GRAND TOYS INTERNATIONAL LTD
Form 20-F
November 15, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2005.

OR

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

OR

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

Date of event requiring this shell company report ....

For the transition period from

-

to

Commission File Number: **333-114220**

GRAND TOYS INTERNATIONAL LIMITED

(Translation of registrant s name into English)

HONG KONG

(Jurisdiction of incorporation or organization)

Room UG202, Floor UG2, Chinachem Golden Plaza, 77 Mody Road, Tsimshatsui East, Kowloon,

Hong Kong

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

None

NASDAQ

Securities registered or to be registered pursuant to Section 12(g) of the Act:

American Depositary Shares (as evidenced by American Depositary Receipts), Each representing one Ordinary Share

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

1

= "

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report. _____

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes

No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes

No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule l2b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

Table of Contents

to Annual Report on Form 20-F

Fiscal year ended December 31, 2005

= "

INTRODUCTION AND USE OF CERTAIN TERMS

Unless otherwise indicated, throughout this report

.

all references to the Company , we , our and Grand refer to Grand Toys International Limited and its subsidiaries;

.

Grand Toys International, Inc., a wholly-owned subsidiary of the Company is referred to as Grand US and, where the context requires, includes its subsidiaries;

.

Playwell International Limited, a wholly-owned subsidiary of the Company, is referred to as Playwell and, where the context requires, includes its subsidiaries;

.

Hua Yang Holdings Company Limited, a wholly-owned subsidiary of the Company, is referred to as Hua Yang and, where the context requires, includes its subsidiaries, Hua Yang Printing Holdings Company Limited, Dongguan Hua Yang Printing Products Company Ltd., , , Hua Yang (UK) Printing and Hua Yang USA Inc.;

.

Kord Holdings Inc., a wholly-owned subsidiary of the Company, is referred to as Kord and, where the context requires, includes its subsidiaries, Kord Printing Company Limited, Kord Gifts Manufactory Limited, Kord Plastic Manufactory Company Limited, Kord Party Favour Manufactory Limited and Kord s variable-interest entities, Kord (Qing Xin) Packing Products Limited, Dongguan Kord Packing Products Limited, Qing Xin Kord Gifts Manufactory Company Limited, Sun Tat Toys Factory and Sun Tat Plastic Factory;

.

International Playthings, Inc., a wholly-owned subsidiary of Grand US, is referred to as International Playthings or IPI;

.

Centralink Investments Limited, the owner of approximately 83.77% of the Company s American Depositary Shares, or ADSs and 2,000,000 Series A Preference Shares, is referred to as Centralink;

.

Cornerstone Beststep International Limited, the owner of 10,840,598 Series B Preference Shares, is referred to as Cornerstone Beststep;

.

Cornerstone Overseas Investments Limited, the owner of 100% of the outstanding shares of Centralink and Cornerstone Beststep, is referred to as Cornerstone;

.

ADSs refer to the Company s American depositary shares representing beneficial ownership of the Company s ordinary shares and evidenced by American depositary receipts, or ADRs;

.

Hong Kong refers to the Hong Kong Special Administrative Region of the People s Republic of China;

.

China and Mainland China refers to the People s Republic of China;

.

U.K. refers to United Kingdom;

.

References to U.S. dollars , U.S. $ and $ are to the lawful currency of the United States of America;

.

Series A Preference Shares refer to the Company s Series A Convertible Preference Shares;

.

Series B Preference Shares refer to the Company s Series B Convertible Preference Shares; and

.

Preference Shares refer to the Company s Series A Preference Shares and Series B Preference Shares.

3

= "

FORWARD-LOOKING STATEMENTS

Our disclosure and analysis in this report contain some forward-looking statements. Forward-looking statements give our current beliefs or expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Such statements may include words such as anticipate, estimate, expect, inten plan, believe and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. In particular, these statements include, among other things, statements relating to:

.

our business strategy;

.

the development of our products; and

.

our liquidity.

Such statements involve a number of known and unknown risks and uncertainties that could cause our future results, performance or achievements to differ significantly from the results, performance or achievements express or implied by such forward-looking statements. Important factors that could cause or contribute to such differences include our ability to successfully develop and commercialize additional products, the introduction of competing products, the impact of competition from customers that sell their own brand products under private-label brands, our inability to successfully identify, consummate and integrate acquisitions, our potential exposure to product liability claims, the fact that we have operations outside the United States that may be adversely affected by terrorism or major hostilities, fluctuations in currency, exchange and interest rates, operating results and other factors that are discussed in this report and in our other filings made with the SEC.

