US primarily contributed to the significant decrease in net earnings from the 2004 period to the 2005 period. Included in the Company s general and administrative expenses was $669,000 of costs that the Company incurred in connection with a potential acquisition transaction that was being pursued by the Company with an unaffiliated third party. The Company terminated the discussions with the third party in the third quarter. Without these one time charges, the Company would have had a net earnings from operations for the third quarter of 2005 of $355,000 or $0.02 per basic ADS.

Net sales:

Net sales increased during the third quarter of 2005 by approximately $9.4 million or by 119%, to $17.3 million from $7.9 million for the third quarter of 2004. The addition of sales from IPI, Grand Canada and Grand US s Crayola Dough product line in 2005 offset the declining OEM sales for Toy Biz Worldwide Limited (Toy Biz) product line by the Company s Hong Kong Toy Center subsidiary.

The product mix for goods sold by the Company for the 3-months ended September 30, 2005 and 2004 was as follows:

(The amounts in the table below are expressed in thousands

		For the Three Months ended September 30,		
		2005		2004
US Distribution, net	$	9,377	$	81
OEM products		2,415		2,292
Canadian distribution sales, net		3,039		1,499
Mould income and other related services		941		1,010
Playwell brand products Plastic toys		1,088		1,984
Playwell brand products Wooden toys		461		1,050
Net sales	$	17,321	$	7,916

IPI net sales for the three months ended September 30, 2005 were approximately $8.0 million. Included in the IPI sales are approximately $5,000 of commission income earned during the period.

The three-month period ended September 30, 2005 includes approximately $3.0 million of Canadian distribution sales from Grand Canada. Included in the Canadian distribution sales are approximately $66,000 of commissions earned during the period.

OEM product sales remained relatively flat at approximately $2.3 million in the three months ended September 30, 2004 and approximately $2.4 million during the three months ended September 30, 2005.

The Playwell brand products are divided into plastic and wooden toys. The Playwell plastic toy sales decreased by 45% from $2.0 million in the three months ended September 30, 2004 to $1.1 million in the three months ended September 30, 2005 due to no new Playwell plastic toys introduced during the period. The Playwell wooden toy sales decreased by 56% from $1.1 million in the three months ended September 30, 2004 to $461,000 in the three months ended September 30, 2005. Mould income and other related services remained relatively consistent at $1.0 million and $941,000 for the three months ended September 30, 2004 and 2005, respectively.

Gross profit:

Gross profit for the Company increased during the third quarter of 2005 by approximately $3.0 million from $2.4 million to $5.4 million. As a percentage of sales, gross profit increased from 30% in the third quarter of 2004 to 31% in the third quarter of 2005. The increased margin is due to the shift in product mix from the third quarter of 2004 to the third quarter of 2005. For the third quarter of 2005, IPI sales contributed a margin of 41%, the Canadian sales contributed a margin of 37% and the Playwell and OEM business maintained a 17% margin.

General and administrative expenses:

General and administrative expenses increased by approximately $2.5 million to $3.6 million in the third quarter of 2005, from $1.1 million in the third quarter of 2004. The Corporate group increased overhead in the latter part of 2004 to handle the increased business and prepare for assets that are to be acquired by Grand in 2005 and beyond. Corporate expenses for the quarter were $779,000, consisting primarily of salaries, insurance and professional fees. During this quarter, the company expensed $669,000 of costs and expenses that the Company incurred in connection with a potential acquisition transaction that was being pursued by the Company with an unaffiliated third party. The Company terminated the discussions with the third party in the third quarter. Increased expenses as a result of the acquisitions of Grand US on August 16, 2004 and IPI in March 2005 accounted for approximately $762,000 and $882,000, respectively, of additional costs.

Selling and distribution expenses:

Selling and distribution expenses increased from $216,000 for the quarter ended September 30, 2004 to approximately $1.7 million for the quarter ended September 30, 2005. The increase is due to a shift in product mix. The Playwell product typically requires a very low percentage of selling and distribution costs (0.7% of net revenue in the 2004 and 0.9% in the 2005 period), while the Canadian distributed product generally requires selling and distribution costs that are approximately 10% - 12% of net revenues and the IPI sales to specialty stores require selling and distribution costs that are approximately

21% - 23% of net revenues. The addition of the IPI, the Canadian distribution and Crayola Dough businesses added significant selling and distribution costs into the third quarter of 2005 that were not present in the third quarter of 2004.

Depreciation and amortization:

Depreciation and amortization increased from $219,000 for the quarter ended September 30, 2004 to $471,000 for the quarter ended September 30, 2005. $40,000 of the increase is due to amortization of the intangibles acquired in the Playwell acquisition; while $63,000 relates to amortization of the Crayola license and $93,000 relates to amortization of intangibles from the IPI acquisition. The balance of the increase relates to additional depreciation from Playwell assets and the newly acquired assets of IPI and Grand Canada.

Interest expense:

Interest expense relates primarily to IPI s working capital financing.

Dividends:

The three month period in 2005 includes $201,000 of dividends on the Series A Convertible Preference Shares.

Comparison of the nine months ended September 30, 2005 to the nine months ended September 30, 2004:

	For the nine months ended September 30,			
	2005		2004	
	$	%	$	%
Net sales	$ 35,823,993	100.00	$ 22,711,495	100.00
Cost of goods sold	23,837,076	66.54	16,289,161	71.72
Gross profit	11,986,917	33.46	6,422,334	28.28
Other operating income	(657,048)	(1.83)	(282,461)	(1.24)
Operating costs and expenses:				
General and administrative	9,579,210	26.74	2,257,625	9.94
Selling and distribution	4,495,126	12.55	432,856	1.91
Depreciation and amortization	1,337,098	3.73	431,530	1.90
Total operating costs and expenses	15,411,434	43.02	3,122,011	13.75
Non-operating expense (income):				
Interest expense	299,796	0.84	19,522	0.09
Interest revenue	(35,521)	(0.10)	(17,972)	(0.08)
Total non-operating (income) expense	264,275	0.74	1,550	0.01
(Loss) earnings before income taxes	(3,031,744)	(8.47)	3,581,234	15.76
Net (loss) earnings from operations	$ (3,062,044)	(8.55)	$ 2,847,548	12.54
Dividends	(1,361,155)	(3.80)	-	-
Net (loss) earnings applicable to ADS holders	**$ (4,423,199)**	**(12.35)**	**$ 2,847,548**	**12.54**

Net (loss) earnings from operations:

Net loss from operations for the first nine months of 2005 was approximately $4.4 million, as compared to net earnings of approximately $2.8 million for the first nine months of 2004. Gross margins increased from 28% to 33%. Increased general and administrative expenses at the corporate group and a reduction in sales for the Playwell group, offset by the seven months activity of the distribution unit of IPI and the nine months activity of Grand US primarily contributed to the significant decrease in net earnings from the 2004 period to the 2005 period. Included in the Company s general and administrative expenses was approximately $669,000 of costs that the Company incurred during 2005 in connection with a potential acquisition transaction that was being pursued by the Company with an unaffiliated third party. The Company terminated the discussions with the third party in the third quarter. Also included in the net loss for the period is approximately $991,000 of deemed dividends on the preference shares resulting from the difference between the effective conversion price and the market price at the date of issuance. Without these one time charges, the Company would have had a net loss from operations for the first nine months of 2005 of $2.4 million.

Net sales:

Net sales increased during the first nine months of 2005 by approximately $13.1 million, or by 58%, to $35.8 million from $22.7 million for the first nine months of 2004. The addition of sales from IPI, Grand Canada and Grand US s Crayola Dough product line in the first nine months of 2005 more than offset the declining OEM sales for specific Toy Biz Worldwide Limited (Toy Biz) line by the Company s Hong Kong Toy Center subsidiary.

The product mix for goods sold by the Company for the 9-months ended September 30, 2005 and 2004 were as follows:

(The amounts in the table below are expressed in thousands

		For the nine months ended September 30,		
		2005		**2004**
US Distribution, net	$	18,572	$	81
Canadian distribution sales, net		6,521		1,499
OEM products		5,221		14,262
Mould income and other related services		2,823		2,049
Playwell brand products Plastic toys		1,962		3,310
Playwell brand products Wooden toys		725		1,511
Net sales	$	35,824	$	22,712

Sales from IPI for US distribution are included from March 1, 2005, the date of the IPI acquisition. IPI net sales for the period ended September 30, 2005 were approximately $16.0 million. Included in the IPI sales are approximately $140,000 of commission income earned during the period.

The nine-month period ended September 30, 2005 includes approximately $6.5 million of Canadian distribution sales from Grand Canada. Included in the Canadian distribution sales are approximately $272,000 of commissions earned during the period.

OEM product sales decreased 63% from approximately $14.2 million in 2004 to approximately $5.2 million in 2005 due to the decrease in demand of specific Toy Biz items, partly offset by increased OEM sales of wooden toys.

The Playwell brand products are divided into plastic and wooden toys. The Playwell plastic toy sales decreased by 41% from approximately $3.3 million in 2004 to $2.0 million in 2005 due to no new Playwell plastic toys introduced during the period. The Playwell wooden toy sales decreased by 52% from $1.5 million in the first nine months of

2004 to $725,000 in the first nine months of 2005. The increase in mould income and other related services resulted from an increase in moulds for Toy Biz Worldwide and Hong Kong Toy Center in 2005.

Gross profit:

Gross profit for the Company increased during the first nine months of 2005 by $5.6 million from $6.4 million to $12.0 million. As a percentage of sales, gross profit increased from 28% in the 2004 period to 33% in the first nine months of 2005. The increased margin is due to the shift in product mix from 2004 to 2005. For the first nine months of 2005, IPI sales contributed a margin of 44%, the Canadian sales contributed a margin of 40% and the Playwell and OEM business maintained a 20% margin.

General and administrative expenses:

General and administrative expenses increased by approximately $7.3 million to $9.6 million in the first nine months of 2005, from $2.3 million in the first nine months of 2004. The Corporate group increased overhead in the latter part of 2004 to handle the increased business and prepare for assets that are to be acquired by Grand in 2005 and beyond. Corporate expenses for the period were approximately $2.8 million, consisting primarily of salaries, insurance and professional fees. During this period, the company expensed $669,000 of costs and expenses that the Company incurred in connection with a potential acquisition transaction that was being pursued by the Company with an unaffiliated third party. The Company terminated the discussions with the third party in the third quarter. Increased expenses as a result of the acquisitions of Grand US on August 16, 2004 and IPI in March 2005 accounted for approximately $2.2 million and $3.6 million, respectively, of additional costs.

Selling and distribution expenses:

Selling and distribution expenses increased from $433,000 for the first nine months of 2004 to approximately $4.5 million for the first nine months of 2005. The increase is due to a shift in product mix. The Playwell product typically requires a very low percentage of selling and distribution costs (1% of net revenue in the 2004 and 2% in the 2005 period), while the Canadian distributed product generally requires selling and distribution costs that are approximately 10% - 12% of net revenues. During the first nine months of 2005, a television campaign was run in Canada that did not result in the expected increase in sales, due to no open-to-buy from one of the Company s major customers. This event resulted in an actual percentage of selling and distribution costs of 12% of net revenue for Canadian distribution during the nine-month period. The IPI sales to specialty stores require selling and distribution costs that are approximately 21% - 23% of net revenues. The addition of the IPI and Canadian distribution business added significant selling and distribution costs into the 2005 period that were not present in the 2004 period.

Depreciation and amortization:

Depreciation and amortization increased from $432,000 for the first nine months of 2004 to $1.3 million for the first nine months of 2005. $257,000 of the increase is due to amortization of the intangibles acquired in the Playwell acquisition; while $222,000, relates to amortization of the Crayola license and $213,000 relates to amortization of intangibles from the IPI acquisition. The balance of the increase relates to additional depreciation from Playwell assets and the newly acquired assets of IPI and Grand Canada.

Interest expense:

The nine month period ended September 30, 2005 includes $145,000 of interest expense relating to the 15% exchangeable notes that were sold to Centralink for the IPI financing on March 1, 2005 and $150,000 of interest expense related to IPI s working capital financing. The interest was satisfied on April 15, 2005 with the issuance of additional ADSs to Centralink.

Dividends:

The nine month period ended September 30, 2005 includes $991,000 of deemed dividends on the Series A Convertible Preference Shares which resulted from the difference between the effective conversion price of the Series A Convertible Preference shares and the market price of the ADSs at the March 1, 2005 issuance date of the Exchangeable Note.

Also included in the nine month period in 2005 is $370,000 of dividends on the Series A Convertible Preference Shares for the period from April 15, 2005 September 30, 2005.

Liquidity and Capital Resources

The Company generally finances its operations through its cash flow from operations and the existence of two working capital facilities, one for IPI and one for the Company s indirect Canadian subsidiary, Grand Toys Ltd.

Net cash used for operating activities was approximately $8.3 million in the first nine months of 2005 compared to net cash provided by operating activities of approximately $1.5 million in the first nine months of 2004. This change primarily resulted from the shift of focus of the operations in 2004 as an OEM manufacturer to a distributor in 2005. As a distributor, the Company has a seasonal increase in receivables resulting from receivable dating programs at IPI and a seasonal build-up of inventory for our distribution divisions, both of which use cash. Also, the corporate structure in place in 2005 used more operating cash than in the 2004 period. Cash for additions to equipment and leasehold improvements was $270,000 in the first nine months of 2005 compared to $529,000 for the first nine months of 2004.

IPI maintains a $10.0 million revolving credit facility agreement with Citibank, expiring June 30, 2006, although the facility is uncommitted and Citibank has the right to refuse to make advances in its sole discretion. The interest rate on the revolving loan payable is LIBOR + 175 basis points or prime ½%, at the Company s election. The loan is collateralized by all IPI s assets and there are covenants and cross defaults attached to the facility. Borrowing is limited based on a borrowing base formula consisting of eligible receivables and inventory. As of September 30, 2005, the amount outstanding is $8.0 million.

Grand Toys Ltd. has a line of credit with Montcap Financial Inc. to finance its inventory and accounts receivable for advances of up to $2,894,000 (CA$3,500,000). The receivable loan has a discount fee of 2.0% on invoices purchased 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. As of September 30, 2005, the amount outstanding on the accounts receivable loan is $685,000. The loan is secured by a lien in the principal amount of $3,307,000 (CA$4,000,000) on all present and future assets of the Company and the assignment of insurance. There are no debt covenants or cross-default provisions.

PIL as of September 30, 2005 had no bank indebtedness.

Net accounts receivable at September 30, 2005 were approximately $14.6 million compared to approximately $3.7 million at December 31, 2004. The sales were mainly to mass retailers and specialty stores. Net inventory at September 30, 2005 increased to approximately $9.2 million from approximately $2.0 million at December 31, 2004. The levels of accounts receivable and inventory are higher primarily due to the inclusion of the assets from IPI in the 2005 period and to seasonality.

Working capital increased from approximately $13.0 million at December 31, 2004 to approximately $15.9 million at September 30, 2005.

The Company received $8.7 million cash consideration from Centralink at the completion of the reorganization merger of Grand US and Playwell acquisition in August 2004. On the date of the reorganization merger, Grand Toys Ltd had a cash balance of approximately $1.3 million. Acquisition costs relating to the reorganization merger of approximately $2.5 million were paid out of these proceeds.

On March 1, 2005, the Company received $7.4 million from Centralink. These funds were used to purchase IPI and inject working capital in the IPI operations. These proceeds, along with a $275,000 value to compensate Centralink for its option to purchase the Grand ADSs from the IPI sellers, were evidenced by the Exchangeable Note which was exchanged for Preference Shares on April 15, 2005.

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 2005 forecasts, the current credit facilities are sufficient to meet the Company s financial needs. In October 2005, the Company amended the existing Citibank financing for IPI by increasing the line to $15.0 million which includes a $2.0 million sub-limit for Grand Toys Ltd. The amended credit facility includes certain financial covenants and a lien on the assets of Grand Toys Ltd. Grand Toys Ltd. has also guaranteed $4.3 million (Canadian $ 5.0 million) of the Citibank facility. In conjunction with the amendment of the Citibank facility, the Montcap facility was terminated.

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	$	270,141	$	4,088,356	$	1,602,716	$ -

RISK FACTORS

The Company s business faces significant risks. Investors should carefully consider all of the information set forth in this Form 6-K and in the Company s other filings with the SEC, including the following risk factors which we face and which are faced by the toy industry. The Company s business, financial condition or results of operations could be materially adversely affected by any of these risks. This Form 6-K also contains forward-looking statements that involve risks and uncertainties. The Company s results could materially differ from those anticipated in these forward-looking statements, as a result of certain factors including due to the risks described below and elsewhere in this Form 6-K. See Forward-Looking Statements on page 3.

The Company is controlled by a single investor and this control could inhibit potential changes of control which could benefit shareholders

Centralink owns approximately 72.42% of the Company s outstanding ADSs on a fully diluted basis assuming conversion of the Company s Preference Shares. The ultimate beneficial owner of Centralink is Mr. Jeff Hsieh Cheng. Accordingly, Mr. Hsieh will have the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of the Company s entire board of directors, any merger, consolidation or sale of all or substantially all of the Company s assets, and the ability to control the Company s and affairs. This concentrated control could discourage others from initiating any potential merger, takeover or other change of control transaction that may otherwise be beneficial to the Company s businesses. As a result, the market price of the Company s ADSs could be adversely affected.

Centralink owns all of the Company s Preference Shares which could further restrict the Company s ability to secure additional investment.

In May 2005, the Company issued to Centralink 2,000,000 Preference Shares which are convertible into 2,804,600 ADSs of the Company. The provisions of the preference shares contain provisions protective to Centralink, including prohibitions on the Company issuing additional preference shares with rights equal or senior to the Preference Shares and preemptive rights to acquire shares of the Company if the Company determines to issue additional shares. The existence of the Preference Shares could affect the market price of the Company s ADSs, may discourage potential investors from investing in the Company or otherwise make it more difficult for the Company to issue additional equity securities.

The Company was recently formed through a reorganization merger with Grand US and the acquisition of Playwell and if the contemplated benefits of the transactions are not realized, the market price of the

Company s ADSs may be adversely affected

The Company is operating the combined operations of Grand US and Playwell in a market environment that cannot be predicted and that involves significant risks, many of which will be beyond its control. The failure of the Company to realize any of the anticipated benefits of the reorganization merger and acquisition, including anticipated cost savings, could seriously harm the results of operations of the Company, thereby reducing earnings and potentially affecting the market price of the Company s ADSs. The challenges involved include the following:

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demonstrating to the customers of Grand US and Playwell that the reorganization merger of Grand US and Playwell acquisition will not result in adverse changes in customer service standards or business focus;

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preserving distribution, marketing or other important relationships of both Grand US and Playwell and resolving potential conflicts that may arise;

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minimizing the diversion of management attention from ongoing business concerns;

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persuading employees that the business culture of Grand US and Playwell are compatible, maintaining employee morale and retaining key employees;

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realizing economies of scale through the elimination of certain redundant administrative and overhead costs; and

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realizing cost savings and strategic benefits due to vertical integration resulting from the combination of Grand US distribution capabilities and Playwell's manufacturing capabilities.

If the benefits of the reorganization merger and Playwell acquisition do not exceed the related costs, the Company s financial results could be negatively impacted

If the benefits of the reorganization merger and Playwell acquisition do not exceed the costs associated with the reorganization merger and acquisition, including transaction costs and the dilution to the Company s ADS holders resulting from the issuance of the Company s ADSs to Centralink, the Company s financial results, including earnings per share, could be decreased. The Company incurred, on a consolidated basis, direct transaction costs of approximately $2,500,000 in connection with the reorganization merger and Playwell acquisition. The Company may incur additional charges in subsequent quarters to reflect costs associated with the reorganization merger and the Playwell acquisition. At this time, it cannot be determined whether the benefits will outweigh these costs.