We undertake no obligation to publicly update any forward-looking statements or other information contained in this report, whether as a result of new information, future events or otherwise. You are advised, however, to consult any additional disclosures we make in our 6-K reports periodically filed with the SEC. Also note that we provide a cautionary discussion of risks and uncertainties under Risk Factors beginning on page 10 of this report. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed here could also adversely affect us. This discussion is permitted by the Private Securities Litigation

Reform Act of 1995.

PART I

Item 3. Key Information

Selected Financial Data

The following selected financial data of the Company for each of the years in the three-year period ended December 31, 2005 and at December 31, 2005, 2004 and 2003 are derived from the Company s audited annual consolidated financial statements set forth elsewhere herein, which have been prepared in accordance with US GAAP.

The Company acquired the shares of Hua Yang and Kord on December 23, 2005 from a related company, Cornerstone Beststep, which was under the control of the Company s majority shareholder, Jeff Hsieh Cheng. As a result of these acquisitions involving companies under common control, the Company s financial statements for the year ended December 31, 2004 have been restated by including the results of Hua Yang and Kord as if they had been part of the Company since the original date that they were acquired by Cornerstone, Cornerstone Beststep s parent company.

Selected data for 2001 was omitted since the financial statements were prepared in accordance with Hong Kong GAAP. To convert these statements to US GAAP, the Company would incur additional expense and require unreasonable effort and therefore these periods are not being presented herein.

The selected financial data should be read in conjunction with the financial statements, related notes and other financial information included in this report and the section titled Operating and Financial Review and Prospects beginning on page 36 of this report.

For the Twelve Months Ended December 31 (1):

(The amounts in the table below are expressed in thousands)

Statement of Operations Data		**2005**		**2004**		**2003**		**2002**
				(as restated)				
Net sales	$	131,330	$	75,533	$	39,375	$	35,991
Gross profit		31,823		15,074		5,836		7,402

Earnings (loss) from continuing operations		(16,969)	(59)	3,022	2,737
Earnings from discontinued operations		-	-	1,239	22,128
Dividends		(14,358)	-	-	-
Net earnings applicable to common stockholders	$	(31,326)	$ (59)	$ 4,261	$ 24,865
Earnings (loss) per share:					
Continuing operations					
Basic		(1.94)	(0.00)	0.30	0.27
Diluted		(1.94)	(0.00)	N/A	N/A
Discontinued operations					
Basic		-	-	0.13	2.21
Diluted		-	-	N/A	N/A
Net earnings					
Basic		(1.94)	(0.00)	0.43	2.48
Diluted		(1.94)	(0.00)	N/A	N/A
Weighted average number of common equivalent shares					
Basic		16,138	12,093	10,000	10,000
Diluted		18,191	12,807	10,000	10,000

Balance Sheet Data		**2005**	**2004**	**2003**	**2002**
Working capital	$	4,751	$ 9,011	$ 3,755	$ (2,111)
Long term debt		5,111	789	-	-
Number of shares:					
Common stock		16,310	15,587	10,000	10,000
Preferred stock		12,841	-	-	-
Cash dividends Common Shares		-	-	-	-
Cash dividends Preferred Shares		-	-	-	-
Net assets		48,662	58,430	5,858	4,236
Total assets	$	118,628	$ 106,148	$ 11,788	$ 34,460

(1)

Financial results presented based on U.S. GAAP.

N/A means not applicable.

Exchange Rate Information:

On November 14, 2006, the exchange rate of HK$ per US$ was $7.7842.

The following table sets out the average exchange rate for each year indicated calculated by using the average of the exchange rates on the last day of each month for each of the years indicated

Year Ended December 31, (HK$ per US$1.00)	**Average Exchange Rate**
2001	7.7997
2002	7.7997
2003	7.7875
2004	7.7905
2005	7.7533

The following table sets forth the high and low exchange rates and average calculated by using the average of the exchange rates on the last day of each month for each of the months indicated

Month ended, 2006	**High**	**Low**	**Average Exchange Rate**
January	7.7571	7.7506	7.7537
February	7.7618	7.7564	7.7593
March	7.7620	7.7570	7.7591
April	7.7598	7.7529	7.7561
May	7.7575	7.7510	7.7538
June	7.7684	7.7578	7.7636
July	7.7790	7.7648	7.7731
August	7.7799	7.7684	7.7767
September	7.7925	7.7759	7.7823
October	7.7928	7.7746	7.7849
November thru to the 14^{th}	7.7848	7.7762	7.7814

4

= "

Risk Factors

The Company s business faces significant risks. Investors should carefully consider all of the information set forth in this Form 20-F and in the Company s other filings with the SEC, including the following risk factors which the Company faces and which are faced by the toy, toy-related and packaging industries. The Company s business, financial condition or results of operations could be materially adversely affected by any of these risks. This Form 20-F 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 many factors including those risks described below and elsewhere in this Form 20-F.

The Company is controlled by a single investor and this control could adversely affect actions that may be beneficial to the Company s other shareholders

Mr. Jeff Hsieh Cheng, the Company s chief executive officer, through entities owned by him holds approximately 85.47% of the Company s outstanding ADSs on a fully diluted basis assuming conversion of all the Company s outstanding Preference Shares, all of which are beneficially owned by Mr. Hsieh through Centralink and Cornerstone Beststep, and the exercise of all of the Company s outstanding options and warrants. Accordingly, Mr. Hsieh has the ability to control the Company and its affairs, including the outcome of all matters requiring shareholder approval such as the election and removal of the Company s entire board of directors, and any merger, consolidation or sale of all or substantially all of the Company s assets. This concentrated control gives Mr. Hsieh the right to decide whether the Company should proceed with any action, even if those actions might be beneficial to all shareholders. It also could discourage others from initiating any potential merger, takeover or other change of control transaction. As a result, the market price of the Company s ADSs could be adversely affected.

If Mr. Hsieh s ownership percentage reaches 90%, the minority shareholders of the Company may be forced to sell their shares

Under Hong Kong law, Mr. Hsieh could, through a company, make a general offer to acquire all outstanding ordinary shares (represented by the Company s ADSs) not already beneficially owned by him through Centralink. If such company acquires not less than 90% of the ordinary shares in respect of which the offer is made, it may require the owners of the remaining ordinary shares to transfer such shares to it. In such circumstances, Mr. Hsieh could effectively force minority shareholders of the Company to sell their ADSs. With the Company s ADS price currently below $1.00, and assuming the outstanding options and warrants that are below the current price are not exercised, Mr. Hsieh would have approximately 90% of the outstanding ADSs if he converts all of the Preference Shares owned by him. Mr. Hsieh has mentioned to several members of the Board that he may be interested in acquiring all the

ADSs that he doesn t currently own. Although the Company has not been presented with any documentation stating his intention to buy out the Company s minority interests, should Mr. Hsieh initiate or support such an effort in the future, minority shareholders may be forced to sell their ADSs in the circumstances described above.

The Company may not be able to obtain sufficient funding for its working capital needs

The Company maintains working capital facilities for its operations. All of the Company s loan facilities are uncommitted and the lenders have the right to withhold extending credit in their sole discretion. In addition, these facilities have certain financial covenants that must be maintained. As of December 31, 2005, IPI was not in compliance with certain covenants and received a temporary waiver of these compliance requirements until May 15, 2006. As of May 15, 2006, IPI was still not in compliance and the lender agreed to extend the facility until November, 2006 while IPI negotiates with the lender for a renewal of the facility. IPI is also exploring alternative financing sources. If IPI s facility is not renewed or a substitute facility secured, IPI s operations may be significantly hindered. The failure to regain and maintain compliance in the future could result in the lenders curtailing credit to IPI.

One of the lending institutions used by Hua Yang ceased extending credit to Hua Yang in December 2005, but agreed to allow Hua Yang to gradually pay down outstanding balance by October 2006. Hua Yang is in the process of securing alternative banking facilities to satisfy its working capital needs. However; the failure to do so could significantly hinder Hua Yang s operations.

The Company generally funds its corporate overhead from cash flow from its subsidiaries operations. However, new credit facilities being negotiated by the Company for its subsidiaries may contain restrictions on transferring funds from these subsidiaries to the Company. If this occurs, it may be difficult for the Company to satisfy its corporate overhead or other cash requirements or to use funds from one subsidiary to meet temporary working capital needs of another subsidiary of the Company.

The Company s Asian credit facilities are dependent in part on guarantees extended by Mr. Hsieh

The Company s Asian credit facilities are guaranteed by Mr. Hsieh. A change in Mr. Hsieh s financial condition or his refusal to extend further guarantees could result in the Asian lenders refusal to extend credit to the Company s Asian subsidiaries or demanding immediate repayment of outstanding credit balances. Any change in the Company s ability to borrow could result in the Company being forced to curtail or delay its business activities.