The Company is in the process of restructuring its Hong Kong operations. If the Company is unsuccessful, the Company s results could be negatively impacted

Playwell's OEM business, conducted through its subsidiary, Hong Kong Toy Centre Ltd., is declining due primarily to the end of the lifecycle of various third-party product lines that the Company is servicing. As a result, the Company is restructuring its Hong Kong business to focus on the design, development and promotion of various key licensed products and the refreshing of the Playwell brand. Also, the Company is structuring the Hong Kong operations to develop its agency business for servicing the Company s subsidiaries and third parties. The failure to successfully implement this reorganization would have a material adverse impact on the Company's operating results.

Certain Members of the Company s management team will not perform duties exclusively for the Company and, as a result, their attention may be diverted from the Company s business and could result in conflicts of

interest which would be detrimental to the Company

Although certain members of the Company s management team are employed by the Company under written employment or consulting agreements, including Henry Hai Lin Hu, who is the Company s executive director and chief executive officer, and Elliot L. Bier, who is a director, vice chairman and deputy chief executive officer, the terms of their employment or consulting agreements permit each of them to perform services for the Company on a non-exclusive basis. In the future, the Company may make similar non-exclusive arrangements with other senior management employees. These other business activities could divert their attention from or otherwise interfere with their future availability to, and efforts on behalf of, the Company.

In addition, Mr. Hu performs services for Cornerstone and subsidiaries of Cornerstone. The Company will do business with these subsidiaries, which could result in potential conflicts of interest arising out of his dual responsibilities. Although the Company and Cornerstone and its subsidiaries intend to operate on an arms-length basis, there can be no assurance that these potential conflicts of interest will not be resolved to the detriment of the Company.

Certain relationships among our management and affiliates create various perceived, potential or actual conflicts of interest which could adversely affect our business or the market price or liquidity of the Company s ADSs

The Company is engaged in business with companies that are affiliated with members of management and Mr Hsieh. As a result, situations may arise where an interested party would be required to vote on transactions with affiliated companies that could benefit such interested party and negatively impact the Company, or vice versa. Furthermore, a perceived or actual conflict of interest in the Company s management and/or the Company s affiliates may discourage investors from investing in the Company s ADSs, which may negatively impact the stock price or liquidity of the Company s ADSs.

If the Company fails to maintain existing relationships with related companies on which its business and operating results will be highly dependent, the Company s business and operating results may be adversely affected

The Company is and will continue to be very dependent on companies related to Mr Hsieh, its controlling shareholder, for the

manufacturing, marketing and sale of its toy products. This dependency includes the following:

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Playwell historically purchases most of its plastic products from a factory in Dongguan, China operated by Playwell Industry Limited, a subsidiary of Centralink, and most of its wooden products in certain factories in Zhejiang, China operated by Zhejiang Playwell Toy Co., Ltd., an indirect subsidiary controlled by Mr. Hsieh, the ultimate beneficial owner Centralink;

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27% and 56% of Playwell s net revenues in the first nine months of 2005 and the year ended 2004, respectively are derived from Toy Biz Worldwide Ltd., an entity controlled by Mr. Hsieh (Toy Biz).

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Playwell also accesses, through Playwell Toy "China" Ltd., established retail outlets and multiple sales offices in Mainland China; and

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37% and 70% of Grand US' net sales in the first nine months of 2005 and the year ended 2004, respectively, were from products sold under license from Toy Biz.

If relationships such as those listed above are not maintained, the failure could adversely affect the Company s business and operating results.

The Company may not be able to obtain sufficient funding for Playwell's working capital needs

Historically, Playwell has funded its working capital needs through its cash flow from operations and loans from its affiliates. Therefore, Playwell does not currently have an established line of credit from a financial institution for its working capital needs. In the event that Playwell's cash flow from operations is not sufficient to meet its working capital needs, Playwell could be forced to curtail or delay its business activities.

The Company s business and operating results are and may continue to be highly dependent on sales of products licensed from Marvel Enterprises, Inc.

A significant portion of the revenues of the Company are, and may continue to be, derived from the manufacture and distribution of toys based on certain Marvel comic and movie characters for Toy Biz. Toy Biz acquired the worldwide right to manufacture and sell toys based on these Marvel comic and movie characters from Marvel Enterprises Inc. through the end of 2006. In the event that Toy Biz is unable to secure the rights to continue to manufacture and sell these Marvel products after 2006, this may have a material adverse effect on the business of the Company.

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

The business of the Company is seasonal and a majority of its sales take place in the third and fourth quarters of their fiscal years. Therefore, the Company s annual operating results will depend, in large part, on sales during the relatively brief holiday season from September through December. 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 to 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 products 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 Company s attempts to acquire other companies may not prove fruitful or even if successful could have an adverse effect on its liquidity and earnings

The Company is pursuing an acquisition strategy to expand its business and product offerings and, in anticipation of this

strategy, has significantly expanded its overhead. For the year ended December 31, 2004 and the first nine months of 2005, this overhead has negatively impacted the Company s results and will continue to do so in the near future. In addition, this process will likely divert 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 International Playthings Inc., which the Company recently acquired, 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 the Company s future liquidity and earnings.

An inability to obtain financing could adversely impact the Company s ability to expand its operations

In order to achieve the Company s long-term expansion objectives and to enhance its competitive position in the worldwide toy industry, the Company 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, the management of its working capital and the nature of companies which the Company plans to acquire. 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 is dependent upon key personnel whose loss may adversely impact the Company's business

The Company will depend on the expertise, experience and continued services of its senior management employees, including Henry Hu, the chairman and chief executive officer and director of the Company, Elliot L. Bier, who is vice-chairman and deputy executive officer and a director of the Company, David J. Fremed, who is the chief financial officer and a director of the Company, Tania M. Clarke, who is the vice-president and chief financial officer of Grand US and is a senior financial executive of the Company and Willie Wong who is President of Grand s Hong Kong operations. Each of these individuals has acquired specialized knowledge and skills with respect to the Company and its operations and most decisions concerning the business of the Company will be made or significantly influenced by them. The Company does not maintain "key man" insurance on the life of any of these persons. The loss of some of these senior management employees, or an inability to attract or retain other key individuals, could materially adversely affect the Company. Growth in the Company's business is dependent, to a large degree, on the Company s ability to retain and attract such employees. The Company seeks to compensate and incentivize its key executives, as well as other employees, through competitive salaries, stock ownership and bonus plans, but there can be no assurance that these programs will allow it to retain key employees or hire new key employees. As a result, if any of these individuals were to leave, the Company could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any such successor obtains the necessary training and experience.

The Company may suffer from bad debts and returns of toy products manufactured or sold by the Company

The Company cannot be assured that any customer will not default on a payment of debt. Such a default could have a significant effect on its results. Furthermore, it is industry practice for retailers to hold back payments on slow moving stock or to request markdowns or returns on such stock. In certain instances, where retailers are unable to sell the quantity of products which have been ordered from the Company, the Company may, in accordance with industry practice, assist retailers to enable them to sell such excess inventory by offering discounts or accepting returns. A portion of firm orders, by their terms, may be canceled if shipment is not made by a certain date. There can be no assurance that these defaults, returns and cancellations will not have a material adverse effect on the business, financial condition and results of operations of the Company.

In order to maintain its business, the Company will depend on obtaining and maintaining licenses for the manufacture and distribution of products

The Company has entered into various licenses and royalty agreements in which it pays fees in exchange for rights to the use of product inventions or trademarked names, shapes and likenesses for use in development of its product lines. The major licenses that the Company holds are the right to certain Walt Disney Company and Crayola branded products and for various soccer action figures and the right to distribute Toy Biz products in Canada. These agreements generally include minimum fee guarantees based on a reasonable expectation of the product sales to be generated throughout the life of the agreement. There can be no assurance that the Company will be able to meet these projected expectations and may be obligated to pay unearned fees as a result. License and royalty agreements are also mostly for fixed terms and often contain performance-related covenants. The Company s licenses for such Walt Disney Company and Crayola branded products are both short-term agreements, expiring in 2006. There is no assurance that the Company will be able to maintain or extend the rights to these or other of its existing licenses. The failure to renew these license agreements or any difficulty in entering into other license agreements with other entertainment companies will have an adverse effect on the Company s business and results of operations.

The Company may fail to make new product introductions in a timely fashion, which could negatively impact its operating results

Once a new product is conceived, the principal steps to the introduction of the product include design, sourcing and testing of components, tooling, and purchase and design of graphics and packaging. At any stage in the process, there may be difficulties or delays in completing the necessary steps to meet the contemplated product introduction schedule. It is, for example, common in new product introductions or product revisions to encounter technical and other difficulties affecting manufacturing efficiency and, at times, the ability to manufacture at all, that will typically be corrected or improved over a period of time with continued manufacturing experience and engineering efforts. If one or more aspects necessary for introduction of products are not met in a timely fashion, or if technical difficulties take longer than anticipated to overcome, the anticipated product introductions will be delayed, or in some cases may be terminated. Therefore, no assurances can be given that products will be introduced in a timely fashion. Significant delays in the introduction of, or the failure to introduce, new products or improved products would have an adverse effect on the Company's operating results.

The Company s operating results may be highly volatile which could have a material adverse impact on the Company s results of operations

The toy industry is known for a high level of volatility as a result of changing consumer tastes, competition and over-saturation of popular products. Playwell and Grand US have both experienced significant volatility in their results in their past histories. While the Company is expected to diversify its business in the future to reduce volatility, there can be no guarantee that this history of volatility will not continue.

Because the life cycle for toy products is usually very short and consumer preferences are unpredictable, the Company s business may be adversely affected by its inability to develop or secure the right to distribute new products

The Company s business and operating results will depend largely upon the appeal of the toy products it manufactures and sells. Consumer preferences in the toy industry are highly subjective, and there can be no assurance that consumers will continue to find existing products of the Company appealing or will find new products introduced by the Company appealing. As a result of changing consumer preferences, many toy products are successfully marketed for only one or two years. The Company s continued success will depend on the ability of the Company to redesign, restyle and extend its existing toy and fashion accessory products and to develop, acquire the right to, introduce and gain customer acceptance of new 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. There can be no assurances that

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any of the current products or product lines manufactured or sold 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 manufactured or sold by the Company will achieve an adequate degree of market acceptance;

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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; or

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retailers will react positively to any new product introduced by the Company.

If the market for new or existing products is less than expected, the Company may build excess quantities of certain products and subsequently may be required to sell inventory of such products at a substantial discount or put inventory provisions in place to mark the value of excess inventory quantities down to their estimated market value.

Finally, Playwell continues to offer a relatively limited range of products that are all in the categories of generic toys in the infant, preschool, and activity toys for younger children. This exposes Playwell to the risks of any narrowly focused business.

The Company may have difficulty retaining or increasing market share because the segments of the toy industry in which Playwell, Grand US and IPI operate are highly competitive.

The Company faces significant competition in the segments of the toy industry in which they operate. Playwell faces significant competition in the infant and pre-school toy industry. The barriers for new producers to enter into Playwell's markets are relatively low and Playwell expects that it will face increased competition in the future. Some competitors offer products at lower prices, are better established in the industry and are larger than Playwell. In addition, with respect to original design manufacturing, or ODM, and original equipment manufacturing, or OEM, Playwell competes with a number of substantially larger and more experienced manufacturers.

Grand US and IPI primarily operates in the rapidly consolidating toy distribution business. Many other companies involved in the toy distribution industry in Canada and the U.S. have greater financial resources, larger sales forces, greater name recognition, larger facilities for product development and products that may be more competitively priced than Grand US and IPI products. As a result, some of Grand US' and IPI s competitors may be able to obtain toy products in greater volume or more lucrative distribution contracts than Grand US or IPI can. In addition, as the toy industry consolidates, many retailers have begun to deal directly with toy manufacturers, thereby reducing or eliminating the need for distributors such as Grand US, and to a more limited extent, IPI.

The Company may be involved in disputes regarding its ownership and use of intellectual property which, if unsuccessfully defended, may result in the Company being held responsible for payment of substantial amounts of money

From time to time, other companies and individuals may assert exclusive patent, copyright, trademark and other intellectual property rights to technologies or marks that are important to the toy industry generally or to the Company's business specifically. The Company will evaluate each claim relating to its products or other aspects of its business and, if appropriate, will seek a license to use the protected technology. There can be no assurance that the Company will be able to obtain licenses to intellectual property of third parties on commercially reasonable terms, if at all. In addition, the Company could be at a disadvantage if its competitors obtain licenses for protected technologies on more favorable terms than does the Company. If the Company or its suppliers are unable to license protected technology used in the Company s products, the Company could be prohibited from marketing those products or may have to market products without desirable features. The Company could also incur substantial costs to redesign its products or to defend any legal action taken against the Company. If the Company s products or manufacturing methods should be found to infringe protected technology, the Company could be enjoined from further infringement and required to pay damages to the infringed party. Any of the foregoing could have an adverse effect on the results of operations and financial position of the Company.

The Company may not be able to protect its intellectual property

On occasion in the toy industry, successful products are "knocked-off" or copied. While the Company strives to protect its intellectual property, there can be no guarantee that knock-offs will not have a significant negative effect on its business. In addition, intellectual property laws are less developed in China than in the U.S., and historically, China has not protected companies' intellectual property rights to the same extent as the U.S. The costs incurred in protecting the Company s intellectual property rights could be significant and there is no assurance that it will be able to successfully protect their rights.

The Company may be subject to product liability claims which, if not covered by adequate insurance, could result in the Company becoming responsible for paying substantial amount of damages, which could adversely impact its business, financial condition and results of operations

The Company is subject to product liability claims relating to the products they manufacture and distribute. Since most of Playwell's products are manufactured for infants and pre-school children, safety has been a major concern in the toys that Playwell, in particular, designs, develops and has manufactured. However, the Company cannot assure total safety of its products and therefore can be subject to possible claims for injury or damage, some or all of which may not be covered by insurance. Playwell is not currently, nor has it been in the past, a defendant in any product liability lawsuit. Grand US was a defendant in a product liability claim relating to a third party's product which was distributed by Grand US, but this was settled at minimum cost to the Company in January 2005. A successful claim brought against the Company by a customer which is not covered by insurance or a consumer and the adverse publicity that could accompany any such claim could have a material adverse effect on the business, financial condition and results of operations of the Company.

The Company operates across a number of international borders and may face unanticipated assessments from taxing authorities from these jurisdictions

The Company's operations involve a significant number of cross-border transactions. The Company is expected to establish provisions for its known and estimated income tax obligations. However, whether through a challenge by one of the many tax authorities in international jurisdictions where the Company operates, through the Company's transfer pricing, or through challenges to the Company's claim regarding lack of permanent establishment, or other matters that may exist, the Company could be exposed to possible additional taxation that will not have been accrued.

The Company will be subject to many U.S. regulations when exporting toys into the U.S. that could result in the exclusion of some of its products from U.S. markets

U.S. customers of the Company are and the Company will be subject to the provisions of the Federal Hazardous Substances Act and the Federal Consumer Product Safety Act when importing or producing toys to be sold in the U.S. These laws empower the Consumer Product Safety Commission, or the CPSC, to protect consumers from hazardous toys and other articles. The CPSC has the authority to exclude products from the market that are found to be unsafe or hazardous, and can require a recall of such products under certain circumstances. Similar laws exist in some states and cities in the U.S., as well as in foreign jurisdictions. The Company designs and tests the products it purchases or manufactures for compliance with regulatory standards, however, there can be no assurance that the Company's products will not be found to violate applicable laws, rules and regulations, which could have a material adverse effect on the business, financial condition and results of operations of the Company. In addition, there can be no assurance that more restrictive laws, rules and regulations will not be adopted in the future, or that the Company's products will not be marketed in the future in countries with more restrictive laws, rules and regulations, either of which could make compliance more difficult or expensive, and which could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company may be subject to tariffs and quotas that could restrict its ability to export products to the U.S.

A substantial portion of the Company's products are expected to be shipped to customers in the U.S. The U.S. may, from time to time, impose new quotas, duties, tariffs, or other charges or restrictions, or adjust presently prevailing quota, duty or tariff levels, which could adversely affect the Company's ability to continue to export products to the U.S. at the expected or increased levels. The Company cannot predict what regulatory changes may occur, if any, or the type or extent of any financial impact on the Company that such changes may have in the future. In addition, various forms of protectionist trade legislation have been proposed in the U.S. Adverse changes in tariff structures or other trade policies could have a material adverse effect on the Company's business, financial condition and results of operations.

The market price of the Company s ADSs is expected to be volatile

Market prices of the securities of toy companies are often volatile and Grand US' historical stock price has reflected this volatility. The trading price of the Company's ADSs may be subject to wide fluctuations. These broad market and industry fluctuations may result in the decline of the market price of the Company's ADSs, regardless of its operating performance.

The Company expects that the market price of the Company s ADSs will be, affected by many factors, including:

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fluctuations in the Company's financial results;

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the actions of the Company's customers and competitors;

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new regulations affecting foreign manufacturing;

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other factors affecting the toy industry in general;

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announcements of new products by the Company or its competitors;

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the operating and stock price performance of other companies that investors may deem comparable;

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news reports relating to trends in its markets; and

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sales of the Company s ADSs into the public market.

It may be difficult for the Company s ADSs to be sold at attractive prices

The Company s ADSs have generally experienced limited liquidity and trading volume and there is no coverage of the Company by analysts and market makers. This may or may not affect the future performance of the Company s ADSs. There can be no assurance that a more active trading market for the Company s ADSs will develop or that, if developed, will be sustained. Further, there is no public market for the ordinary shares of the Company underlying the ADSs. In the past several years, many foreign issuers with market capitalization similar to that of the Company have been unable to sustain an active trading market for their securities.

In addition, the stock market in general has experienced extreme volatility that often has been unrelated to the operating performance of any company. These broad market and industry fluctuations may result in the decline of the price of the Company s ADSs, regardless of its operating performance.

Future sales of the Company s ADSs by existing shareholders, option holders and warrant holders could result in a decline of the price of the Company s ADSs

The market price of the Company s ADSs could decline as a result of sales of a large number of its ADSs into the market, or the perception that these sales could occur. There are currently options and warrants to purchase 2,206,851 of the Company s ADSs and the Company intends to file a Form S-8 registration statement covering the shares underlying the ADSs issuable upon exercise of the options shortly after the filing of this reports which would permit the immediately sale of all vested options. In addition, the Company recently issued to Centralink 2,000,000 Preference Shares which are convertible into 2,804,600 ADSs. Centralink has the right to demand registration of the shares underlying these ADSs. If and when these options and warrants are exercised or the Preference Shares are converted and registered, it might have a depressive impact on the market price of the Company s ADSs. This might make it more difficult for the Company to sell equity securities in the future at a time and at a price that it deems appropriate.

The Company does not expect to pay dividends on its common stock

The Company has not paid any cash or other dividends on its ADSs and the Company does not expect to declare or pay any cash dividends on its ADSs in the foreseeable future.

It may be difficult to enforce civil liabilities against the Company

The Company is a Hong Kong company, and a substantial portion of its assets are located outside the U.S. In addition, certain of the Company's directors and officers are resident outside the U.S., and all or a substantial portion of the assets of such persons are or may be located outside the U.S. As a result, it may not be possible for investors to affect service of process within the U.S. upon such persons, or to enforce against them or the Company judgments obtained in the U.S. courts predicated upon the civil liability provisions of the U.S. securities laws. The availability in Hong Kong, in original actions or in actions for enforcement of judgments of U.S. courts, of remedies provided for under the U.S. securities laws may be subject to the discretion of the Hong Kong courts based on consideration of Hong Kong public policy.