The Company is undergoing a restructuring to eliminate unprofitable operating divisions and focus on profitable divisions which, in the immediate future, will result in significant restructuring costs and impact the Company s cash flow, profitability and earnings per ADS.

After the acquisition of Hua Yang and Kord in December 2005, the Company considered restructuring the operating divisions to focus on the profitable divisions. Subsequently, in June 2006, the Company terminated the operations of Playwell s Gatelink subsidiary. Playwell s Gatelink subsidiary manufactured moulds for products developed by Playwell and on an OEM basis for third parties. Historically, a significant portion of Gatelink s operations involved making moulds for Marvel product lines licensed by Toy Biz Worldwide Ltd., a company controlled by Mr. Hsieh. Toy Biz no longer has the rights to develop and distribute the Marvel line of products which eliminated Gatelink s primary source of revenue. In order to develop new business required to operate Gatelink profitably, the Company would have had to invest significant capital in new tooling equipment for Gatelink. Management concluded that such an investment is not in the best interests of the Company as future profitability was uncertain and even if profits were generated from future operations, they might not be sufficient to offset the investment costs. The termination of Gatelink s operations will result in approximately $100,000 of charges for fiscal 2006.

In July 2006, the Company decided not to renew an existing license agreement with Binney & Smith for the Crayola dough product line beyond December 2006. The Crayola dough line was a key element of the Company s plan to enter the US mass market for toys. The product line has been unprofitable, and the Company could not foresee this changing in the near future. The Company is also discontinuing certain other product lines targeted towards the US mass market and, in the future, the Company may de-emphasize its efforts to enter the US mass market for toys. The termination of the Binney & Smith license as well as the other product lines has resulted in charges of approximately $10.5 million as a result of the write-off of goodwill and approximately $2.0 million as a result of early amortization of intangibles relating to the Binney & Smith license in 2005 and the Company estimates that this will result in additional charges in 2006.

In October 2006, the Company decided not to continue distributing toy and toy-related products to the mass market in Canada and cease the operations of its Canadian subsidiary, Grand Toys Ltd. (Grand Canada), which conducted the Company s Canadian mass market sales efforts. For the year ended December 31, 2005, Grand Canada s sales were approximately $7.7 million and the operations resulted in a loss of $334,000. Management determined that future profitability of its Canadian mass market operations was uncertain. The Company expects that the costs to close this operation, which include employee severance costs, and amounts relating to the lease in Montreal, could be as high as $1.2 million in 2006 and 2007.

.

In October 2006, the Company began to consider terminating the operations of Playwell s Hong Kong Toy Centre Limited (HKTC) and Asian World Enterprises Co., Ltd. (Asian World) subsidiaries. HKTC designs, develops and distributes plastic and wooden toys in the infant, preschool and activity toy categories, using the Playwell brand and other third-party licensed brands. Asian World holds licenses to develop toy and toy-related products, most of which are further sublicensed to, and manufactured and sold by, HKTC. HKTC s market is highly competitive and it has not been able to successfully capitalize on its licensed properties. HKTC s revenues for the years ended December 31, 2004 and December 31, 2005 were $22.6 million and $12.1 million, respectively. HKTC s operating income (loss) for the years ended December 31, 2004 and December 31, 2005 were $1.8 million and ($2.7 million), respectively. The costs to close the operations of HKTC and Asian World, including satisfying minimum guarantee payments on certain license agreements and employee severance costs, may be recorded in fiscal 2006.

Although management expects that the termination of these operations should enhance the Company s profitability in the long run, there can be no assurance that the Company will be able to sustain the long term profitability of its remaining operations.

The market price of the Company s ADSs is below $1.00 per ADS and, as a result, may be subject to future delisting from the Nasdaq SmallCap Market

The Company s ADSs are listed on the Nasdaq SmallCap Market. Nasdaq marketplace rules for continued listing require the Company to maintain a minimum bid price of not less than $1.00 per share. In the event that the Company fails to maintain the required minimum bid price for a period of 30 consecutive trading days and then maintain a minimum bid price above $1.00 for 10 consecutive days within the next 180 calendar days, the Company will be subject to delisting from the Nasdaq SmallCap Market unless it regains compliance or provide a plan to regain compliance before the delisting date. Further, even if the Company successfully adopts a plan to regain compliance, it will likely require a recapitalization of the Company s ADSs in the form of a reverse stock split. Companies which undergo such a recapitalization in the form of a reverse split have, in the past, suffered further erosion in its market price even though a reverse stock split does not change the percentage of outstanding ADSs. Accordingly, either the delisting of the Company s ADSs or the recapitalization of the Company s ADSs may have a material adverse impact on the value and liquidity of the Company s ADSs.

The Company s relationships and transactions with entities affiliated with Mr. Hsieh create various perceived, potential or actual conflicts of interest which could adversely affect the Company s business or the market price or liquidity of the Company s ADSs

The Company not only engages in business in the ordinary course with companies that are affiliated with Mr. Hsieh but, as in the case of the acquisitions of Kord and Hua Yang, has engaged in material transactions with businesses owned by Mr. Hsieh. As a result, situations have in the past and may in the future arise where Mr. Hsieh would have the right to vote on transactions with affiliated companies that could benefit Mr. Hsieh and negatively impact the Company, or vice versa. Although the board of directors of the Company works to ensure that all transactions between the Company and entities controlled by Mr. Hsieh are done on an arms-length basis to ensure that they are fair to and in the best interests of the shareholders of the Company, any perceived or actual conflict of interest in the Company s management and/or the companies affiliated with Mr. Hsieh may discourage investors from investing in the Company s ADSs, which may negatively impact the stock price or liquidity of the Company s ADSs.

Entities affiliated with Mr. Hsieh have existing obligations to the Company which are past due and this has had an adverse impact on the Companies cash flow.

The Company engages in material transactions in the ordinary course with businesses owned and controlled by Mr. Hsieh. As of October 1, 2006, entities affiliated with Mr. Hsieh owed the Company approximately $1.0 million, most of which was outstanding for more than 90 days. Although Mr. Hsieh has agreed to pay these amounts by the end of

2006, in accordance with an agreed upon schedule, the delay to date has negatively impacted the Company s cash flow.

Centralink and Cornerstone Beststep own 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 Series A Preference Shares and in December 2005, the Company issued to Cornerstone Beststep 10,840,598 Series B Preference Shares. The provisions of the Preference Shares contain provisions protective to Centralink and Cornerstone Beststep, including liquidation preferences and, in the case of the Series A Preference Shares, 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 s acquisition strategy has resulted in the Company incurring significant acquisition costs and increased overhead costs that have had and will continue to have an impact on the Company s operating results

The Company began a strategy of growth through acquisition in August 2004 when it completed its reorganization merger between Playwell and Grand Toys International, Inc. Since the Company began its acquisition strategy, it has incurred direct transactional acquisition costs of approximately $7,747,000, including the costs associated with the reorganization merger and Playwell acquisition in 2004. The Company s ADS holders have incurred dilution as a result of the issuance of the Preference Shares that were issued in connection with the Company s acquisitions of IPI, Kord and Hua Yang, and will continue to incur further dilution as dividends on the Preference Shares are paid in additional ordinary shares. The Company s acquisition strategy has also required the Company to maintain certain levels of overhead required to follow its acquisition strategy and to maintain the operations of the Company. For the year ended December 31, 2005 and the first nine months of 2006, these transaction expenditures, some of which have not been capitalized, and related overhead has negatively impacted the Company s results and will continue to do so in the near future. If the long-term benefits of these acquisitions do not exceed the short-term costs associated with the acquisitions and the associated overhead, the Company s financial results, including earnings per share, could continue to be negatively impacted.

Since the Company has pursued an acquisition growth strategy, 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 has pursued an acquisition strategy to expand its business and product offerings. Beginning with the Company s acquisition of Playwell following the Company s reorganization merger in August 2004, the Company has made four acquisitions in the past two years, including the Company s acquisitions of Hua Yang and Kord in December 2005. The Company is not actively seeking any additional future acquisitions; however, if an opportunity arises, future acquisitions may be pursued.

Future acquisitions involve known and unknown risks that could adversely affect our future revenues and operating results. For example:

.

The Company may fail to successfully integrate its acquisitions in accordance with our business strategy;

.

The Company competes with others to acquire companies. This may result in decreased availability or increased prices for suitable acquisition candidates;

.

The Company may ultimately fail to consummate an acquisition but will still have to pay the costs associated with the potential acquisition;

.

Potential acquisitions may divert management s attention away from the Company s primary product offerings, resulting in the loss of key customers and/or personnel and expose the Company to unanticipated liabilities;

.

The Company may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses which the Company may acquire and, if the Company cannot retain such personnel, the Company may not be able to locate or hire new skilled employees and experienced management to replace them; and

.

The Company may not realize economies of scale through the elimination of certain redundant administrative and overhead costs.