Features of Hong Kong law which allow an acquiring party to compulsorily acquire shares held by minority shareholders may force minority shareholders of the Company to sell their shares under certain circumstances which may negatively impact the price and liquidity of the Company s ADSs

Hong Kong law allows a party to compulsorily acquire the shares of a Hong Kong company held by minority shareholders. These circumstances are described under the section titled "Additional Information" appearing elsewhere in the Company s

2004 Form 20-F. This in turn may discourage ownership of the Company ADSs and negatively impact the price and liquidity of the Company s ADSs. Mr. Jeff Hsieh, who indirectly or directly controls over 72.42% of the shares of the Company on a fully diluted basis, could potentially force the minority shareholders of the Company to sell their ADSs pursuant to these provisions. Mr. Hsieh has informed the Company that he does not presently intend to initiate or support an effort to force the compulsory acquisition of shares using these provisions. Should he initiate or support such an effort in the future, minority shareholders may be forced to sell their ADSs.

Risks Related to Doing Business in China

The Company is organized and based in Hong Kong, which is part of the People's Republic of China, and the Company is also expected to purchase most of its products from manufacturers in China. The following addresses some of the risks associated with doing business in China.

The Company depends on certain of its related subsidiaries for producing its products. These related subsidiaries have large manufacturing operations in China and interruptions in the production capacity of these related subsidiaries will adversely affect the Company s business and financial results.

Playwell sources most of its supplies of finished products and moulds for manufacturing from two subsidiaries of Cornerstone, Playwell Industry Ltd. and Zhejiang Playwell Toy Co. Ltd. Both of these companies have their manufacturing facilities in China. Should the production capacity of any of these companies be interrupted for whatever reason, including risks inherently associated with doing business in China, the operations of Playwell would be materially affected. The U.S. government is currently reviewing a number of commercial and legal practices widespread in China, such as China's handling of intellectual property and certain of its labor practices, and certain political and military actions taken or proposed by China. If the U.S. ultimately takes negative action against China's exports or its transaction of business with U.S. entities, then the cost of Chinese imports could increase significantly and the ability of Playwell to source its supplies of finished goods and moulds from China may be materially impaired. If the production capacity of any of the companies on which Playwell depends is interrupted for any reason, including the actions described above, there could be an adverse effect on Playwell's ability to develop and supply products until alternative manufacturing arrangements are made on economic, production and operational terms at least as favorable as those currently in effect.

Because China does not have a well developed, comprehensive system of laws, it may be difficult for the Company and its subsidiaries to protect or enforce their legal rights

A majority of the Company's assets and operations are located in Hong Kong, but certain of Playwell's related subsidiaries, on which Playwell depends, have large operations in China. For instance, Playwell Industry Ltd. and

Zhejiang Playwell Toy Co. Ltd., from which Playwell sources most of its supplies of finished products and moulds for manufacturing, have their manufacturing facilities in China. While Hong Kong corporate law is based on English law and is well-developed, the Chinese legal system is a civil law system based on written statutes in which decided legal cases have little value as precedents; unlike the common law system in the U.S. China does not have a well-developed, consolidated body of law governing foreign investment enterprises. As a result, the administration of laws and regulations by government agencies may be subject to considerable discretion and variation.

In addition, the Chinese legal system relating to foreign investments is both new and continually evolving, and currently there can be no certainty as to the application of its laws and regulations in particular instances. Definitive regulations and policies with respect to such matters as the permissible percentage of foreign investment and permissible rates of equity returns have not yet been published, statements regarding these evolving policies have been conflicting, and any such policies, as administered, are likely to be subject to broad interpretation, discretion and modification, perhaps on a case-by-case basis. As the legal system in China develops with respect to these new types of enterprises, foreign investors may be adversely affected by new laws, changes to existing laws (or interpretations thereof) and the preemption of provincial or local laws by national laws. Enforcement of existing laws may be sporadic and implementation and interpretation thereof inconsistent. Furthermore, the Chinese judiciary is relatively inexperienced in enforcing the laws that exist, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. Even where adequate laws exist in China, it may be impossible to obtain swift and equitable enforcement of such laws, or to obtain enforcement of a judgment by a court of another jurisdiction. It is widely believed that China's entry into the World Trade Organization, or WTO, should expedite the uniform interpretation and enforcement of laws throughout China. However, there can be no assurance that the Company's current or future activities in China will have a high degree of certainty under China's legal system.

If the Company is not able to obtain appropriate governmental support and approvals in China, it may not be able to conduct its business activities as planned.

The Company's activities in China may by law be subject, in some circumstances, to administrative review and approval by various national and local agencies of the Chinese government. Although the Company believes that the present level of support from local, provincial and national governmental entities enjoyed by the Company benefits the Company s operations in connection with administrative review and the receipt of approvals, there is no assurance that such approvals, when necessary or advisable in the future, will be forthcoming. The inability to obtain such approvals could have a material adverse effect on the Company's business, financial condition and results of operations.

If the Exchange Rate for the Hong Kong Dollar ceases to be fixed against the U.S. Dollar, the Company would be subject to potentially significant adverse exchange rate risks

The Hong Kong dollar has remained relatively constant against the U.S. dollar due to the U.S. dollar peg and currency board system that has been in effect in Hong Kong since 1983. One U.S. dollar is pegged to $7.80 HK dollar under that system. There can be no assurance that the historical currency peg of the Hong Kong dollar to the U.S. dollar will be maintained in the future. Because the Company's corporate headquarters are located in Hong Kong, a large proportion of the Company's administrative and business expense are denominated in Hong Kong dollars and a large proportion of its revenues is expected to be in U.S. dollars from the sale of toy products to the U.S. Should the currency peg cease to be maintained and the exchange rate between the Hong Kong dollar and the U.S. dollar be allowed to float, the Company's business and results of operations may be negatively impacted.

A change in currency exchange rates could increase the Company's costs relative to its revenues

The Company's sales are mostly denominated in U.S. dollars or Euros. The majority of the Company's expenses are denominated in Hong Kong dollars, followed by Chinese renminbi, the currency of China, Euros and U.S. dollars. The Company is also expected to generate revenues, expenses and liabilities in other currencies such as Singapore dollars and New Taiwan dollars. As a result, the Company will be subject to the effects of exchange rate fluctuations with respect to any of these currencies and the related interest rate fluctuations. Fluctuations in the exchange rate of the U.S. dollar against the respective foreign currencies could have a significant impact on the Company's revenues, results and financial condition. A rise in the value of the foreign currencies relative to the U.S. dollar will increase the Company's relative production costs and decrease the relative value of its revenue, thereby reducing its operating margins. Furthermore, should the U.S. dollar weaken, the Company's products could become more expensive in the U.S. even if the prices of the products in Hong Kong dollars remain unchanged, which could further adversely affect the Company's revenues. Currently, the Company has not entered into agreements or purchase instruments to hedge its exchange rate risks.

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.

Recently Issued Accounting Standards

In November 2004, the FASB issued SFAS No. 151, Inventory Costs - an amendment of ARB No. 43, Chapter 4. SFAS No. 151 clarifies the accounting that requires abnormal amounts of idle facility expenses, freight, handling costs, and spoilage costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred on or after July 1, 2005. The Company adopted SFAS No. 151 effective July 1, 2005 and there were no material impacts on the results presented.

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment. This statement is a revision to SFAS No. 123 and supercedes APB Opinion No. 25. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on the accounting for transactions in which an entity obtains employee services in share-based payment transactions. Entities will be required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service, the requisite service period (usually the vesting period), in exchange for the award. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification. This statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company adopted SFAS No. 123R effective July 1, 2005 and there were no material impacts on the results presented.

Upon adoption, the Company has two application methods to choose from: the modified-prospective transition approach or the modified-retrospective transition approach. Under the modified-prospective transition method the Company would be required to recognize compensation cost for share-based awards to employees based on their grant-date fair value from the beginning of the fiscal period in which the recognition provisions are first applied as well as compensation cost for awards that were granted prior to, but not vested as of the date of adoption. Prior periods remain unchanged and pro forma disclosures previously required by SFAS No. 123 continue to be required. Under the modified-retrospective transition method, the Company would restate prior periods by recognizing compensation cost in the amounts previously reported in the pro forma footnote disclosure under SFAS No. 123. Under this method, the Company is permitted to apply this presentation to all periods presented or to the start of the fiscal year in which SFAS No. 123R is adopted. The Company would follow the same guidelines as in the modified-prospective transition method for awards granted subsequent to adoption and those that were granted and not yet vested. The Company has not yet determined which methodology it will adopt but believes that the impact that the adoption of SFAS No. 123R will have on its financial position or results of operations will approximate the magnitude of the stock-based employee compensation cost disclosed in (p) above pursuant to the disclosure requirements of SFAS No. 148.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Non-Monetary Assets An Amendment of APB Opinion No. 29. SFAS No. 153 amends APB Opinion No. 29, Accounting for Non-Monetary Transactions. The amendments made by SFAS No. 153 are based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the exception for non-monetary exchanges of similar productive assets and replace it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The provisions in SFAS No. 153 are effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Early application of the SFAS No. 153 is permitted. The provisions of this Statement shall be applied prospectively. The Company adopted SFAS No. 153 effective July 1, 2005 and there were no material impacts on the results presented.

In May 2005, the FASB issued SFAS No. 154, Changes and Errors Corrections An Amendment of APB Opinion No. 20. and FASB Statement No. 3. This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. The provisions of this Statement shall be applied prospectively. In accordance with the standard, the Company will adopt SFAS No. 153 effective December 15, 2005.

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 US 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 a portion 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.

Part II: Other Information

Item 1. Legal proceedings

Grand Toys Ltd., an indirect Canadian subsidiary of the Company was named in two lawsuits by former sales agents, dated June 12, 2000 and April 15, 2004. In January 2005, the Company settled the latter claim for $291,181. The settlement was recorded in the December 31, 2004 results. In the opinion of management, it is difficult to ascertain or estimate the value of a settlement if any of the remaining claim.

On May 21, 2003, Grand US was named in a lawsuit for an alleged defective product causing personal injury. Grand US was acting as an agent for the vendor of the alleged defective product. This case was settled in February 2005 and the settlement is covered by insurance.

The Company believes that the ultimate resolution of the claim will not have a material adverse effect on the Company s liquidity, financial condition or results of operations.

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

The following securities were issued on:

ADS transactions:

April 15, 2005:

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52,175 ADS issued in lieu of a cash payment of accrued interest on the exchangeable note.

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10,500 ADSs representing 10,500 ordinary shares were issued upon exercise of stock options

Preferred shares:

April 15, 2005:

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2,000,000 series a convertible preference shares issued in exchange for the exchangeable note.

Material Contract:

Citibank Loan Agreement

October 14, 2005

International Playthings, Inc.

(f/k/a IPI Acquisition Corp.)

75 Lackawanna Avenue

Parsippany, NJ 07054

Re:

$15,000,000 borrowing base line of credit

Gentlemen or Ladies:

Citibank, F.S.B. ("Citibank") is pleased to advise you it holds available for International Playthings, Inc. f/k/a IPI Acquisition Corp. (the "Borrower"), a corporation organized and in good standing under the laws of the State of Delaware, a borrowing base line of credit (the "Line") in the amount of $15,000,000, subject to the following terms and conditions:

1.

<u>Description of the Line</u>:

Loans provided under the Line shall be evidenced by Citibank's Master Note (the "Note") in the amount of the Line. Each advance thereunder shall bear interest at a rate to be elected by the Borrower at the time of each request for an advance equal to either:

(i)

<u>Prime Rate Option</u>:

A rate of interest equal to 1/2% below the prime rate of interest as published in the Money Rates column of the Wall Street Journal from time to time (the Prime Rate). Any change in the Prime Rate shall take effect on the date of the change in the Prime Rate, or

(ii)

<u>LIBOR Rate Option</u>:

A rate per annum equal to the Reserve Adjusted LIBOR, as such term is defined in the Note, plus a margin of 175 basis points for interest periods of 30, 60, 90 or 180 days.

Interest on the unpaid principal balance of the Note from time to time outstanding shall be payable monthly in arrears commencing on the first day of the month following the date of the first advance under the Note. Any advance under the Line made by Citibank in its discretion shall be in an amount not less than $100,000 for Prime Rate advances and $500,000 for LIBOR Rate advances.

In the case of a Prime Rate advance, such advance may be prepaid, in whole or in part, in increments of not less that $100,000, without premium or penalty.

The Borrower agrees to indemnify Citibank and hold Citibank harmless from any loss or expense that Citibank may sustain or incur, as more particularly described in the Note should the Borrower make any prepayment of the principal of an advance hereunder bearing interest at the LIBOR Rate or in the event of a default by the Borrower in the payment or performance of any terms of the Note or this line letter.

There shall be available under the Line a sublimit for commercial letters of credit (each, an "L/C" and collectively, the "L/Cs") in the amount of $2,000,000.

The maximum tenor for each L/C shall be 180 days. Each L/C issued under the Line shall be governed by the terms and conditions set forth in Citibank's Master Letter of Credit Agreement. There shall be payable in respect of each L/C, a fee equal to 1/8% upon the opening and 1/8% upon the negotiation thereof together with Citibank's fees and charges therewith.

Notwithstanding any provisions herein to the contrary, the maximum availability under the Line shall not exceed an amount determined with application to the following borrowing base formula:

The sum of (i) eighty-five percent (85%) of the Borrower's "Eligible Accounts Receivable", that is, (a) all domestic accounts of the Borrower dated not more than sixty (60) days from their respective due dates, (b) all Canadian credit-insured accounts of the Borrower and the Guarantor (as defined below) dated not more than sixty (60) days from their respective due dates up to an aggregate amount of $2,750,000 and solely to the extent that such accounts are within the credit insurance coverage with respect to each Canadian account debtor and (c) all Canadian accounts of the Guarantor (as defined below) owing by Wal-Mart or Canadian Tire Corp. dated not more than sixty (60) days from their respective due dates, excluding, in each case, those accounts deemed ineligible by Citibank in its sole reasonable discretion, and (ii) the lesser of (x) fifty percent (50%), reducing to thirty-five percent (35%) in November and December of each year, of the sum of, without duplication, the Borrower's "Eligible Inventory" (excluding the Borrower s inventory in transit) and the Borrower s inventory with respect to which a L/C is in effect or (y) $4,250,000 (the "Borrowing Limit"). Terms used in this paragraph shall have the meaning given to such terms in the Borrowing Base Certificate, identified herein. The aggregate of all advances and loans under the Line shall at no time exceed the availability under the Borrowing Limit and the Borrower shall pay to Citibank promptly after demand such amounts as may be necessary from time to time to reduce the aggregate of all such loans and advances to an amount not in excess of the Borrowing Limit.

The Borrower acknowledges and agrees that the Line is uncommitted and requests for advances or extensions of credit thereunder shall be approved in the discretion of Citibank, which may refuse to make an extension of credit under the Line at any time without prior notice to the Borrower, and that the performance or compliance by the Borrower of the agreements contained in this letter, or in any other document or agreement evidencing or securing such advances or extensions of credit, shall not obligate Citibank to make an advance or provide an extension of credit thereunder.

Subject to the terms and conditions hereof, the Line shall be available until June 30, 2006.

2.

Guarantors:

Repayment of all loans, extensions of credit and financial accommodations provided under the Line together with interest and costs thereon shall be guaranteed by Grand Toys Ltd. (the "Guarantor") pursuant to a Guarantee in form and substance satisfactory to Citibank.

3.

Purpose of the Line:

The purpose of the Line shall be to support the collection of accounts receivable and to finance inventory purchases.

4.

Security for the Line:

The Line and all other obligations of the Borrower and obligations of the Guarantor shall be secured by a first priority security interest in all assets and personal property of the Borrower and the Guarantor pursuant to security documents in form and substance satisfactory to Citibank.

The Line shall also be secured by a $2,000,000 note executed by the Guarantor in favor of the Borrower, which note shall be satisfactory in form and substance to Citibank and which shall be endorsed to Citibank.

5.

Conditions Precedent:

Prior to the Borrower's initial request for an advance under the Line, it shall have provided to Citibank, if it has not already done so:

(i)

A copy of the resolutions passed by the Borrower's Board of Directors certified by its Secretary as being in full force and effect authorizing the borrowing described herein and the execution of all documents and agreements required by Citibank to evidence and secure the Line; and

(ii)

A certified copy of the certificate of incorporation of the Borrower.

6.

Financial Reporting:

The Borrower shall provide to Citibank:

(i)

As soon as available, but in any event within one hundred twenty (120) days after the last day of each fiscal year, a balance sheet of the Borrower, as of such last day of the fiscal year, and statements of income and retained earnings and cash flows for such fiscal year prepared in accordance with generally accepted accounting principles consistently applied, in reasonable detail, such statements to be reviewed by a firm of independent certified public accountants satisfactory to Citibank.

(ii)

As soon as available, but in any event within sixty (60) days after the last day of each semi-annual, a balance sheet of the Borrower as of the last day of such semi-annual period, and statements of income and retained earnings and cash flows for such period, each prepared in accordance with generally accepted accounting principles consistently applied, in reasonable detail, such statements to be prepared on a review basis by a firm of independent certified public accountants satisfactory to Citibank.

(iii)

As soon as available, but in any event within sixty (60) days after the end of the first and third fiscal quarters, a balance sheet of the Borrower and statements of income and retained earnings and cash flows of the Borrower for such quarter, and the portion of the fiscal year through such date all in reasonable detail, such statements to be prepared by the Borrower in accordance with generally accepted accounting principles consistently applied.

(iv)

As soon as available, but in any event within sixty (60) days after the end of each fiscal quarter, a balance sheet of the Guarantor and statements of income and retained earnings and cash flows of the Guarantor for such quarter, and the portion of the fiscal year through such date all in reasonable detail, such statements to be prepared by the Guarantor in accordance with generally accepted accounting principles consistently applied.

(v)

As soon as available, but in any event within one hundred eighty (180) days after the end of the 2005 fiscal year, a copy of the Form 20-F filed or to be filed with the Securities and Exchange Commission (SEC) for Grand Toys International, Ltd. (Grand).

(vi)

As soon as available, but in any event within sixty (60) days after the end of each fiscal quarter, a copy of the Form 6-K report filed or to be filed with the SEC for Grand.

Each of the financial statements specified in Sections (i), (ii), (iii) and (iv) above shall be accompanied by a certificate signed by the president or chief financial officer of the Borrower or the Guarantor as applicable, to the effect that such statements fairly present the financial condition of the Borrower or the Guarantor as applicable, as of the balance sheet date and results of the operations of the Borrower or the Guarantor as applicable, for the period(s) then ended in accordance with generally accepted accounting principles consistently applied.

(vii)

As soon as available, but in any event within twenty (20) days after the end of each calendar month, a statement, in such form and in such detail as Citibank may reasonably require, setting forth a description of the Borrower's inventory and its valuation as of the end of such month, accompanied by a certificate signed by the Borrower's president or chief financial officer to the effect that such statement is true and correct and has been prepared in accordance with the Borrower's prior methods and procedures.

(viii)

As soon as available, but in any event within twenty (20) days after the end of each calendar month, schedules of the Borrower s and the Guarantor s accounts receivable and accounts payable aged to show the number of days each such account has been outstanding from its invoice date, in form satisfactory to Citibank and accompanied by a statement signed by the Borrower's president or chief financial officer to the effect that such statement is true, correct and complete.

(ix)

As soon as available, but in any event within twenty (20) days after the end of each calendar month, a Borrowing Base Certificate, in form and substance satisfactory to Citibank.

(x)

As soon as available, but in any event within one hundred twenty (120) days after the last day of each fiscal year, internally prepared financial projections, in form and substance satisfactory to Citibank.

(xi)

Such other financial or additional information as Citibank may from time to time request.

7.

Special Requirements:

a.

The Borrower agrees to maintain:

(i)

a minimum working capital (the excess of current assets over current liabilities) of not less than $4,500,000 at all times.