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 its fiscal year. 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 like the Company to fill orders promptly, thereby shifting 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 increases 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 portion of the year preceding 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 operating results may be highly volatile which could have a material adverse impact on the Company s results of operations

The toy and toy related industries in which the Company operates 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 has recently diversified into specialty toy distribution, packaging and party good categories to reduce volatility, there can be no guarantee that this history of volatility will not continue.

The Company is dependent upon key personnel whose loss may adversely impact the Company's business

The Company relies on the expertise, experience and continued services of its senior management employees, including Jeff Hsieh, who is the chief executive officer and a director of the Company, Elliot L. Bier, who is chairman and deputy chief executive officer and a director of the Company, David J. Fremed, who is the chief financial officer and a director of the Company, Roger Bildsten, who is President of Grand US, Kevin Murphy who is General Manager of Hua Yang, Li Sang Tung, who is General Manager of Kord. 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 or its subsidiaries will be made or significantly influenced by them. The Company is not the beneficiary of any "key man" insurance on the life of any of these persons. The loss of some of these senior management employees without a suitable replacement, 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 and stock option 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.

Certain members of the Company s management team do not perform duties exclusively for the Company and, as a result, their attention may be diverted from the Company s business

Although certain members of the Company s management team are engaged by the Company under written employment or consulting agreements, including Elliot L. Bier, who is a director, chairman and deputy chief executive officer, the terms of these employment or consulting agreements permit them to perform services for the Company on a non-exclusive basis. Mr. Hsieh does not have a written agreement with the Company and devotes a significant portion of his time to Cornerstone, its subsidiaries and other companies. 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 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 Company is constantly seeking additional licenses and distribution agreements. 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. As is customary in the toy business, some of these projected expectations have not materialized and the Company pays unearned fees as a result. In addition, when licenses do not meet expectations, the Company has to write-off all or part of the value of the licenses resulting in a charge against its net income. Unrecouped license fees or minimum guarantees have recently become a more significant problem as the Company wrote-off approximately $465,000 in 2005 and will be required to write-off certain amounts in 2006 from its licenses for products targeted for the US mass market which the Company has determined to de-emphasize.

License and royalty agreements are also mostly for fixed terms and often contain performance-related covenants. There is no assurance that the Company will be able to maintain or extend the rights 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.

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 products it manufactures and sells. Consumer preferences in the toy and toy-related industries are highly subjective, and there can be no assurance that consumers will continue to find existing or new products of the Company appealing. As a result of changing consumer preferences, many 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.

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 discounts which may be substantial or provide inventory provisions to mark the value of excess inventory quantities down to their estimated market value.

Introduction of new products by third parties whose products the Company distributes and manufactures, and market acceptance of these products, will have a significant impact on the success of the Company s business

A significant portion of the Company s business involves the distribution of toy, toy-related product and packaging for product developed by third parties and the contract manufacture of other companies products. The Company s long-term operating results therefore depend, in part, on the ability of third parties to continue to conceive, design and market new products and upon continuing market acceptance of these third parties existing and future products. In the ordinary course of their businesses, these third parties continuously develop new products and create additions to their existing product lines. Significant delays in the introduction of, or their failure to introduce or market, new products or additions to their respective product lines would impair the Company s results of operations.

Some of the Company s products have limited life cycles and may be discontinued by a third party at any time. Accordingly, there can be no assurance that existing or future products of our customers will continue to receive substantial market acceptance.

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

The Company designs and develops its own proprietary products as well as products for third parties. Once a new product is conceived, the principal steps to introduce 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.

Due to the highly competitive nature of the Company s operations, the Company may have difficulty retaining or increasing market share in the segments of the toy and toy-related industries in which the Company operates

IPI operates primarily in the specialty retail distribution market by distributing both proprietary toys and licensed toys in the North American market, focusing on toys for infants to teenagers. There is no assurance that IPI can continue to maintain the same level of sales and shelf space for the specialty retail market, as the barriers for other distributors to enter the specialty retail toy market are relatively low.

Hua Yang faces significant competition in its business segments. In "pop up" books, Hua Yang competes with contract manufacturers located in Southeast Asia and South America. In novelty and board books as well as specialty packaging, Hua Yang competes with contract manufacturers located in Hong Kong and other parts of the PRC. In addition, Hua Yang competes with customers that have the capability to manufacture their products internally.

The Company does not believe that there are any significant barriers to entry into the light manufacturing business in which Hua Yang and Kord operate. Although Hua Yang and Kord seek patent, trademark, trade name or copyright protection for some of their products, neither Hua Yang nor Kord characterizes its business as proprietary. Accordingly, additional participants may enter the market at any time.

Kord s principal factory lease expires in 2007 and the failure to renew this lease would have a material impact on its operations

Kord leases its principal manufacturing facilities and these leases expire in the second half of 2007. If Kord is unable to renew the leases, it would be forced to relocate and improvements made by Kord would revert to the owner of the facilities. No assurance can be given as to the ability of Kord to renew its leases of existing facilities on acceptable terms, and the inability to do so would result in Kord incurring significant expenditures for relocation and improvements to new facilities. This relocation and additional costs could have a material adverse effect on the Company s business, financial condition and results of operations.

The operation of the Hua Yang Facility is dependent on third parties not under our control

Hua Yang s principal manufacturing facility is owned and operated by a co-operative joint venture in which Hua Yang has a majority interest. The other party to this contractual joint venture is an entity that is controlled by PRC governmental authorities. The efficient and cost-effective operation of the Hua Yang facility depends upon the cooperation and support of PRC authorities and the joint venture partner. Should a dispute develop between Hua Yang and its joint venture partner, there can be no assurance that Hua Yang would be able to enforce its understanding of its agreements or interests with its joint venture partner, which could result in a significant loss of, or depreciation in the value of, the Hua Yang facility. Hua Yang s investment in the Hua Yang facility is significant and it could not be replaced without considerable new investment, if at all. The lack of cooperation by Hua Yang s joint venture partner could subject Hua Yang to additional risks and costs, including the interruption or cessation of its present operations in the PRC, all of which would have a material adverse effect on Hua Yang s business, financial condition and results of operations.

Hua Yang and Kord s operations depend on access to raw materials which must be available in significant quantities and reasonable prices in order for their operations to be conducted profitably

Hua Yang and Kord use various plastic resins, paper, ink and glue in their manufacturing operations. Hua Yang s and Kord s financial performance is dependent, to a substantial extent, on the cost of such raw materials. The supply and demand for both plastic resins and the petrochemical intermediates from which plastic resins are produced are subject to cyclical and other market factors and may fluctuate significantly. As a result, the cost of raw materials to Hua Yang and Kord is subject to substantial increases and decreases over which Hua Yang and Kord have no control except by seeking to time their purchases in order to take advantage of favorable market conditions. In the past , Hua Yang and Kord have experienced significant increases in the price of certain raw materials, which resulted in an increase in Hua Yang s and Kord s production costs that Hua Yang and Kord were not able to pass on fully to their respective customers. To the extent that future increases in the cost of raw materials cannot be passed on to customers, such increases could have a material adverse effect on Hua Yang s and Kord s results of operations and financial condition.

Hua Yang and Kord purchase their raw materials from a limited number of suppliers. Hua Yang and Kord have no formal written agreements with any of their suppliers. No assurance can be given that Hua Yang and Kord will be able to obtain sufficient quantities of such raw materials to meet their needs. Any lack of sufficient raw materials for their needs would have a material adverse effect on Hua Yang s and Kord s business, financial condition and results of operations.

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 its 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 it manufactures and distributes. Since some of the Company s products are manufactured for infants and pre-school children, safety has been a major concern in the products that the Company designs, develops and manufactures. 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. A successful claim brought against the Company by a customer which is not covered by insurance or 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 is subject to many U.S. regulations when exporting toy products into the U.S. that could result in the exclusion of some of its products from U.S. markets

The Company and its U.S. distribution customers are subject to the provisions of the U.S. Federal Hazardous Substances Act and the U.S. Federal Consumer Product Safety Act when importing or producing toys to be sold in the U.S. These laws empower the U.S. 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 shares of microcap stocks like the Company, as well as the market price of stocks of toy and toy-related companies, are often volatile and the historical stock price of the Company and its predecessor Grand US, 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:

.

fluctuations in the Company's financial results;

.

the actions of the Company's customers and competitors;

.

new regulations affecting foreign manufacturing;

.

other factors affecting the toy industry in general;

.

announcements of new products by the Company or its competitors;

.

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

.

news reports relating to trends in its markets;

.

sales of the Company s ADSs into the public market; and

.

volume of trading of the Company ADSs on NASDAQ.