(ii)

a capital base (the sum of capital surplus, earned surplus, capital stock and such other items as are allowable under generally accepted accounting principles and subordinated liabilities minus deferred charges, intangibles, receivables due from stockholders, officers or affiliates and treasury stock) in an amount not less than $5,500,000 at September 30, 2005 and in an amount not less than $6,000,000 at all times thereafter.

(iii)

a maximum leverage ratio (the ratio of total unsubordinated liabilities to capital base) of not greater than 2.75 to 1.0 at all times.

b.

The Borrower shall maintain hazard insurance on its inventory and equipment with a financially sound and reputable insurance company in such amounts as are necessary to cover not less than the replacement cost of such inventory and equipment and covering such risks as are usually carried by companies engaged in the same or similar business which insurance policy shall be endorsed to name Citibank lender loss payee.

c)

The Borrower agrees that it shall not make any investments, advances or loans to the Guarantor, Grand or any of Grand s other affiliates or any of the Borrower s other affiliates in an aggregate amount greater than $2,000,000.

d)

Each of Borrower and the Guarantor agrees that there shall be no change in its management, ownership or control without the prior written consent of Citibank; provided, however, that (i) Borrower shall be permitted to terminate any member of management without cause without the consent of Citibank, so long as, in the case of Borrower, each of Ted Kiesewetter, David J. Fremed and Michael Varda remains a member of senior management of Borrower and, in the case of Guarantor, the senior management of the Guarantor in effect as of the date hereof remains the senior management of Guarantor and (ii) the death or disability of any member of management of Borrower or Guarantor shall not be deemed a change in management of Borrower or Guarantor. Each of Borrower and Guarantor agrees to promptly notify Citibank in writing of any change in management of Borrower or Guarantor in accordance with clause (i) or (ii) of the foregoing proviso.

e)

The Borrower shall cause the Guarantor to maintain, and the Guarantor agrees to maintain:

(i)

a capital base (the sum of capital surplus, earned surplus, capital stock and such other items as are allowable under generally accepted accounting principles and subordinated liabilities minus deferred charges, intangibles, receivables due from stockholders, officers or affiliates and treasury stock) in an amount not less than $2,500,000 at each fiscal quarter.

(ii)

a minimum working capital (the excess of current assets over current liabilities) of not less than $2,000,000 at each June 30th semi annual period and not less than $2,500,000 at each fiscal year end.

(iii)

a maximum leverage ratio (the ratio of total unsubordinated liabilities to capital base) of not greater than 1.5 to 1.0 at each fiscal quarter.

f)

The Borrower shall not pay or accrue any dividends, distributions or management fees or any other payments to any of its affiliates in any fiscal year in excess of an aggregate amount of its net income as stated in the financial statements delivered to Citibank in accordance with paragraph 6 (i) hereof for such fiscal year, and such dividends, distributions, management fees or other payments shall be made only after the Borrower demonstrates to Citibank in a manner satisfactory to Citibank that the Borrower is, and will be, in full compliance with all covenants contained herein both immediately prior to and after giving effect to such dividends, distributions, management fees or other payments.

g)

The Borrower agrees not to sustain or incur a net operating loss in any fiscal year.

h)

The Borrower shall maintain credit insurance on its accounts receivable with a financially sound and reputable insurance company which insurance policy shall be endorsed to name Citibank lender loss payee.

i)

The Borrower agrees to permit Citibank or its agents or representatives to conduct an annual field audit of the Borrower's books and records and its operations at the Borrower's sole cost and expense, which field audit shall disclose no adverse facts or circumstances not currently known to Citibank.

8.

Annual Clean-Down:

The Borrower covenants and agrees that for a period of not less than thirty (30) consecutive days at any one time prior to the expiration of the Line, the aggregate of all loans outstanding thereunder shall not exceed $3,500,000.

9.

Administration Fee:

In order to compensate Citibank for costs attributable to Citibank's due diligence review of the Borrower's financial condition and business operations, including, without limitation, any credit and financial analysis conducted by Citibank to determine whether the Line shall be made available to the Borrower, the Borrower agrees to pay Citibank upon the acceptance hereof an administration fee of $9,375.

10.

Integration:

This letter replaces, amends and supersedes all prior agreements and understandings between the Borrower and Citibank with respect to the matters addressed herein.

11.

Acceptance:

If the foregoing is acceptable, please so indicate by signing and returning this letter together with the administration fee before October 27, 2005, the date this letter will otherwise expire, unless extended in writing by Citibank.

Very truly yours,

CITIBANK, F.S.B.

By: ______________________

Chris Webb

Senior Vice President

Agreed and Accepted this

day of October, 2005

INTERNATIONAL PLAYTHINGS, INC.

(f/k/a IPI ACQUISITION CORP.)

By:___________________________

Name:

Title:

GRAND TOYS LTD.

By: __________________________

Name:

Title:

MASTER NOTE (Eurodollar/Prime Rate)

This Master Note replaces and supercedes that certain Master Note dated March 3, 2005 in the original amount of $10,000,000 from the undersigned to the Bank.

$15,000,000 Date: , 2005

FOR VALUE RECEIVED, the undersigned, a Delaware corporation, promises to pay to the order of CITIBANK, F.S.B. (the "Bank"), on or before June 30, 2006 (the "Maturity Date"), the sum of Fifteen Million Dollars ($15,000,000), or, if less, the aggregate unpaid principal amount of all advances made by the Bank pursuant to the line of credit (each an "Advance" and collectively, the "Advances"), not to exceed an aggregate amount at any one time outstanding of Fifteen Million Dollars ($15,000,000), available to the undersigned hereunder (the "Line") together with interest thereon as set forth herein.

Each Advance hereunder which is a Eurodollar Advance (as defined below) shall bear interest on the unpaid principal amount thereof for the Interest Period applicable thereto at a rate per annum equal to the Reserve Adjusted Libor determined for each Interest Period therefor in accordance with the terms of this Note plus a margin of 175 basis points. Each Advance which is a Prime Rate Advance (as defined below) shall bear interest on the unpaid principal amount thereof from the date thereof until payment of such Prime Rate Advance in full at a fluctuating rate per annum equal to 1/2% below the prime rate of interest. The undersigned shall notify the Bank not later than 12 noon three Business Days prior to each Advance hereunder which the undersigned requests to maintain at a rate of interest based on Reserve Adjusted Libor (a "Eurodollar Advance"), and not later than 12 noon on the date of each Advance which the undersigned requests to maintain at a rate of interest based on the Prime Rate (a "Prime Rate Advance"). All requests for Advances shall be irrevocable and shall be in the minimum amount of $100,000 with respect to each Prime Rate Advance and $500,000 with respect to each Eurodollar Advance. Each request by the undersigned for an Advance hereunder shall specify whether the requested Advance is a Eurodollar Advance or a Prime Rate Advance, the proposed date to fund the Advance, and if a Eurodollar Advance is requested, the Interest Period applicable thereto.

Any Eurodollar Advance may be continued as a Eurodollar Advance upon expiration of an Interest Period with respect thereto by complying with the notice provisions contained in the definition of Interest Period; provided, however, that no Eurodollar Advance may be continued as such when any Event of Default or event which upon notice, passage of time or both would constitute an Event of Default has occurred and is continuing but shall be automatically converted to a Prime Rate Advance on the last date of the Interest Period in effect when the Bank is notified of such default or Event of Default.

The undersigned may elect from time to time to convert outstanding Eurodollar Advances to Prime Rate Advances by giving the Bank at least three Business Days prior irrevocable notice of such election; provided that any conversion of a Eurodollar Advance may be made only on the last day of an Interest Period with respect thereto. The undersigned may elect from time to time to convert an outstanding Prime Rate Advance to a Eurodollar Advance by giving the Bank irrevocable written notice of such election not later than 12 noon, three Business Days prior to the date of the proposed conversion and further provided that (i) the conversion shall be in the minimum principal amount of $500,000 and (ii) no Event of Default or event upon notice, passage of time or both would constitute an Event of Default shall have occurred and be continuing. Notwithstanding the foregoing, no Advance may be converted to or continued as a Eurodollar Advance if the Interest Period would extend beyond the Maturity Date.

Interest in respect of Prime Rate Advances shall be payable on the first day of each month commencing on the first such date to occur after the date the Advance is made, and on the Maturity Date. Interest in respect of Eurodollar Advances shall be payable on the last day of the Interest Period in respect thereof. Interest shall be calculated on the basis of a 360-day year for the actual number of days elapsed. All payments hereunder shall be payable in immediately available funds in lawful money of the United States. The undersigned authorizes the Bank to charge any of the undersigned's accounts for payments of principal or interest. Any payment of principal of or interest payable hereunder which is not paid when due, whether at maturity, by acceleration, or otherwise, shall bear interest from the date due until paid in full at a rate per annum equal to three percent (3%) above the rate otherwise payable with respect thereto.

This note provides that interest be paid monthly in respect of Prime Rate Advances and on the last day of an Interest Period in respect of Eurodollar Advances.

All requests for advances shall be irrevocable and must be received by the Bank no later than 12:00 noon on the date of the proposed advance. The Bank may act without liability upon the basis of telephonic notice believed by the Bank in good faith to be from the undersigned. In each such case, the undersigned hereby waives the right to dispute the Bank's record of the terms of such telephonic notice. The undersigned shall immediately confirm to the Bank in writing each telephonic notice. All advances under the Line are at the

Bank's sole and absolute discretion and the Bank, at its option and in its sole and absolute discretion and without notice to the undersigned, may decline to make any advance requested by the undersigned.

Subject to the terms and conditions hereof and the terms and conditions set forth in any agreement in writing between the Bank and the undersigned, the undersigned may borrow, repay in whole or in part, and reborrow on a revolving basis, up to the maximum amount of the Line. Prime Rate Advances may be prepaid without premium or penalty together with accrued interest thereon to and including the date of prepayment. Eurodollar Advances may be prepaid without premium or penalty (except as provided in the next succeeding paragraph) together with accrued interest thereon to and including the date of prepayment, provided such prepayment date must be the last day of the then current Interest Period of such Advance. The Bank shall maintain its records to reflect the amount and date of each advance and of each payment of principal and interest thereon. All such records shall, absent manifest error, be conclusive as to the outstanding principal amount hereof; provided, however, that the failure to make any notation to the Bank's records shall not limit or otherwise affect the obligations of the undersigned to repay each advance made by the Bank, in accordance with the terms hereof.

The undersigned agrees to indemnify the Bank and hold the Bank harmless from any loss or expense which the Bank may sustain or incur, including without limitation, interest or fees payable by the Bank to lenders of funds obtained by it in order to maintain a Eurodollar Advance hereunder, as a consequence of (a) default by the undersigned in payment of the principal amount of or interest on a Eurodollar Advance, (b) default by the undersigned in making any prepayment of a Eurodollar Advance after the undersigned gives notice in accordance with this Note and/or (c) the making of any payment of a Eurodollar Advance on a day which is not the last day of the then applicable Interest Period with respect thereto. When claiming indemnification under this paragraph, the Bank shall provide to the undersigned a statement explaining the amount of any such loss or expense which statement shall in the absence of manifest error be conclusive with respect to the undersigned. The indemnity obligations hereunder shall survive payment in full of the Note.

As security for the payment of this Note and of all other obligations and liabilities of the undersigned to the Bank, whether now or hereafter existing, joint, several, direct, indirect, absolute, contingent, secured, matured or unmatured, the undersigned grants to the Bank a right of setoff against, a continuing security interest in, and an assignment and pledge of all moneys, deposits (general or special), securities and other property of the undersigned and the proceeds thereof, now or hereafter held by the Bank on deposit, in safekeeping, in transit or otherwise, at any time credited by or due from the Bank to the undersigned, or in which the undersigned shall have an interest.

Upon the occurrence and continuance of any of the following (each an "Event of Default"): (a) default in the payment when due of any amount hereunder; (b) filing by or against the undersigned of a petition commencing any proceeding under any bankruptcy, reorganization, rearrangement, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction, now or hereafter in effect; (c) making by the undersigned of an assignment for the benefit of creditors; (d) petitioning or applying to any tribunal for the appointment of a custodian, receiver or trustee for the undersigned or for a substantial part of its assets; (e) death or incapacity of the undersigned (if an individual); (f) entry of any judgment or order of attachment, injunction or governmental tax lien or levy issued against the undersigned or against any property of the undersigned; (g) consent by the undersigned to assume, suffer or allow to exist, without the prior written consent of the Bank, any lien, mortgage, assignment or other encumbrance on any of its assets or personal property, now owned or hereafter acquired, except those liens, mortgages, assignments or other encumbrances in existence on the date hereof and consented to in writing by the Bank; (h) default in the punctual payment or performance of this or any other obligation to the Bank or to any other lender at any time; (i) the existence or occurrence at any time of one or more conditions or events which, in the sole opinion of the Bank, has resulted or is reasonably likley to result in a material adverse change in the business, properties or financial condition of the undersigned; (j) failure on request to furnish any financial information or to permit inspection of the books and records of the undersigned; (k) any warranty, representation or statement in any application, statement or agreement which proves false in any material respect, (l) default in the observance or performance of any covenant or agreement of the undersigned herein or in any other agreement between the Bank and the undersigned; or (m) any of the foregoing events (other than the event described in clause (a)) shall occur with respect to any guarantor of the undersigned's obligations hereunder then this Note shall, at the sole option of the Bank, become due and payable without notice or demand; provided, however, if an event described in clause (b), clause (c) or clause (d) above occurs, this Note shall automatically become due and payable.

Upon the occurrence and during the continuance of an Event of Default, the Bank, its affiliates and subsidiaries shall be entitled to setoff against and apply to the payment hereof the balance of any account or accounts maintained with the Bank its affiliates or subsidiaries by the undersigned and to exercise any other right or remedy granted hereunder, or under any agreement between the undersigned and the Bank or available at law or in equity, including, but not limited to, the rights and remedies of a secured party under the New York Uniform Commercial Code. The failure by the Bank at any time to exercise any such right shall not be deemed a waiver thereof, nor shall it bar the exercise of any such right at a later date. Each and every right and remedy granted to the Bank hereunder or under any agreement between the undersigned and the Bank or available at law or in equity shall be cumulative and not exclusive of any other rights, powers, privileges or remedies, and may be exercised by the Bank from time to time and as often as may be necessary in the sole and absolute discretion of the Bank.

The undersigned agrees to pay, on demand, all of the Bank's costs and expenses, including reasonable counsel fees (whether in-house or outside counsel), in connection with the collection of any amounts due to the Bank hereunder or in connection with the enforcement of the Bank's rights under this Note.

This Note shall be governed by and construed in accordance with the laws of the State of New Jersey, without giving effect to principles of conflict or choice of laws.

THE UNDERSIGNED HEREBY IRREVOCABLY SUBMITS TO THE JURISDICTION OF ANY FEDERAL OR STATE COURT IN THE STATE OF NEW JERSEY IN ANY ACTION, SUIT OR PROCEEDING BROUGHT AGAINST IT AND RELATED TO OR IN CONNECTION WITH THIS NOTE OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY AND CONSENTS TO THE PLACING OF VENUE IN THE COUNTY PERMITTED BY LAW. TO THE EXTENT PERMITTED BY APPLICABLE LAW, THE UNDERSIGNED HEREBY WAIVES AND AGREES NOT TO ASSERT BY WAY OF MOTION, AS A DEFENSE OR OTHERWISE, IN ANY SUCH SUIT, ACTION OR PROCEEDING ANY CLAIM THAT IT IS NOT PERSONALLY SUBJECT TO THE JURISDICTION OF SUCH COURTS, THAT THE SUIT, ACTION OR PROCEEDING IS BROUGHT IN AN INCONVENIENT FORUM, THAT THE VENUE OF THE SUIT, ACTION OR PROCEEDING IS IMPROPER, OR THAT THIS NOTE OR ANY OTHER DOCUMENT OR INSTRUMENT REFERRED TO HEREIN MAY NOT BE LITIGATED IN OR BY SUCH COURTS. TO THE EXTENT PERMITTED BY APPLICABLE LAW, THE UNDERSIGNED AGREES NOT TO SEEK AND HEREBY WAIVES THE RIGHT TO ANY REVIEW OF THE JUDGMENT OF ANY SUCH COURT BY ANY COURT OF ANY OTHER NATION OR JURISDICTION WHICH MAY BE CALLED UPON TO GRANT AN ENFORCEMENT OF SUCH JUDGMENT. THE UNDERSIGNED AGREES THAT SERVICE OF PROCESS MAY BE MADE UPON IT BY CERTIFIED OR REGISTERED MAIL TO ITS ADDRESS SET FORTH BELOW OR SUCH OTHER ADDRESS THAT THE UNDERSIGNED SHALL HAVE NOTIFIED THE BANK IN WRITING OR ANY METHOD AUTHORIZED BY THE LAWS OF THE STATE OF NEW JERSEY. EXCEPT AS PROHIBITED BY LAW, THE UNDERSIGNED HEREBY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF, UNDER OR IN CONNECTION WITH THIS NOTE.

The undersigned and the Bank hereby agree and acknowledge that any and all information relating to the undersigned which is furnished by the undersigned to the Bank (or to any affiliate of the Bank), and which is non-public, confidential or proprietary in nature, shall be kept confidential by the Bank or such affiliate in accordance with applicable law; provided, however, that such information and other credit information relating to the undersigned may be distributed by the Bank or such affiliate (a) to the Bank's or such affiliate's directors, officers, employees, attorneys, affiliates, attorneys, auditors and regulators, and (b) upon the order of a court or other governmental agency having jurisdiction over the Bank or such affiliate, to any other party. The undersigned and the Bank further agree that this provision shall survive the termination of this Note.

The Bank shall not, by any act, delay, omission or otherwise, be deemed to have waived any of its rights and/or remedies hereunder. No change, amendment, modification, termination, waiver, or discharge, in whole or in part, of any provision of this Note shall be effective unless in writing and signed by the Bank, and if so given by the Bank, shall be effective only in the specific instance in which given. The undersigned acknowledges that this Note and the undersigned's obligations under this Note are, and shall at all times continue to be, absolute and unconditional in all respects, and shall at all times be valid and enforceable irrespective of any other agreements or circumstances of any nature whatsoever which might otherwise constitute a defense to this Note and the obligations of the undersigned under this Note. The undersigned absolutely, unconditionally and irrevocably waives any and all right to assert any set-off, counterclaim or crossclaim of any nature whatsoever with respect to this Note or the undersigned's obligations hereunder.

In the event any one or more of the provisions contained in this Note should be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired thereby.

The undersigned hereby waives presentment, demand for payment, protest, notice of dishonor, and any and all other notices or demands in connection with the delivery, acceptance, performance, default, or enforcement of this Note.

As used herein the following terms shall have the following meanings:

"Bank" shall be deemed to include the Bank, its successors and assigns and any holder hereof.

"Business Day" means (a) a day other than a Saturday, Sunday or other day on which commercial banks in New Jersey are authorized or required by law to close and (b) relative to the date of (i) continuing an Advance as, or converting an Advance to, a Eurodollar Advance, (ii) making any payment or prepayment of principal of or payment of interest on a Eurodollar Advance, or (iii) the undersigned giving any notice (or the number of Business Days to elapse prior to the effectiveness thereof) in connection with any matter referred to in (b)(i) or (b)(ii), any day on which dealings in U.S. dollars are carried on in the London interbank eurodollar market.

"Eurocurrency Reserve Requirement" means for any day as applied to a Eurodollar Advance, the aggregate (without duplication) of the rates (expressed as a decimal fraction) of reserve requirements in effect on such day (including, without limitation, basic, supplemental, marginal and emergency reserves under any regulations of the Board of Governors of the Federal Reserve System or other governmental authority having jurisdiction with respect thereto), as from time to time hereafter in effect, dealing with reserve requirements prescribed for eurocurrency funding (currently referred to as "Eurocurrency Liabilities" in Regulation D of such Board) maintained by a member bank of such system.

"Interest Period" with respect to any Eurodollar Advance means:

(a) Initially, the period commencing on the date such Eurodollar Advance is made and ending one, two, three or six months thereafter; and

(b) thereafter, each period commencing on the last day of the next preceding Interest Period applicable to such Eurodollar Advance and ending one, two, three or six months thereafter, as selected by the undersigned by irrevocable written notice to the Bank not less than three (3) Business Days prior to the last day of the then current Interest Period with respect to such Eurodollar Advance; provided, however, that all of the foregoing provisions relating to Interest Periods are subject to the following:

(i) if any Interest Period pertaining to a Eurodollar Advance would otherwise end on a day which is not a Business Day, the Interest Period shall be extended to the next succeeding Business Day unless the result of such extension would be to carry such Interest Period into another calendar month, in which event such Interest Period shall end on the immediately preceding Business Day;

(ii) if the undersigned shall fail to give notice as provided in clause (b) above, the undersigned shall be deemed to have requested conversion of the affected Eurodollar Advance to a Prime Rate Advance on the last day of the then current Interest Period with respect thereto;

(iii) any Interest Period that begins on the last Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such Interest Period) shall end on the last Business Day of a calendar month; and

(iv) no Interest Period may be selected which ends later than the Maturity Date.

"Prime Rate" shall mean a fluctuating rate per annum equal to the prime rate of interest as published in the Money Rates column of the Wall Street Journal from time to time. Any change in the Prime Rate shall take effect on the date of the change in the Prime Rate.

"Reserve Adjusted Libor" shall mean with respect to the Interest Period pertaining to a Eurodollar Advance, the rate per annum equal to the quotient (rounded upwards to the next higher 1/16 of one percent) of (a) the annual rate of interest at which dollar deposits of an amount comparable to the amount of such Loan and for a period equal to the Interest Period applicable thereto are offered to the Bank in the London interbank market at approximately 11:00 a.m. (London time) on the second Business Day prior to the beginning of such Interest Period, divided by (b) a number equal to 1.00 minus the Eurocurrency Reserve Requirement.

"Undersigned" shall mean, if this Note is signed by more than one party, unless otherwise stated herein, shall mean the "undersigned and each of them" and each undertaking herein contained shall be their joint and several undertaking. The Bank may proceed against one or more of the undersigned at one time or from time to time as it elects in its sole and absolute discretion.

In the event that the Bank shall have determined (which determination shall be conclusive and binding upon the undersigned) that, by reason of circumstances affecting the London interbank market, adequate and reasonable means do not exist for ascertaining the Reserve Adjusted Libor for any requested Interest Period or with respect to the continuation of a Eurodollar Advance beyond the expiration of the then current Interest Period with respect thereto, the Bank shall forthwith give notice of such determination, confirmed in writing, to the undersigned. If such notice is given, any outstanding Eurodollar Advance shall be converted, on the last

day of the then current Interest Period with respect thereto, to a Prime Rate Advance. Such notice shall be withdrawn by the Bank when the Bank shall determine that adequate and reasonable means exist for ascertaining Reserve Adjusted Libor.

Notwithstanding anything to the contrary contained elsewhere in this Note, if any change after the date hereof in law, rule, regulation, guideline or order or in the interpretation thereof by any governmental authority charged with the administration thereof, shall make it unlawful for the Bank to make or maintain any Advance as a Eurodollar Advance, then, by written notice to the undersigned, the Bank may require that the Eurodollar Advance be converted to a Prime Rate Advance, whereupon the Eurodollar Advance shall be automatically converted to a Prime Rate Advance as of the date of such notice to the undersigned.

In the event that any change in applicable law or regulation, or in the interpretation thereof by any governmental authority charged with the administration thereof, shall impose on or deem applicable to the Bank any reserve requirements against this Note or the Line or impose upon the Bank any other costs or assessments, the undersigned shall pay to the Bank on demand an amount sufficient to compensate the Bank for the additional cost resulting from the maintenance or imposition of such reserves, costs or assessments.

Any consents, agreements, instructions or requests pertaining to any matter in connection with this Note, signed by any one of the undersigned, shall be binding upon all of the undersigned. This Note shall bind the respective successors, heirs or representatives of the undersigned. This Note and the Line shall not be assigned by the undersigned without the Bank's prior written consent.

IN WITNESS WHEREOF, the undersigned has duly executed this Note the day and year first above written.

Witness:_________________________

International Playthings, Inc.

By:__ ________________________

Name:

Title:

Borrower's Address:

75 Lackawanna Ave.

Parsippany, NJ 07054

GENERAL HYPOTHEC AGREEMENT

Date: October 25, 2005

The undersigned (herein, whether one or more in number, referred to as Debtor and which, if two or more in number, shall be solidarily (jointly and severally) bound) with an address as it appears with the signature below, hereby agree(s) in favor of CITIBANK, F.S.B., having an address at One Court Square, Long Island City, New York 11120 (herein referred to as Secured Party), as follows:

1.

Security

(a)

Grant of Hypothec. As security for the Obligations (as defined below), Debtor hereby grants to Secured Party a first priority hypothec to the extent of Five Million Canadian dollars (C$5,000,000.00) (the Principal) with interest thereon at the rate of twenty-four percent (24%) per annum, both before and after maturity, demand, default and judgment, and to the extent of an amount equal to twenty (20%) of the Principal with respect to other money owed by the Debtor to the Secured Party pursuant hereto, including the cost incurred for the recovery of the Principal and interest thereon, as well as for the conserving of the Collateral, in all of Debtor's right, title and interest, whether now existing or hereafter arising or acquired, in and to any and all items of personal property described on Schedule A hereto together with all attachments, accessions and equipment now or hereafter affixed thereto or used in connection therewith, all substitutions and replacements thereof and any supporting obligations and products and proceeds thereof (the Collateral).

(b)

Security for Obligations. This Hypothec Agreement secures the payment of all now existing or hereafter arising obligations of Debtor to Secured Party, whether primary or secondary, direct or indirect, absolute or contingent, joint or several, secured or unsecured, due or not, liquidated or unliquidated, arising by operation of law or otherwise under any promissory note, guarantee, loan or credit agreement, letter of credit, draft, acceptance, interest rate or foreign exchange agreement, mortgage or other documents evidencing indebtedness whether for principal, interest, fees, expenses or other–wise, together with all costs of collection or enforcement, including, without limitation, reason–able attorneys' fees incurred in any collection efforts or in any action or proceeding (all such obligations being the Obligations).

(c)

Debtor Remains Liable. This Hypothec Agreement shall not affect Debtor's liability to perform all of its duties and obligations under the transactions giving rise to the Obliga−tions. The exercise by Secured Party of any of the rights hereunder shall not release Debtor from any of its duties or obligations under the transactions giving rise to the Obligations, which shall remain unchanged as if this Hypothec Agreement had not been executed. Secured Party shall not have any obligation or liabili−ty under the transactions giving rise to the Obligations by reason of this Hypothec Agreement, nor shall Secured Party be obligated to perform any of the obligations or duties of Debtor thereunder or to take any action to collect or enforce any claim for payment assigned hereunder.

(d)

Continuing Agreement. This security is a continuous security and shall subsist notwithstanding any fluctuation of the amounts hereby secured. The Debtor shall be deemed to obligate itself again with respect to any future obligation hereby secured. This Agreement does not operate novation and the security hereby constituted shall be in addition to any other guarantee or security which the Secured Party has or may have from time to time.

2.

<u>Debtor's Title; Liens and Encumbrances</u>.

Debtor represents and warrants that Debtor is, or to the extent that this Hypothec Agreement states that the Collateral is to be acquired after the date hereof, will be, the owner of the Collateral, having good and marketable title thereto, or has rights in or the power to transfer the Collateral, which is free from any and all liens, hypothecs, prior claims, security interests, encumbrances and claims. Debtor will not create, assume or permit to exist any such lien, hypothec, prior claim, security interest, encumbrance or claim on or against the Collater−al except as permitted by this Hypothec Agreement, and Debtor will promptly notify Secured Party of any such other claim, lien, hypothec, prior claim, security interest or other encumbrance made or asserted against the Collateral and will defend the Collateral against any such claim, lien, hypothec, prior claim, security interest or other encumbrance.

3

<u>Representations and Warranties: Location of collateral and Records: Business and Trade names of Debtor.</u>

(a)

Debtor represents and warrants to secured party as follows: Debtor s correct legal name is that indicated on the signature page of this Hypothec Agreement and on Schedule 1 annexed hereto; the state of Debtor s incorporation or organization is that indicated on Schedule 1 annexed hereto; Debtor has no place of business, offices where Debtor s books of account and records are kept, or places where the Collateral is used, stored or located, except as set forth on Schedule 1 annexed hereto. Debtor shall promptly notify Secured party of any change in the foregoing representation; provided, however, that without providing at least thirty (30) days prior written notice to Secured Party, Debtor shall not change its legal name, domicile, jurisdiction of incorporation or chief executive office. Debtor shall at all times maintain its records as to the Collateral delivered to Secured Party or an agent for secured Party, Debtor will not store, use or locate any of the Collateral at any place other than as listed on Schedule 1 annexed hereto.

(b)

Debtor currently uses; and during the last five years has used, no business or trade names, except as set forth on Schedule 1 annexed hereto. Debtor shall promptly notify Secured Party, in sufficient detail, of any changes in, additions to, or deletions from the business or trade names used by Debtor for billing purposes.

(c)

The Collateral is now and will be used in Debtor s business and not for personal, family, household or farming use.

(d)

Debtor has paid and will continue to pay or otherwise provide for the payment when due, of all taxes, assessments or contributions required by law which have been or may be assessed or levied against Debtor, whether with respect to any of the Collateral, to any wages or salaries paid by Debtor, or otherwise, and will deliver satisfactory proof of such payment to secured Party on Demand.

(e)

The grant of the security in the Collateral is effective to vest in Secured Party a valid first priority hypothec, superior to the rights of any person in and to the Collateral as set forth herein.

(f)

Debtor has not entered into a control agreement in favor of any party, except Secured Party, with respect to Collateral constituting deposit accounts or investment property. And

(g)

All inventory, goods and merchandise purchased or manufactured by or on behalf of Debtor, the sale of which gives rise to an account has been manufactured in conformity with all federal, local and provincial laws, including all applicable federal, state and local statutes dealing with the control, shipment, storage or disposal of hazardous materials.

4.

Publication of Security.

Debtor shall execute all such notices appropri–ate under applicable law as Secured Party may require, each in form satisfactory to Secured Party, necessary to publish rights created under this Hypothec Agreement. Debtor also shall pay all filing or recording costs with respect thereto, and all costs of filing or recording this Hypothec Agreement or any other agreement or document executed and delivered pursuant hereto or to the Obligations, in each case, in all public offices where filing or recording is deemed by Secured Party to be necessary or desirable. Debtor authorizes Secured Party to (i) file any financing statements or application for registration under the Civil Code of Quebec or amendments thereto without the signature of Debtor or by signing of Debtor's name to any such financing statements as its attorney-in-fact, in jurisdictions in which Secured Party is unable to file financing statements or amendments without Debtor s signature; (ii) file a photographic or other reproduction of this Hypothec Agreement as a financing statement, (iii) file notices of assignment pursuant to the Financial Administration Act (Canada), or (iv) take all other action which Secured Party may deem necessary or desirable to perfect or otherwise protect the security created hereunder and to obtain the benefits of this Hypothec Agreement.

Debtor authorizes Secured Party to file one or more financing statements or applications for registration with broader collateral descriptions than that provided in this Hypothec Agreement. Debtor also authorizes Secured Party to file any financing statements that contain any information required by Part 5 of Article 9 of the UCC for the sufficiency of filing office acceptance of any financing statement, including whether the Debtor is an organization, the type of organization, and any organization identification number issued to the Debtor. The Debtor shall also furnish any such information to Secured Party promptly upon request. Debtor also ratifies its authorization for Secured Party to have filed one or more financing statements or amendments thereto if filed prior to the date of this Hypothec Agreement.

5.

General Covenants.

Debtor shall:

(a)

furnish Secured Party from time to time, at Secured Party's request, written statements and schedules further identifying and describing the Collateral in such detail as Secured Party may reasonably require;

(b)

advise Secured Party promptly, in sufficient detail, of any substantial change in the Collateral or of the occurrence of any event which would affect the value of the Collateral or Secured Party's security interest therein;

(c)

comply with all acts, rules, regulations and orders of any legislative, administrative or judicial body or official applicable to Debtor or any Collateral or to the operation of Debtor's business except where the failure to comply (i) is non-material and (ii) has no effect on the value of the Collateral or on the ability of Secured Party to exercise its rights and remedies hereunder;

(d)

perform and observe all covenants, restrictions and conditions contained in any agreement or document executed in connection with the Obligations as though the same were fully set forth in this Hypothec Agreement;

(e)

promptly execute and deliver to Secured Party such further agreements or other instruments and take such further action from time to time as Secured Party may deem necessary to perfect, protect or enforce its security interests in the Collater–al or otherwise to effect the intent of this Hypothec Agreement;

(f)

keep or cause to be kept the Collateral in good working order and marketable condition, ordinary wear and tear excepted;

(g)

insure the Collateral against loss or damage by fire or other hazards, and extended coverage, theft, burglary, bodily injury and such other risks, with such companies and in such amounts, as is required by Secured Party at any time;

(h)

use the Collateral for lawful purposes only in conformity with all laws, rules and regulations;

(i)

allow Secured Party and its agents, at all reason–able times, to inspect any of the Collateral and to examine and make extracts from Debtor's books and records relating to the Collater–al; and

(j)

not assign, sell, mortgage, lease, transfer, pledge, grant a hypothec, security interest in or lien upon, encumber or otherwise dispose of or abandon, any part or all of the Collateral, without the express prior written consent of Secured Party, except for the sale from time to time in the ordinary course of business of Debtor of such items of Collateral as may constitute part of the business inventory of Debtor.

6.

Collateral Covenants.

Further, to insure the publication and first priority of and the ability of Secured Party to enforce Secured Party s security in the Collateral, the Debtor agrees, in each case at Debtor s own expense, to take the following actions with respect to the following property insofar as such property constitutes Collateral:

(a)

Instruments, Promissory Notes, Documents and Tangible Chattel Paper. If the Debtor shall at any time hold or acquire any instruments, promissory notes or documents, the Debtor shall forthwith endorse, assign and deliver the same to Secured Party, accompanied by such instruments of transfer, acknowledgement or assignment duly executed in blank as Secured Party may from time to time specify.

(b)

Deposit Accounts. For each deposit account that Debtor at any time opens or maintains, the Debtor shall, at Secured Party s request and option, pursuant to an agreement in form and substance satisfactory to Secured Party, either (i) cause the depositary bank to agree to comply at any time with instructions from Secured Party to such depositary bank directing the disposition of funds from time to time credited to such deposit account, without further consent of Debtor, or (ii) arrange for Secured Party to become the customer of the depositary bank with respect to the deposit account, with Debtor being permitted, only with the consent of Secured Party, to exercise rights to withdraw funds from such deposit account. The provisions of this subparagraph shall not apply to (x) any deposit account for which Debtor, the depositary bank and Secured Party have entered into a cash collateral agreement specially negotiated among Debtor, the depositary bank and Secured Party for the specific purpose set forth therein, and (y) deposit accounts specially and exclusively used for payroll, payroll taxes and other employee wage and benefit payments to or for the benefit of Debtor s salaried employees.

(c)

Investment Property. If Debtor shall at any time hold or acquire any certificated securities, Debtor shall forthwith endorse, assign and deliver the same to Secured Party, accompanied by such instruments of transfer or assignment duly executed in blank as Secured Party may from time to time specify. If any securities now or hereafter acquired by Debtor are uncertificated and are issued to Debtor or its nominee directly by the issuer thereof, Debtor shall immediately notify Secured Party thereof and, at Secured Party s request and option, pursuant to an agreement in form and substance satisfactory to Secured Party, either (i) cause the issuer to agree to comply with instructions from Secured Party as to such securities, without further consent of Debtor or such nominee, or (ii) arrange for Secured Party to become the registered owner of the securities. If any securities, whether certificated or uncertificated, financial assets or other investment property now or hereafter acquired by Debtor are held by Debtor or its nominee through a securities intermediary or commodity intermediary, Debtor shall immediately notify Secured Party thereof and, at Secured Party s request and option, pursuant to an agreement in form and substance satisfactory to Secured Party, either (x) cause such securities intermediary to agree to comply with entitlement orders or other instructions from Secured Party to such securities intermediary as to such securities or financial assets or other investment property, without the further consent of Debtor or such nominee, or (y) in the case of financial assets or other investment property held through a securities intermediary, arrange for Secured Party to become the entitlement holder with respect to such investment property, with Debtor being permitted, only with the consent of Secured Party, to exercise rights to withdraw or otherwise deal with such investment property.

(d)

Collateral in the Possession of a Bailee/Depositary. If any goods are at any time in the possession of a depositary, Debtor shall promptly notify Secured Party thereof and, if requested by Secured Party, shall promptly obtain an acknowledgment from the depositary, in form and substance satisfactory to Secured Party, that the depositary holds such Collateral for the benefit of Secured Party and shall act upon the instructions of Secured Party, without the further consent of Debtor.

(e)

(intentionally deleted).

(f)

Letter of Credit Rights. If Debtor is at any time a beneficiary under a letter of credit now or hereafter issued in favor of Debtor, Debtor shall promptly notify Secured Party thereof and, at the request and option of Secured Party, the Debtor shall, pursuant to an agreement in form and substance satisfactory to Secured Party, either (i) arrange for the issuer and any confirmer of such letter of credit to consent to an assignment to Secured Party of the proceeds of any drawing under the letter of credit or (ii) arrange for Secured Party to become the transferee beneficiary of the letter of credit, with Secured Party agreeing, in each case, that the proceeds of any drawing under the letter to credit are to be applied in reduction of the Obligations, or to be held as Collateral, as Secured Party in its sole discretion shall deem appropriate.

(g)

Commercial Claims. If Debtor shall at any time hold or acquire a commercial delict claim, Debtor shall immediately notify Secured Party in a writing signed by Debtor of the details thereof and grant to Secured Party in such writing security therein and in the proceeds thereof, all upon the terms of this Hypothec Agreement, with such writing to be in form and substance satisfactory to Secured Party.

7.

Assignment of Insurance.

At or prior to the date hereof, Debtor shall deliver to Secured Party certificates of the issuing companies with respect to all policies of insurance owned by Debtor covering or in any manner relating to the Collater−al, in form and substance satisfac−tory to Secured Party, naming Secured Party as an additional insured party as its interests may appear with respect to liability coverage and as loss payee with respect to property and extended insurance coverage, and indicating that no such policy will be terminated, or reduced in coverage or amount, without at least thirty (30) days prior written notice from the insurer to Secured Party. Debtor hereby assigns and hypothecates to the extent set out in section 1 of this Hypothec Agreement to Secured Party all sums, including returned or unearned premiums, which may become payable under or in respect of any such policy of insurance, and Debtor hereby directs each insurance company issuing any such policy to make payment of sums directly to Secured Party. Debtor hereby appoints Secured Party as Debtor's attorney-in-fact with authority to endorse any check or draft represent−ing any such payment and to execute any proof of claim, subrogation receipt and any other document required by such insurance company as a condition to or otherwise in connection with such payment, and upon the occurrence of any Event of Default, to cancel, assign or surrender any such policies. All such sums received by Secured Party shall be applied by Secured Party to satisfaction of the Obligations or, to the extent that such sums represent unearned premiums in respect of any policy of insurance on the Collateral refunded by reason of cancellation, toward payment for similar insurance protecting the respective interests of Debtor and Secured Party, or as otherwise required by applicable law.

8.

Movable Property.

If the Collateral or any part thereof is or is to become attached, affixed or joined to any immovable property, Debtor will, upon request, furnish Secured Party with a disclaimer or subordination in form satisfactory to Secured Party of the holder of any interest in the immovable property to which the Collateral is attached, joined or affixed, together with the names and addresses of the record owners of, and all other persons having interest in, and a general description of, such immovable property.

9.

Collections.

(a)

Except as otherwise provided herein, Debtor may collect all cheques, drafts, cash or other remittances (i) in payment of any of its accounts, contract rights or general intangibles constitut–ing part of the Collateral, (ii) in payment of any Collateral sold, transferred, leased or otherwise disposed of, or (iii) in payment of or on account of its accounts, contracts, notes, drafts, acceptances and all other forms of obligations relating to any of the Collateral so sold, transferred, or leased or otherwise disposed of. All of the foregoing amounts so collected after the occurrence of an Event of Default shall be held in trust and as mandatary by Debtor for and as the property of Secured Party, and shall not be commin–gled with other funds, money or property of Debtor.

(b)

Upon the request of Secured Party, Debtor will immediately upon receipt of all such cheques, drafts, cash or other remittances in payment of any of its accounts, contract rights or general intangibles constituting part of the Collateral or in payment for any Collateral sold, transferred, leased or otherwise disposed of, deliver any such items to Secured Party accompanied by a remittance report in form supplied or approved by Secured Party. Debtor shall deliver such items in the same form received, endorsed or otherwise assigned by Debtor where necessary to permit collec–tion of such items.

(c)

Upon the request of Secured Party, Debtor will promptly notify Secured Party in writing of the return or rejection of any goods represented by any accounts, contract rights or general intangibles and Debtor shall forthwith account therefor to Secured Party in cash without demand or notice. Until such payment has been received by Secured Party, Debtor will receive and hold all such goods separate and apart, in trust and as mandatary for and subject to the security interest in favor of Secured Party, and Secured Party is authorized to sell, for Debtor's account and at Debtor's sole risk, all or any part of such goods.

(d)

In its discretion, Secured Party may, upon the occurrence of an Event of Default, in its name or Debtor's or otherwise, notify any account debtor or obligor of any account, contract, instrument or general intangible or the securities intermediary of any Collateral consisting of investment property or the custodian of any Collateral consisting of deposit accounts or the issuer of any letters of credit subject to the control of Secured Party included in the Collateral to make payment to Secured Party.

(e)

All of the foregoing remittances shall be applied and credited by Secured Party in accordance with the provisions of Section 11(c) of this Hypothec Agreement.

10.

Events of Default.

The occurrence of any one or more of the following events shall constitute an event of default ("Event of Default") by Debtor under this Hypothec Agreement: (a) if a Default or Event of Default shall occur under the terms of any agreement giving rise to or executed in connection with the Obligations or if the Obligations are not paid when due or demanded; (b) if at any time Secured Party shall, in its sole discretion, consider the Obligations insecure or any part of the Collateral unsafe, insecure or insufficient, and Debtor shall not on demand furnish other collateral or make payment on account, satisfactory to Secured Party; (c) if Debtor or any obligor, guarantor of or any party to any of the Obligations or the Collateral (the same, including Debtor, being collectively referred to herein as Obligors) shall default in the punctual payment of any sum payable with respect to, or in the observance or perfor−mance of any of the terms and conditions of, any Obligations or of this Hypothec Agreement or any other agree−ment between any Obligor and Secured Party; (d) if any warranty or representation made to Secured Party by or on behalf of any Obligor is false or misleading in any material respect; (e) if a control agreement has been entered into with respect to investment property or deposit accounts, or the Secured Party has control of letter of credit rights, the termination or purported termination of such control agreement without the Secured Party s consent, or the securities intermediary thereto or the custodian or issuer of the property subject to the control agreement or the issuer of a letter of credit that has been assigned or charged to Secured Party; (f) in the event of loss, theft, substantial damage to or destruc−tion of any Collater−al, or the making or filing of any lien, levy, or execution on, or seizure, attachment or garnishment of, any of the Collateral; (g) if any of the Obligors being a natural person or any general partner or member of an Obligor which is a partnership or a limited liability company, shall die or (being a partner−ship, limited liability company or corporation) shall be dissolved, or if any of the Obligors (if an entity) shall fail to maintain its existence in good standing; (h) if any of the Obligors shall become insolvent (however defined or evidenced) or make an assignment for the benefit of creditors, or make or send notice of an intended bulk transfer, or if there shall be convened a meeting of the creditors or principal creditors of any of the Obligors or if a committee of creditors is appointed for any of them; (i) if there shall be filed by or against any of the Obligors any petition for any relief under the bankruptcy laws of the United States now or hereafter in effect or under any insol−vency, readjustment of debt, dissolution or liquidation law or statute of any jurisdiction now or hereafter in effect ; (j) if the usual business of any of the Obligors shall be terminated or suspended; (k) if any proceed−ings, procedure or remedy supplementa−ry to or in enforcement of judgment shall be commenced against, or with respect to any property of, any of the Obligors; (l) if any petition or application to any court or tribunal, at law or in equity, be filed by or against any of the Obligors for the appointment of any receiver or trustee for any of the Obligors or any part of the property of any of them; or (m) the existence or

occurrence at any time of one or more conditions or events which, in the sole opinion of the Bank, has resulted or is reasonably likely to result in a material adverse change in the business, properties or financial condition of the Debtor.

11.

Rights and Remedies.

(a)

Upon the occurrence of an Event of Default which is continuing, the security constituted by this Hypothec Agreement will become enforceable, and the Secured Party may exercise all of the rights and remedies granted to secured parties under the Civil Code of Quebec (CCQ) and any other applicable statute, or otherwise available to the Secured Party. The Debtor agrees to surrender voluntarily to the Secured Party the Collateral, at the request of the Secured Party, in all cases where the Secured Party is entitled to accept such surrender, and the Debtor agrees not to oppose any measures taken by the Secured Party in order to take possession of the Collateral surrendered by the Debtor. Moreover, the Debtor shall diligently execute all the required transfer documents and deeds for the surrender of the Collateral to the Secured Party. Upon the occurrence of an Event of Default which is continuing, any or all security granted hereby shall, at the option of Secured Party, become immediately enforceable and Secured Party may elect to give the Debtor a prior notice of the exercise of the following hypothecary right (i) to take administrative possession, or (ii) to take the Collateral or any part of it in payment, or (iii) to sell the same privately, or (iv) to sell the same under judicial authority.

(b)

Whatever hypothecary rights the Secured Party may choose to exercise, the following provisions shall apply:

(1)

to protect or to realize the value of the Collateral, the Secured Party may, at the Debtor's expense, but without being obliged thereto;

(i)

pursue the transformation thereof, proceed with the processes the Debtor subjects it to in the ordinary course of business or continue operating the enterprise of the Debtor;

(ii)

dispose of the Collateral that is likely to depreciate or that is perishable;

(iii)

use information obtained during the exercise of its rights;

(iv)

fulfill any of the Debtor's covenants;

(v)

exercise any right attached to the Collateral; and

(vi)

use the premises where the Debtor's property is located.

(2)

the Secured Party shall only be obliged to render account to the Debtor according to the usual business practices and in the time limits generally followed by the Secured Party, and the Secured Party shall not be obliged to make an inventory, purchase insurance or provide any other security;

(3)

the Secured Party may itself purchase the Collateral, directly or indirectly;

(4)

the Secured Party may, upon the exercise of its rights, waive any right of the Debtor, even without consideration;

(5)

the Secured Party shall not be obliged to make the Collateral productive or to maintain them in good operating order;

(6)

if the Secured Party withdraws its hypothecary rights or other rights against the Collateral, the Secured Party may, at its discretion, if the Collateral has been surrendered to the Secured Party, return the Collateral, or what remains thereof, to the Debtor without warranty or without any express or implicit representation on the part of the Secured

Party, but without prejudice to any of its other rights and recourses.

(b)

subject to applicable laws, if the Secured Party, pursuant to its hypothecary rights, avails itself of the taking in payment and if the Debtor provided it is entitled thereto, demand that the Secured Party instead proceed with the sale of the Collateral with respect to which the Secured Party is exercising its rights, the Debtor acknowledges that the Secured Party shall not be obliged to abandon its right regarding the taking in payment unless, prior to the expiry date granted with respect to the surrender, the Secured Party has obtained a security, deemed satisfactory to the Secured Party, to the effect that the Collateral will be sold at a sufficient price to ensure full payment of the Secured Party's claim, has been reimbursed for any expenses incurred by it until such time, and has obtained the necessary advances with respect to the sale of the property.

(c)

The sale of the Collateral may take place without legal warranty from the Debtor, or at the option of the Secured Party, with total or partial exclusion of such warranty.

(d)

Should the Secured Party take possession for administration, the Debtor agrees that the Secured Party may, in the name of the Debtor, execute, modify, renew and compromise any Leases and on such terms as the Secured Party in the exercise of its sole discretion shall determine, and the Secured Party may sue for all Rentals in the name of the Debtor and may transact any such suits or other claims. The Secured Party shall not be required to give any bond or security in respect of such possession for administration.

(e)

All of the Secured Party s rights pursuant hereto are separate and cumulative, and it is understood and agreed that none of the said rights shall be deemed to cancel any other right which the Secured Party may claim, nor limit or otherwise prejudice any other legal or contractual right of the Secured Party.

(f)

The Secured Party need only exercise reasonable diligence in the exercise of its rights or in the performance of its obligations and shall not be liable for any material damages caused by the fault of the Secured Party, other than gross or intentional fault, or by the fault of its agents.

(g)

The Secured Party may delegate to another person the exercise of its rights or the performance of its obligations pursuant hereto. In such case, the Secured Party may provide such other person with any information that it has regarding the Debtor or with respect to any Collateral or regarding a guarantor.

(h)

The instruments or sums of money remitted or held by the Secured Party in application hereof may be invested by the Secured Party at its discretion without the Secured Party being obliged to comply with the statutory rules regarding the investment of the property of others.

(i)

The Secured Party may act and shall be protected in acting in good faith on the opinion or advice of or information obtained from any counsel, accountant, engineer, appraiser or other expert or adviser, whether retained or employed by the Debtor or by the Secured Party, in the execution of the rights under this Section or at law.

(j)

In the event of Secured Party taking possession of the Collateral or any part thereof in accordance with the provisions of this Agreement, Secured Party shall have the right to maintain the same upon the premises on which the Collateral may then be situate, and for the purpose of such maintaining shall be entitled to the free use and enjoyment of all necessary premises for the proper maintaining, housing and protection of the Collateral and for its servant or servants, assistant or assistants, and Debtor covenants and agrees to provide the same without cost or expense to Secured Party until such time as Secured Party shall determine in its discretion to remove, sell or otherwise dispose of the Collateral so taken possession of by it as aforesaid.

(k)

To facilitate the realization of the Collateral Secured Party may carry on or concur in the carrying on of all or any part of the business of Debtor and may to the exclusion of all others, including Debtor, enter upon, occupy and use all or any of the premises, buildings, plant and undertaking of or occupied or used by Debtor and use all or any of the tools, machinery and equipment of Debtor for such time as Secured Party sees fit, free of charge, to manufacture or complete the manufacture of any inventory and to pack and ship the finished product, and Secured Party shall not be liable to Debtor for any neglect in so doing or in respect of any rent, charges, depreciation or damages in connection with such actions. If any of the Collater–al consists of motor vehicles, Secured Party may use Debtor's license plates

(l)

Secured Party may, if it deems it necessary for the proper realization of all or any part of the Collateral, pay any encumbrance, lien, hypothec, prior claim, security interest or charge that may exist or be threatened against the same and in every such case the amounts so paid together with costs, charges and expenses incurred in connection therewith shall be added to the obligations of Debtor to Secured Party as hereby secured, and shall bear interest at the highest rate currently charged to Debtor under its obligations to Secured Party at the date of payment thereof by Secured Party.

(m)

Secured Party shall not be liable or accountable for any failure to exercise its remedies, take possession of, collect, enforce, realize, sell, lease or otherwise dispose of all or any part of the Collateral or to institute any proceedings for such purposes. Furthermore, Secured Party shall have no obligation to take any steps to preserve any rights against prior parties to any instrument or chattel paper, whether Collateral or proceeds and whether or not in Secured Party's possession and shall not be liable or accountable for failure to do so.

(n)

The proceeds of any sale, lease, license, or other disposition of the Collateral by the Secured Creditor shall be applied first to the expenses of retaking, holding, storing, processing and preparing for sale, selling, and the like, and to the reasonable attorneys fees and legal expenses incurred by Secured Party, and then to satisfaction of the Obligations, and to the payment of any other amounts required by applicable law, after which Secured Party shall account to Debtor for any surplus proceeds. If, upon the sale, lease, license or other disposi–tion of the Collateral, the proceeds thereof are insuffi–cient to pay all amounts to which Secured Party is legally entitled, Debtor will be liable for the deficiency, together with interest thereon, at the rate prescribed in the agreements giving rise to the Obligations, and the reasonable fees of any attorneys employed by Secured Party to collect such deficiency. To the extent permitted by applicable law, Debtor waives all claims, damages and demands against Secured Party arising out of the repossession, removal, retention or sale of the Collateral.

(o)

In addition to the foregoing rights, in the event of the occurrence and continuance of any Event of Default, Secured Party may deliver a notice of exclusive control under any control agreement specifying that Secured Party has the exclusive right to give entitlement orders with respect to investment property covered by such control agreement or to otherwise direct the disposition of any deposit account subject to a control agreement or any electronic chattel paper or letter of credit rights controlled by Secured Party.

(p)

To the extent that applicable law imposes a duty on Secured Party to exercise any remedy in a commercially reasonable manner, Debtor acknowledges and agrees that it is not commercially unreasonable for Secured Party (a) to fail to incur expenses reasonably deemed significant by Secured Party to prepare Collateral for disposition or otherwise to complete raw material or work in process into finished goods or other finished products for disposition, (b) to fail to obtain third party consents for access to Collateral to be disposed of, or to obtain or, if not required by other law, to fail to obtain governmental or third party consents for the collection or disposition of Collateral to be collected or disposed of, (c) to fail to exercise collection remedies against account debtors or other persons obligated on Collateral or to remove liens or encumbrances on or any adverse claims against Collateral, (d) to exercise collection remedies against account debtors and other persons obligated on Collateral directly or through the use of collection agencies and other collection specialists, (e) to advertise dispositions of Collateral through publications or media of general circulation, whether or not the Collateral is of a specialized nature, (f) to contact other persons, whether or not in the same business as Debtor, for expressions of interest in acquiring all or any portion of the Collateral, (g) to hire one or more professional auctioneers to assist in the disposition of Collateral, whether or not the Collateral is of a specialized nature, (h) to dispose of Collateral by utilizing Internet sites that provide for the auction of assets of the types included in the Collateral or that have the reasonable capability of doing so, or that match buyers and sellers of assets, (i) to dispose of assets in wholesale rather than retail markets, (j) to disclaim disposition warranties, (k) to purchase insurance or credit enhancements to insure Secured Party against risks of loss, collection or disposition of Collateral or to provide to Secured Party a guaranteed return from the collection or disposition of Collateral, or (l) to the extent deemed appropriate by Secured Party, to obtain the services of other brokers, investment bankers, consultants and other professionals to assist Secured Party in the collection or disposition of any of the Collateral. Debtor acknowledges that the purpose of this subparagraph is to provide non-exhaustive indications of what actions or omissions by Secured Party would not be commercially unreasonable in Secured Party s exercise of remedies against the Collateral and that other actions or omissions by Secured Party shall not be deemed commercially unreasonable solely on account of not being indicated in this subparagraph. SECURED PARTY SHALL HAVE NO DUTY OR OBLIGATION TO EXERCISE ANY OF THE AFORESAID RIGHTS AND REMEDIES AND SHALL NOT BE RESPONSIBLE FOR ANY FAILURE TO DO SO, FOR ANY DELAY IN DOING SO OR FOR ANY LOSS IN THE VALUE OF THE COLLATERAL RESULTING FROM SECURED PARTY S ACTION OR INACTION.

12.

Costs and Expenses.

Any and all fees, costs and expenses, of whatever kind or nature, including the reasonable attorneys fees and legal expenses incurred by Secured Party, in connection with the filing or recording of financing statements and other documents (including all taxes in connection therewith) in public offices, the payment or discharge of any taxes, insurance premiums, encumbrances or otherwise protecting, maintaining or preserving the Collateral and Secured Party's security interest therein, or in defending or prosecuting any actions or proceedings arising out of or related to the transaction to which this Hypothec Agreement relates, shall be paid by Debtor on demand. Until so paid, all such amounts shall be added to the principal amount of the Obligations and shall bear interest at the rate prescribed in the agreements giving rise to the Obligations.

13.

Power of Attorney.

Debtor authorizes Secured Party and does hereby make, constitute and appoint Secured Party, and any officer or agent of Secured Party, with full power of substitution, as Debtor's true and lawful attorney-in-fact, with power, in its own name or in the name of Debtor to take any of the following action upon the occurrence of an Event of Default: (a) to endorse any notes, cheques, drafts, money orders, or other instruments of payment (including payments payable under or in respect of any policy of insurance) in respect of the Collateral that may come into possession of Secured Party; (b) to sign and endorse any invoice, freight or express bill, bill of lading, storage or warehouse receipts, drafts against debtors, assignments, verifications and notices in connection with accounts, and other documents relating to Collateral; (c) to pay or discharge any taxes, liens, security interest or other encumbrances at any time levied or placed on or threatened against the Collateral; (d) to demand, collect, receipt for, compromise, settle and sue for monies due in respect of the Collateral; (e) to receive, open and dispose of all mail addressed to Debtor and to notify the Post Office authorities to change the address for delivery of mail addressed to Debtor to such address as Secured Party may designate; and (f) generally to do all acts and things which Secured Party deems necessary to protect, preserve and realize upon the Collater−al and Secured Party's security interest therein. Debtor hereby approves and ratifies all acts of said attorney or designee, who shall not be liable for any acts of commission or omission, nor for any error or judgment or mistake of fact or law except for its own gross negligence or willful misconduct. This power of attorney shall be irrevocable for the term of this Hypothec Agreement and thereafter as long as any of the Obligations shall be outstanding.

14.

Notices.

Unless the party to be notified otherwise notifies the other party in writing as provided in this Section, notices shall be given hereunder by ordinary first class mail, by certified mail or by recognized overnight delivery services to Debtor at its address specified in Schedule I to this Hypothec Agreement as the location where records are kept and to Secured Party at One Court Square, Long Island City, New York 11120, Attn: Legal Department. Notices shall be effective (a) if given by first class mail on the fifth day after deposit in the mails with postage prepaid, addressed as aforesaid; (b) if given by certified mail, on the third day after deposit in the mails with postage prepaid, addressed as aforesaid; (c) if given by recognized overnight delivery service, on the business day following deposit with such service, addressed as aforesaid; provided that all notices to Secured Party shall be effective on receipt.

15.

Other Security.

To the extent that the Obligations are now or hereafter secured by property other than the Collateral or by the guarantee, endorsement or property of any other person, then Secured Party shall have the right in its sole discretion to pursue, relinquish, subordinate, modify or take any other action with respect thereto, without in any way modifying or affecting any of Secured Party's rights and remedies hereunder.

16.

Further Security.

To further secure the Obligations, Debtor hereby grants, pledges and assigns to Secured Party a continuing lien on, security interest and hypothec, for the amounts and at the interest rate set out in section 1, in and rights of set-off in all money, securities and other property of Debtor, and the proceeds thereof, now or hereafter actually or constructively held or received by or for Secured Party or any affiliate of Secured Party. Debtor hereby authorizes Secured Party to deliver a copy of this Hypothec Agreement to others as written notification of Debtor's transfer of security in the foregoing property. Secured Party is hereby authorized at any time and from time to time, without notice, to apply all or part of such moneys, securities, property, proceeds, deposits or credits to any of the Obligations in such amounts as Secured Party may elect in its sole and absolute discretion, although the Obligations may then be contingent or unmatured and whether or not the collateral security may be deemed adequate.

17.

Miscellaneous.

(a)

Beyond the safe custody thereof, Secured Party shall have no duty as to the collection of any Collateral in its possession or control or in the possession or control of any agent or nominee of Secured Party, or any income thereon or as to the preservation of rights against prior parties or any other rights pertaining thereto.

(b)

No course of dealing between Debtor and Secured Party, or Secured Party's failure to exercise or delay in exercis–ing any right, power or privilege hereunder shall operate as a waiver thereof. Any single or partial exercise of any right, power or privilege hereunder shall not preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

(c)

All of Secured Party's rights and remedies with respect to the Collateral, whether established hereby or by any other agreements, instruments or documents or by law, shall be cumulative and may be exercised singly or concurrently.

(d)

This Hypothec Agreement may be amended or modified only by a writing signed by all of the parties hereto and any provision hereof may be waived only by a writing signed by the Secured Party.

(e)

The provisions of this Hypothec Agreement are severable, and if any clause or provision shall be held invalid or unenforceable in whole or in part in any jurisdiction, then such invalidity or unenforceability shall affect only such clause or provision, or part thereof, in such jurisdiction and shall not in any manner affect such clause or provision in any other jurisdic−tion, or any other clause or provision of this Hypothec Agreement in any jurisdiction.

(f)

The benefits of this Hypothec Agreement shall inure to the benefit of the successors and assigns of Secured Party. The rights and obligations of Debtor under this Hypothec Agreement shall not be assigned or delegated without the prior consent of Secured Party.

(g)

THIS HYPOTHEC AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE PROVINCE OF QUEBEC AND THE FEDERAL LAWS OF CANADA APPLICABLE THEREIN WITHOUT REGARD TO ITS CONFLICTS OF LAWS PRINCIPLES.

(h)

Debtor hereby irrevocably consents to the jurisdic−tion of the courts of the Province of Quebec in connection with any action or proceeding arising out of or relating to the Obligations, this Hypothec Agreement or the Collateral, or any document or instrument delivered with respect to any of the Obligations. Debtor hereby waives personal service of any summons, complaint or other process in connection with any such action or proceeding and agrees that the service thereof may be made by certified mail directed to Debtor at the address provided herein for receipt of notices. In the alternative, in its discretion Secured Party may effect service upon Debtor in any other form or manner permitted by law.

(i)

IN THE EVENT OF ANY LITIGATION RELATING TO THIS HYPOTHEC AGREEMENT OR THE OBLIGATIONS, DEBTOR WAIVES ANY AND ALL RIGHTS TO A TRIAL BY JURY.

(j)

The parties acknowledge that they have required that this agreement and all related documents be drawn up in English. Les parties reconnaissent avoir exigé que la présente convention et tous les documents connexes soient rédigés en anglais.

IN WITNESS WHEREOF, the Debtor has executed this Hypothec Agreement as of the day and year first written above.

Witness:________________________

GRAND TOYS LTD.

By: ______________________________

Name:

Title:

Address:

SCHEDULE I

TO

GENERAL HYPOTHEC AGREEMENT

Offices Where Records Are Kept:

Other Locations Where Collateral

Is Stored, Used or Located:

Debtor s Legal Name:

Grand Toys Ltd.

Debtor s Trade Names:

Debtor s Jurisdiction of Incorporation

or Organization:

Canada

SCHEDULE A TO GENERAL HYPOTHEC AGREEMENT DATED 10/25/05

ALL ASSETS

All movable property of Debtor, now owned and hereafter acquired, of every kind and description wherever located, includ–ing, without limitation all accounts, general incorporeal property, instruments (including promissory notes), documents, goods (including inventory, equipment and embedded software and all accessions to any goods); letter of credit rights (whether or not the letter of credit is evidenced by a writing), financial assets and investment property, securities, deposit accounts (whether or not maintained at Secured Party), commercial tort claims, supporting obligations and all products and proceeds thereof.

GRAND TOYS LTD.

By: ____

Name:

Title:

INTERCOMPANY DEMAND PROMISSORY NOTE

U.S. $2,000,000

October 25, 2005

FOR VALUE RECEIVED, the undersigned, GRAND TOYS LTD. ("Company"), HEREBY PROMISES TO PAY to the order of INTERNATIONAL PLAYTHINGS, INC. (together with its successors and assigns, "Holder"), on demand, the amount of U.S. TWO MILLION DOLLARS (U.S. $2,000,000), or, if less, the aggregate unpaid amount of all advances, indebtedness, loans, payable and other extensions of credit and obligations (individually, an "Advance" and, collectively, "Advances") made by Holder to Company, or otherwise owing by Company to Holder, from time to time, as set forth on the books and records of Holder.

1.

Payments. This Note may be prepaid at any time in whole or in part from time to time without penalty or premium. The principal of this Note is payable in lawful money of the United States of America and in same day funds, without abatement, reduction, deduction, counterclaim, recoupment, defense or setoff, to Holder at such account as Holder may designate. Each Advance made by Holder to Company, and all payments made on account of principal thereof, shall be recorded by Holder.

2.

Interest. Company shall pay to Holder accrued but unpaid interest on this Note on demand when and as demanded by Holder. This Note shall bear interest on the principal amount from time to time outstanding at a floating rate of interest per annum announced from time to time by Holder (which interest rate shall in no event exceed the rate then applicable to the loans made by Citibank, F.S.B. to Holder).

3.

Holder rights. Upon demand for payment hereunder, Holder is hereby authorized at any time and from time to time, to the fullest extent permitted by law, to set off and apply any indebtedness at any time owing by Holder to or for the credit or the account of Company against any and all of the obligations of Company now or hereafter existing under this Note, irrespective of whether or not Holder shall have made any demand under this Note and although such obligations may be unmatured. Holder agrees promptly to notify Company after any such setoff and application; provided that the failure to give such notice shall not affect the validity of such setoff and application. The rights of Holder under this Section are in addition to other rights and remedies (including, without limitation, other rights of setoff) that Holder may have.

4.

Waiver. Except as otherwise provided for in this Note, and to the fullest extent permitted by applicable law, Company waives: (a) presentment, notice, demand and protest, and notice of presentment, dishonor, intent to accelerate, acceleration, protest, default, nonpayment, maturity, release, compromise, settlement, extension or renewal of this Note at any time held by Holder on which Company may in any way be liable, and hereby ratifies and confirms whatever Holder may do in this regard; (b) all rights to notice and a hearing prior to Holder s taking possession or control of, or to Holder s replevy, attachment or levy upon, any property, real or personal, tangible or intangible of Company or any bond or s security which might be required by any court prior to allowing Holder to exercise any of its remedies; and (c) the benefit of all valuation, appraisal and exemption laws. No failure or delay on the part of Holder in the exercise of any power, right or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such power, right or privilege preclude other or further exercise thereof or of any other right, power or privilege. All rights and remedies existing hereunder are cumulative to, and not exclusive of, any rights or remedies otherwise available.

5.

Judgment Currency. If, for the purposes of obtaining or enforcing judgment in any court in any jurisdiction, it becomes necessary to convert into the currency of the jurisdiction giving such judgment (the Judgment Currency) an amount due hereunder in any other currency (the Original Currency), then the date on which the rate of exchange for conversion is selected by the court is referred to herein as the Conversion Date . If there is a change in the rate of exchange between the Judgment Currency and the Original Currency between the Conversion Date and the actual receipt by the Creditor of the amount due hereunder or under such judgment, the undersigned shall, notwithstanding such judgment, pay all such additional amounts as may be necessary to ensure that the amount received by the Creditor in the Judgment Currency, when converted at the rate of exchange prevailing on the date of receipt, will produce the amount due in the Original Currency. Company's liability hereunder constitutes a separate and independent liability which shall not merge with any judgment or any partial payment or enforcement of payment of sums due under this note. The term "rate of exchange", as used herein, includes any premiums or costs payable in connection with the currency conversion then being effected.

6.

Taxes. All payments to be made hereunder by Company shall be made free and clear of, and without deduction or withholding for or on account of, any present or future tax, levy, impost, duty, charge, assessment or fee (including interest, penalties and additions thereto) (herein Taxes), but excluding net income taxes and taxes on capital. If any Taxes are required to be withheld from any payment hereunder, the undersigned shall: (a) increase the amount of such payment so that Holder will receive a net amount (after deduction and withholding of all Taxes) equal to the amount otherwise due hereunder; (b) pay such Taxes to the appropriate taxing authority for the account of Holder and (c) as promptly as possible thereafter, send Holder an original receipt showing payment thereof, together with such additional documentary evidence as Holder may from time to time reasonably require. Company shall use reasonable measures to avoid or to minimize any amounts which might otherwise be payable pursuant to this section, but Holder shall not be required to disclose any information about its taxes to Company that is not publicly available. If Company fails to perform its obligations under this paragraph, the undersigned shall indemnify Holder for any incremental Taxes, interest or penalties that may become payable by Holder as a consequence of such failure. The obligations of Company under this paragraph shall survive the termination of this Note.

7.

Severability. Wherever possible, each provision of this Note shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Note shall be prohibited by or invalid under applicable law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Note.

8.

Amendment and Modification. Each of Company and Holder agrees that no change, waiver, modification or amendment of this Note shall be effective without the prior written consent of Citibank, F.S.B. Holder agrees not to take any action, enter into any agreement or perform any activity with respect to this Note and the Advances evidenced hereby, except as previously approved in writing by Citibank, F.S.B.

9.

Costs and Expenses. Company agrees to pay on demand all costs and expenses, including legal fees and expenses, in connection with the enforcement (whether through negotiations, legal proceedings or otherwise) of this Note.

10.

GOVERNING LAW AND JURISDICTION AND WAIVER OF JURY TRIAL. THIS NOTE SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK WITHOUT REGARD TO CONFLICTS OF LAW PIRNCIPLES THEREOF. COMPANY HEREBY IRREVOCABLY SUBMITS TO THE JURISDICTION OF ANY FEDERAL OR STATE COURT IN THE STATE OF NEW YORK IN ANY ACTION, SUIT OR PROCEEDING BROUGHT AGAINST IT AND RELATED TO OR IN CONNECTION WITH THIS NOTE OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY AND CONSENTS TO THE PLACING OF VENUE IN THE COUNTY OF NEW YORK OR OTHER COUNTY PERMITTED BY LAW. TO THE EXTENT PERMITTED BY APPLICABLE LAW, COMPANY HEREBY WAIVES AND AGREES NOT TO ASSERT BY WAY OF MOTION, AS A DEFENSE OR OTHERWISE, IN ANY SUCH SUIT, ACTION OR PROCEEDING ANY CLAIM THAT IT IS NOT PERSONALLY SUBJECT TO THE JURISDICTION OF SUCH COURTS, THAT THE SUIT, ACTION OR PROCEEDING IS BROUGHT IN AN INCONVENIENT FORUM, THAT THE VENUE OF THE SUIT, ACTION OR PROCEEDING IS IMPROPER, OR THAT THIS NOTE OR ANY OTHER DOCUMENT OR INSTRUMENT REFERRED TO HEREIN MAY NOT BE LITIGATED IN OR BY SUCH COURTS. NOTWITHSTANDING THE FOREGOING, HOLDER SHALL HAVE THE RIGHT TO BRING ANY ACTION OR PROCEEDING AGAINST COMPANY OR ITS PROPERTY IN THE COURTS OF ANY OTHER JURISDICTION. TO THE EXTENT PERMITTED BY APPLICABLE LAW, COMPANY AGREES NOT TO SEEK AND HEREBY WAIVES THE RIGHT TO ANY REVIEW OF THE JUDGMENT OF ANY SUCH COURT BY ANY COURT OF ANY OTHER NATION OR JURISDICTION WHICH MAY BE CALLED UPON TO GRANT AN ENFORCEMENT OF SUCH JUDGMENT. EXCEPT AS PROHIBITED BY LAW, COMPANY HEREBY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF, UNDER OR IN CONNECTION WITH THIS NOTE.

11.

Successors and Assigns . This Note shall inure to the benefit of Holder and its successors and permitted assigns (including Citibank, F.S.B.). Company shall not assign this Note (by operation of law or otherwise) without the prior written consent of Citibank, F.S.B.

12.

Acknowledgment of Security Assignment. To secure the payment and performance of Holder s obligations, indebtedness and liabilities to Citibank, F.S.B. and without limiting any other rights and remedies of Citibank, F.S.B., Holder, pursuant to the terms of the General Hypothec Agreement dated as of October 25, 2005 by Holder in favor of Citibank, F.S.B. (the GHA), has, among other things, irrevocably granted, assigned, transferred and set over unto Citibank, F.S.B., all of Holder s rights, title and interest in and to this Note, including, without limitation, the right to collect all amounts due hereunder. Company hereby consents to such assignment and the irrevocable power of attorney granted by Holder to Citibank, F.S.B., pursuant to the GHA, to (i) perform any act, execute any documents or otherwise to take any action with respect to the Advances evidenced by this Note and (ii) demand, receive and enforce all of the Holder s rights, powers and remedies with respect to this Note, including, without limitation, Citibank, F.S.B. s right to receive directly (or as it otherwise directs) any and all payments to be made to Holder under this

Note. Company acknowledges that Citibank, F.S.B. is providing certain loans and other financial accommodations to Holder in reliance in part on such assignment and power of attorney and the representations, warranties and covenants made by Company and, accordingly, Company hereby repeats and reaffirms directly to Citibank, F.S.B. each such representation, warranty and covenant and agrees that Citibank, F.S.B. may, but shall have no obligation or duty to, enforce each directly against Company.

13.

English Language. It is the express wish of the parties that this Note and any related documents be drawn up in English. Les parties aux présentes ont expressément demandé que ce document et tous les documents s y rattachant soient rédigés en anglais.

GRAND TOYS LTD.

By:______________________________

Name:

Title:

GUARANTY OF ALL LIABILITY

THIS GUARANTY, IS ENTERED INTO AS OF OCTOBER 25, 2005 BY THE UNDERSIGNED (THE GUARANTOR), IN FAVOR OF AND FOR THE BENEFIT OF CITIBANK, F.S.B., (THE "BANK").

RECITALS

A

.

The Bank has made and may make, from time to time, loans, advances, extensions of credit and/or other financial accommodations (collectively, the "Loans") for the account of INTERNATIONAL PLAYTHINGS, INC. (the Borrower).

B

.

The Guarantor, being affiliated with the Borrower, acknowledges and agrees that the Guarantor has received and will receive direct and indirect benefits from the extension of the Loans made to the Borrower from time to time.

C

.

The Guarantor wishes to grant the Bank security and assurance in order to secure the payment and performance by the Borrower of all of its present and future Obligations (as that term is defined below), and, to that effect, to guaranty the Borrower's Obligations as set forth herein.

Accordingly, the Guarantor hereby agrees as follows:

1.

Guaranty.

(a)

The Guarantor hereby unconditionally and irrevocably guarantees, solidarily, to the Bank the full and punctual payment by the Borrower, when due, whether at the stated due date, by acceleration or otherwise of all Obligations (as defined below) of the Borrower, howsoever created, arising or evidenced, voluntary or involuntary, whether direct or indirect, absolute or contingent now or hereafter existing or owing to the Bank, (collectively, the Guaranteed Obligations). This Guaranty is an absolute, unconditional, continuing guaranty of payment and not of collection of the Guaranteed Obligations and includes Guaranteed Obligations arising from successive transactions which shall either continue such Guaranteed Obligations or from time to time renew such Guaranteed Obligations after the same has been satisfied. This Guaranty is in no way conditioned upon any attempt to collect from the Borrower or upon any other event or contingency, and shall be binding upon and enforceable against the Guarantor without regard to the validity or enforceability of any document, instrument or agreement evidencing or governing the Obligations or any other agreement or instrument executed in connection therewith (including, without limitation, this Guaranty) or contemplated thereby (each, a Loan Document and, collectively, the Loan Documents). If for any reason the Borrower shall fail or be unable duly and punctually to pay any of the Guaranteed Obligations (including, without limitation, amounts that would become due but for the operation of the automatic stay under Section 362(a) of the Bankruptcy Code, 11 U.S.C. § 362(a)), the Guarantor will forthwith pay the same, in cash, immediately upon demand. As used herein Obligations shall mean all obligations, liabilities and indebtedness of the Borrower to the Bank, whether now existing or hereafter created, absolute or contingent, direct or indirect, due or not, whether created directly or acquired by assignment or otherwise, including, without limitation, the Loan and the payment and performance of all other obligations, liabilities, and indebtedness of the Borrower to the Bank under the Loan Documents, including without limitation all fees, costs, expenses and indemnity obligations thereunder.

(b)

In the event any Loan Document shall be terminated as a result of the rejection thereof by any trustee, receiver or liquidating agent of the Borrower or any of its properties in any bankruptcy, insolvency, reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar proceeding, the Guarantor's obligations hereunder shall continue to the same extent as if such Loan Document had not been so rejected.

(c)

The Guarantor agrees to pay all costs, expenses (including, without limitation, attorneys' fees and disbursements) and damages incurred in connection with the enforcement of the Guaranteed Obligations of the Borrower to the extent that such costs, expenses and damages are not paid by the Borrower pursuant to the respective Loan Documents.

(d)

The Guarantor further agrees that if any payment made by the Borrower or the Guarantor to the Bank on any Guaranteed Obligation is rescinded, recovered from or repaid by the Bank, in whole or in part, in any

bankruptcy, insolvency or similar proceeding instituted by or against the Borrower or Guarantor, this Guaranty shall continue to be fully applicable to such Guaranteed Obligation to the same extent as though the payment so rescinded, recovered or repaid had never originally been made on such Guaranteed Obligation regardless of, and, without giving effect to, any discharge or release of the Guarantor's obligations hereunder granted by the Bank after the date hereof.

2.

Guaranty Continuing, Absolute, Unlimited.

The obligations of the Guarantor hereunder shall be continuing, absolute, unlimited and unconditional, shall not be subject to any counterclaim, setoff, deduction or defense based upon any claim the Guarantor may have against the Bank or the Borrower or any other person, and shall remain in full force and effect without regard to, and, to the fullest extent permitted by applicable law, shall not be released, discharged or in any way affected by, any circumstance or condition (whether or not any Guarantor shall have any knowledge or notice thereof) whatsoever which might constitute a legal or equitable discharge or defense including, but not limited to, (a) any express or implied amendment, modification or supplement to any Loan Document or any other agreement referred to in any Loan Document; (b) any failure on the part of the Borrower to perform or comply with any Loan Document, or any failure of any other person to perform or comply with any term of any Loan Document; (c) any waiver, consent, change, extension, indulgence or other action or any action or inaction under or in respect of any Loan Document or any other agreement as aforesaid, whether or not the Bank, the Borrower or the Guarantor has notice or knowledge of any of the foregoing; (d) any bankruptcy, insolvency, reorganization, arrangement, readjustment, composition, liquidation or similar proceeding with respect to the Borrower, or its properties or its creditors, or any action taken by any trustee or receiver or by any court in any such proceeding; (e) any furnishing or acceptance of additional security or any release of any security; (f) any limitation on the liability or obligations of the Borrower under any Loan Document or any termination, cancellation, frustration, invalidity or unenforceability, in whole or in part, of any Loan Document; (g) any lien, charge or encumbrance on or affecting the Guarantor's or any of the Borrower's respective assets and properties; (h) any act, omission or breach on the part of the Bank under any Loan Document or any other agreement at any time existing between the Bank and the Borrower or any law or governmental regulation applicable to the Bank or any Loan Document; (i) any claim as a result of any other dealings among the Bank, the Guarantor or the Borrower; (j) the assignment of this Guaranty or any Loan Document to any other person; (k) any change in the name of the Bank, the Borrower or any other person or entity referred to herein; or (l) any change in the status, the constitution, the business, the objects or the shareholders of the Guarantor and notwithstanding any termination of or change in the relationships that exist between the Guarantor and the Borrower.

3.

Waiver.

The Guarantor unconditionally and irrevocably waives, to the fullest extent permitted by applicable law: (a) notice of any of the matters referred to in Section 2 hereof; (b) all notices which may be required by statute, rule of law or otherwise to preserve any rights against the Guarantor hereunder, including, without limitation, notice of the acceptance of this Guaranty, or the creation, renewal, extension, modification or accrual of the Guaranteed Obligations or notice of any other matters relating thereto, any presentment, demand, notice of dishonor, protest, nonpayment of any damages or other amounts payable under any Loan Document; (c) any requirement for the enforcement, assertion or exercise of any right, remedy, power or privilege under or in respect of any Loan Document, including, without limitation, diligence in collection or protection of or realization upon the Guaranteed Obligations or any part thereof or any collateral therefor; (d) any requirement of diligence; (e) any requirement to mitigate the damages resulting from a default by the Borrower under any Loan Document; (f) the occurrence of every other condition precedent to which the Guarantor or the Borrower may otherwise be entitled; (g) the right to require the Bank to proceed against the Borrower or any other person liable on the Guaranteed Obligations, to proceed against or exhaust any security held by the Borrower or any other person, or to pursue any other remedy in the Bank's power whatsoever; (h) the right to have the property of the Borrower first applied to the discharge of the Guaranteed Obligations, (i) any and all rights it may now or hereafter have under any agreement or at law (including, without limitation, any law subrogating the Guarantor to the rights of the Bank) to assert any claim against or seek contribution, indemnification or any other form of reimbursement from the Borrower or any other party liable for payment of any or all of the Guaranteed Obligations for any payment made by the Guarantor under or in connection with this Guaranty or otherwise and (j) the benefit of division and discussion.

The Bank may, at its election, exercise any right or remedy it may have against the Borrower without affecting or impairing in any way the liability of the Guarantor hereunder and the Guarantor waives, to the fullest extent permitted by applicable law, any defense arising out of the absence, impairment or loss of any right of reimbursement, contribution or subrogation or any other right or remedy of the Guarantor against the Borrower, whether resulting from such election by the Bank or otherwise. The Guarantor waives any defense arising by reason of any disability or other defense of the Borrower or by reason of the cessation for any cause whatsoever of the liability, either in whole or in part, of the Borrower to the Bank for the Guaranteed Obligations.

The Guarantor assumes the responsibility for being and keeping informed of the financial condition of the Borrower and of all other circumstances bearing upon the risk of nonpayment of the Guaranteed Obligations and agrees that the Bank shall not have any duty to advise the Guarantor of information regarding any condition or circumstance or any change in such condition or circumstance. The Guarantor acknowledges that the Bank has not made any representations to the Guarantor concerning the financial condition of the Borrower.

4.

Representations and Warranties of the Guarantor.

The Guarantor hereby represents and warrants that:

(a)

If not an individual, it is a general partnership, limited partnership, corporation, limited liability company or limited liability partnership (as indicated on the signature page hereto) duly organized or formed, as the case may be, under the laws of the jurisdiction of its incorporation or formation and has all requisite power and authority to enter into this Guaranty and to carry out its obligations hereunder.

(b)

The execution, delivery and performance of this Guaranty by the Guarantor have been duly authorized by all necessary action (other than a Guarantor who is an individual) and this Guaranty constitutes the legal, valid and binding obligation of the Guarantor, enforceable against the Guarantor in accordance with its terms.

(c)

If not an individual, it has the power and authority to own its properties and assets and to conduct its business as now being conducted and is duly qualified to do business in every jurisdiction in which the nature of its assets or the conduct of its business requires it to be so qualified.

(d)

Neither this Guaranty nor any other Loan Document to which the Guarantor is a party will violate any provision of law, rule or regulation or any order of any court or other governmental agency to which the Guarantor is subject, the organizational documents of the Guarantor, any provision of any agreement or instrument to which the Guarantor is a party or by which the Guarantor or any of the Guarantor's properties or assets are bound, or be in conflict with, result in a breach of, or constitute a default under (with or without notice or lapse of time), any such agreement or instrument, or result in the creation or imposition of any lien, charge or encumbrance of any nature whatsoever upon any properties or assets of the Guarantor.

(e)

No action or approval by or of and no filing or registration with any governmental or public body or authority, or any subdivision thereof, nor the consent of any other person or entity, nor any other legal formality is required in connection with the entering into, performance or enforcement of this Guaranty, except such as have been obtained or taken and with respect to which a copy or other satisfactory evidence thereof has been furnished to the Bank.

5.

Security; Events of Default/Setoff.

As security for any and all of the obligations of the Guarantor under this Guaranty, now existing or hereafter arising hereunder or otherwise (collectively, the "Liabilities"), the Guarantor hereby grants to the Bank a lien upon, a security interest and a hypothec to the extent of $5,000,000.00 (Canadian Dollars) bearing interest at 24% per annum in any and all moneys or other property (i.e., goods and merchandise, as well as any and all documents relative thereto; funds, securities, choses in action and any and all other forms of property whether real, personal or mixed, and any right, title or interest of the Guarantor therein or thereto), and the proceeds thereof, which have been, or may hereafter be, deposited or delivered to the Bank (or with any third party acting on the Bank's behalf) by or for the account or credit of the Guarantor whether for safekeeping, custody, pledge, deposit, transmission, collection or otherwise. All remittances and property shall be deemed delivered to the Bank as soon as put in transit to the Bank by mail or carrier.

Upon the occurrence of any of the following events (each an "Event of Default"):

(a)

the Guarantor defaults under this Guaranty or any Loan Document to which the Guarantor is a party;

(b)

any representation or warranty made by the Guarantor herein or in any other Loan Document to which the Guarantor is a party is false or untrue as of the date such representation or warranty is made;

(c)

the Guarantor commences any case, proceeding, or other action under any law of any jurisdiction relating to bankruptcy, insolvency, reorganization, or relief of debtors or seeks to have an order for relief entered with respect to the Guarantor or seeks to be adjudicated a bankrupt or insolvent, or seeks reorganization, arrangement, adjustment, liquidation, dissolution, composition or other relief with respect to the Guarantor or the Guarantor's debts, or seeks the appointment of a receiver, trustee, custodian, or other similar official for the Guarantor or for all or any substantial part of the Guarantor's property;

(d)

the Guarantor makes a general assignment for the benefit of creditors;

(e)

there is commenced against the Guarantor, any case, proceeding or other action of the type referred to in clause (c) above or seeking the issuance of a warrant of attachment, execution, distraint, or similar process against all or any substantial part of the Guarantor's property, which case, proceeding or other action results in an entry of an order for relief or is not dismissed, discharged or bonded within sixty days of the commencement thereof;

(f)

the Guarantor takes any action indicating the Guarantor's consent to, approval of, or acquiescence in or in furtherance of, any of the acts set forth in clause (c) and (e) above;

(g)

the death or incapacity of a Guarantor, if an individual;

(h)

the Guarantor admits in writing the Guarantor's inability to pay the Guarantor's debts as they mature;

(i)

the Guarantor terminates or dissolves or suspends the Guarantor's usual business activities or conveys, sells, leases, transfers or otherwise disposes of all or a substantial part of the Guarantor's property, business or assets other than in the ordinary course of business;

(j)

the Obligations are not paid when due or demanded; or

(k)

the existence or occurrence at any time of one or more conditions or events which, in the sole opinion of the Bank, has resulted or is reasonably likely to result in a material adverse change in the business, properties or financial condition of the Guarantor;

then, in any of such events any or all of the Liabilities shall, at the Bank's option, become immediately due and payable by the Guarantor, without demand or notice. In addition, upon the occurrence of any Event of Default, the Bank shall be entitled to setoff against and apply to the payment of Guaranteed Obligations the balance of any account or accounts maintained with the Bank or any of the Bank s affiliates by the undersigned and to exercise any other right or remedy granted hereunder or available at law or in equity, including, but not limited to, the rights and remedies of a secured party under the Civil Code of Quebec.

6.

Parties.

This Guaranty shall inure to the benefit of the Bank and its successors, assigns or transferees, and shall be binding upon the Guarantor and its successors and assigns and heirs and legal representatives. The Guarantor shall not delegate any of the Guarantor's duties under this Guaranty without the prior written consent of the Bank.

7.

Notices.

Any notice shall be conclusively deemed to have been received by a party hereto and to be effective on the day on which delivered to such party at the address set forth below if hand delivered or sent by Federal Express or other reputable courier of national reputation, or if sent by registered or certified mail, on the third business day after the day on which mailed in the United States or Canada, as the case may be, addressed to such party at said address:

(a)

if to the Bank, at

CITIBANK, F.S.B.

666 5th Avenue, 3rd Floor

New York, NY 10103

Attention: Michael Peroni

(b)

if to the Guarantor,

1710, ROUTE TRANS-CANADA,

DORVAL (QUÉBEC),

CANADA H9P 1H7

Attention: ____________________

- and -

(c)

as to each such party at such other address as such party shall have designated to the other in a written notice complying as to delivery with the provisions of this Section 7.

8.

Right to Deal with the Borrower.

At any time and from time to time, without terminating, affecting or impairing the validity of this Guaranty or the obligations of the Guarantor hereunder, the Bank may deal with the Borrower in the same manner and as fully as if this Guaranty did not exist and shall be entitled, among other things, to grant the Borrower, without notice or demand and without affecting the Guarantor's liability hereunder, such extension or extensions of time to perform, renew, compromise, accelerate or otherwise change the time for payment of or otherwise change the terms of indebtedness or any part thereof contained in or arising under any Loan Document or any other document evidencing Obligations of the Borrower to the Bank, or to waive any obligation of the Borrower to perform, any act or acts as the Bank may deem advisable.

9.

Delivery of Financial Statements.

The Guarantor shall deliver to the Bank:

(a)

If the Guarantor is other than an individual, annually, as soon as available, but in any event within 120 days after the last day of each of its fiscal years, a balance sheet of the Guarantor and its subsidiaries, as at such last day of the fiscal year, and statements of income and retained earnings and cash flow for such fiscal year, each prepared in accordance with generally accepted accounting principles consistently applied, in reasonable detail.

(b)

If the Guarantor is an individual, annually, as soon as available, but in any event within 120 days after the last day of each calendar year, the personal financial statement of the Guarantor on the Bank's standard form or such other form as may be acceptable to the Bank from time to time.

(c)

Promptly after a written request therefor, such other financial data or information as the Bank may reasonably request from time to time.

10.

Survival of Representations, Warranties, and Agreements.

All representations, warranties, covenants and agreements made herein, including representations and warranties deemed made herein, shall survive any investigation or inspection made by or on behalf of the Bank and shall continue in full force and effect until all of the obligations of the Guarantor under this Guaranty shall be fully performed in accordance with the terms hereof, and until the payment in full of the Guaranteed Obligations.

11.

GOVERNING LAW; CONSENT TO JURISDICTION; WAIVER OF JURY TRIAL. THIS GUARANTY SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE PROVINCE OF QUEBEC AND THE FEDERAL LAWS OF CANADA APPLICABLE THEREIN. THE GUARANTOR HEREBY IRREVOCABLY SUBMITS TO THE JURISDICTION OF COURT LOCATED IN QUEBEC IN ANY ACTION, SUIT OR PROCEEDING BROUGHT AGAINST THE GUARANTOR AND RELATED TO OR IN CONNECTION WITH THIS GUARANTY OR THE TRANSACTIONS CONTEMPLATED HEREBY, AND TO THE EXTENT PERMITTED BY APPLICABLE LAW, THE GUARANTOR HEREBY WAIVES AND AGREES NOT TO ASSERT BY WAY OF MOTION, AS A DEFENSE OR OTHERWISE IN ANY SUCH SUIT, ACTION OR PROCEEDING, ANY CLAIM THAT THE GUARANTOR IS NOT PERSONALLY SUBJECT TO THE JURISDICTION OF SUCH COURTS, THAT THE SUIT, ACTION OR PROCEEDING IS BROUGHT IN AN INCONVENIENT FORUM, THAT THE VENUE OF THE SUIT, ACTION OR PROCEEDING IS IMPROPER, OR THAT THIS GUARANTY OR ANY DOCUMENT OR ANY INSTRUMENT REFERRED TO HEREIN OR THE SUBJECT MATTER THEREOF MAY NOT BE LITIGATED IN OR BY SUCH COURTS. NOTWITHSTANDING THE FORGOING, THE BANK SHALL HAVE THE RIGHT TO BRING ANY ACTION OR PROCEEDING AGAINST THE GUARANTOR OR ITS PROPERTY IN THE COURTS OF ANY OTHER JURISDICTION. TO THE EXTENT PERMITTED BY APPLICABLE LAW, THE GUARANTOR AGREES (i) NOT TO SEEK AND HEREBY WAIVES THE RIGHT TO ANY REVIEW OF THE JUDGMENT OF ANY SUCH COURT BY ANY COURT OF ANY OTHER NATION OR JURISDICTION WHICH MAY BE CALLED UPON TO GRANT AN ENFORCEMENT OF SUCH JUDGMENT AND (ii) NOT TO ASSERT ANY COUNTER–CLAIM, IN ANY SUCH SUIT, ACTION OR PROCEEDING UNLESS SUCH COUNTERCLAIM COULD NOT, BY REASON OF ANY APPLICABLE FEDERAL OR STATE PROCEDURAL LAWS, BE INTERPOSED, PLEADED OR ALLEGED IN ANY OTHER ACTION. THE GUARANTOR AGREES

THAT SERVICE OF PROCESS MAY BE MADE UPON THE GUARANTOR BY CERTIFIED OR REGISTERED MAIL TO THE ADDRESS FOR NOTICES SET FORTH IN THIS GUARANTY OR

ANY METHOD AUTHORIZED BY THE LAWS OF THE PROVINCE OF QUEBEC. THE GUARANTOR IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS GUARANTY, THE LOAN DOCUMENTS OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY.

12.

Miscellaneous.

(a)

If this Guaranty is executed by two or more parties, they shall be solidarily (jointly and severally) liable hereunder, and the word "Guarantor" wherever used herein shall be construed to refer to each of such parties separately, all in the same manner and with the same effect as if each of them had signed separate instruments; and in any such case this Guaranty shall not be revoked or impaired as to any one or more of such parties by the death or dissolution of any of the others or by the revocation or release of any liabilities hereunder of any one or more of such other parties and the Bank may proceed against none, one or more of the Guarantors at one time, or from time to time, in its sole and absolute discretion.

(b)

If any term of this Guaranty or any application hereof shall be invalid or unenforceable, the remainder of this Guaranty and any other application of such term shall not be affected thereby.

(c)

Any term of this Guaranty may be amended, waived, discharged or terminated only by an instrument in writing signed by the Guarantor and the Bank. No notice to or demand on the Guarantor shall be deemed to be a waiver of the obligations of the Guarantor or of the right of the Bank to take further action without notice or demand as provided in this Guaranty. No course of dealing between the Guarantor and the Bank shall change, modify or discharge, in whole or in part, this Guaranty or any obligations of the Guarantor hereunder. No waiver of any term, covenant or provision of this Guaranty shall be effective unless given in writing by the Bank and if so given shall only be effective in the specific instance in which given.

(d)

The headings in this Guaranty are for purposes of reference only and shall not limit or define the meaning hereof.

(e)

No delay or omission by the Bank in the exercise of any right under this Guaranty shall impair any such right, nor shall it be construed to be a waiver thereof; nor shall any single or partial exercise of any right hereunder preclude any other or further exercise of any other right.

(f)

The liability of any Guarantor under this Guaranty may be terminated, but only with respect to Guaranteed Obligations arising subsequent to the effective Date of Termination, upon written notice to that effect, signed and delivered by the Guarantor to the Bank, provided, however, that such termination shall only be effective upon the Bank's receipt thereof. In the event of such termination, the Guarantor shall remain liable with respect to the Guaranteed Obligations prior to date of termination, including any renewals, extensions, modifications thereof, and this Guaranty shall remain in full force and effect as if no such termination has been made.

(g)

The execution and delivery of this Guaranty shall not supersede, terminate, modify or supplement in any manner any other Guaranty previously executed and delivered to the Bank by a Guarantor and no release or termination of any Guaranty shall be construed to terminate or release any other Guaranty unless such Guaranty is specifically referred to in any such termination.

(h)

If, for the purposes of obtaining or enforcing judgment in any court in any jurisdiction, it becomes necessary to convert into the currency of the jurisdiction giving such judgment (the Judgment Currency) an amount due hereunder in any other currency (the Original Currency), then the date on which the rate of exchange for conversion is selected by the court is referred to herein as the Conversion Date . If there is a change in the rate of exchange between the Judgment Currency and the Original Currency between the Conversion Date and the actual receipt by the Bank of the amount due hereunder or under such judgment, the Guarantor shall, notwithstanding such judgment, pay all such additional amounts as may be necessary to ensure that the amount received by the Bank in the Judgment Currency, when converted at the rate of exchange prevailing on the date of receipt, will produce the amount due in the Original Currency. Guarantor's liability hereunder constitutes a separate and independent liability which shall not merge with any judgment or any partial payment or enforcement of payment of sums due under this Guaranty. The term "rate of exchange", as used herein, includes any premiums or costs payable in connection with the currency conversion then being effected.

(i)

All payments to be made hereunder by the Guarantor shall be made free and clear of, and without deduction or withholding for or on account of, any present or future tax, levy, impost, duty, charge, assessment or fee (including interest, penalties and additions thereto) (herein Taxes), but excluding net income taxes and taxes on capital. If any Taxes are required to be withheld from any payment hereunder, the Guarantor shall: (a) increase the amount of such payment so that the Bank will receive a net amount (after deduction and withholding of all Taxes) equal to the amount otherwise due hereunder; (b) pay such Taxes to the appropriate taxing authority for the account of the relevant Bank and (c) as promptly as possible thereafter, send the Bank an original receipt showing payment thereof, together with such additional documentary evidence as the Bank may from time to time reasonably require. The Bank shall use reasonable measures to avoid or to minimize any amounts which might otherwise be payable pursuant to this section, but the Bank shall not be required to disclose any information about its taxes to the Guarantor that is not publicly available. If the Guarantor fails to perform its obligations under this Section, the Guarantor shall indemnify the Bank for any incremental Taxes, interest or penalties that may become payable by the Bank as a consequence of such failure. The obligations of the Guarantor under this Section shall survive the termination of this Guaranty.

(j)

The Guarantor acknowledges that it has required that this agreement and all related documents be drawn up in English. La caution reconnaît avoir exigé que la présente convention et tous les documents connexes soient rédigés en anglais.

IN WITNESS WHEREOF, the undersigned has executed and delivered this Guaranty as of the day and year first above written.

GRAND TOYS LTD.

By:_________________________________

Name:

Title:

WITNESS:_____________________________

For value received, International Playthings, Inc. hereby endorses and assigns to Citibank, F.S.B., all of its right, title and interest to the Intercompany Demand Promissory Note made by Grand Toys Ltd., dated October 25, 2005, payable to International Playthings, Inc.

INTERNATIONAL PLAYTHINGS, INC.

By:___________________________

Name:

Title:

GRAND TOYS INTERNATIONAL LIMITED

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, 2005

GRAND TOYS INTERNATIONAL LIMITED.

By: /s/ Henry Hai Lin Hu
Henry Hai Lin Hu
Chief Executive Officer and Chairman of the Board