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. 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 2,898,977 of the Company s ADSs outstanding, and the Company intends to file a Form S-8 registration statement covering the ordinary shares underlying the ADSs issuable upon exercise of the options shortly after the filing of this report which would permit the immediate sale of all vested options. In addition, the Preference Shares are convertible into 31,951,606 ADSs and the Company intends to issue additional ordinary shares, being represented by ADSs, to satisfy the Company s obligation to pay dividends on the Preference Shares. Centralink and Cornerstone Beststep, subsidiaries of Cornerstone and the holders of the Preference Shares, have the right to demand registration of the ordinary shares underlying these ADSs. If and when these options and warrants are exercised or the Preference Shares are converted and registered, there might be 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 cash dividends on its stock

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

It may be difficult to enforce civil liabilities against the Company

Grand Toys International Limited 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 residents 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 effect 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 will depend on relevant Hong Kong laws.

Risks Related to Doing Business in China

The Company is organized and based in Hong Kong, which is part of the PRC, and a significant portion of the Company s operations and assets are located in the PRC. The following addresses some of the risks associated with doing business in China.

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 China. The Chinese legal system is a civil law system based on written statutes in which decided legal cases have little value as precedents.. Certain areas of the Chinese legal system, such as aspects of business law, are less developed than in common law jurisdictions like the U.S. As a result, the administration of laws and regulations by government agencies may be subject to considerable discretion and vary from locality to locality. .

In particular, the Chinese legal system relating to foreign investments is relatively new and continually evolving, and there cannot always be certainty as to the application of specific laws and regulations in particular instances., Statements regarding evolving policies on foreign investment have occasionally 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, 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, when compared with their counterparts in other jurisdictions, 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. There can be no assurance that the Company's current or future activities in China will have a high degree of security 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 such 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 expenses 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 the PRC, Euros and U.S. 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.

5

= "

Item 4. Information on the Company

Description of Business

Overview

Grand Toys International Limited, a Nasdaq SmallCap listed company, is organized under the laws of Hong Kong. The Company, through its Hong Kong, US and Canadian operating subsidiaries, develops, manufactures and distributes toy and toy-related products throughout the world; prints and assembles books and specialty packaging; and develops and manufactures party goods. The Company operates through four main subsidiaries: Hua Yang, Kord, Playwell and Grand US. The Company was formerly a subsidiary of Grand US. It became the parent of Grand US on August 16, 2004, pursuant to a reorganization merger. Immediately after the reorganization merger, the Company acquired Playwell.

On March 1, 2005, Grand US acquired International Playthings, Inc., a New Jersey-based US toy distributor.

On December 23, 2005, the Company purchased the shares of Hua Yang and Kord, which were owned by Cornerstone Beststep, a subsidiary of Cornerstone.

The Company was incorporated in Hong Kong on October 15, 2003, although it did not commence actual operations until the completion of the reorganization merger of Grand US and the Playwell acquisition on August 16, 2004. Its executive offices are located at 77 Mody Road, Tsimshatsui East, Kowloon, Hong Kong, telephone number 852.2866.8323.

Grand Toys International Limited is the holding company of a group of operating subsidiaries, which includes manufacturing and distribution segments:

Manufacturing:

.

Hua Yang and subsidiaries - Printing & Packaging

.

Kord - Party Goods

.

Gatelink Mould manufacturing

Distribution:

.

Grand US and subsidiaries - North America toy distribution

.

Playwell and subsidiaries - Worldwide toy distribution

The Company s overall strategy is to:

.

Sustain and maintain current profitable business segments;

.

Grow through the development, distribution and sale to global retail markets of innovative products at competitive prices; and

.

Grow through the acquisition of complementary companies that fit into the Company s vertically-integrated structure.

Operating Subsidiaries

Playwell

Playwell is a Hong Kong limited company formed in 2000 which, through its subsidiaries and predecessor has been active in the toy business for over 30 years. As of December 31, 2005, Playwell was a holding company with four operating subsidiaries:

.

Hong Kong Toy Centre Ltd., or HKTC, which, since 1969, develops products for sale under the Playwell brand and supervises the outsourced manufacture in the PRC of Playwell branded products and products designed by customers of HKTC for sale under their own brands;

.

Gatelink Mould Engineering Limited, which manufactures moulds for Playwell and third parties ;

.

Great Wall Alliance Ltd., which holds Playwell trademarks; and

.

Asian World Enterprises, Co., Ltd., which holds intellectual property licenses from The Walt Disney Company and other third parties.

Grand US

Grand US is a Nevada corporation which, through its subsidiaries, has been engaged in the toy business for over 45 years. The March 1, 2005 acquisition by Grand US of International Playthings, Inc. substantially increased Grand US distribution capabilities to the toy retailers throughout North America. Prior to that acquisition, Grand US focus was mainly distribution of toys throughout Canada through its Canadian subsidiary, Grand Toys Ltd. Expansion efforts have been focused on expanding product offerings through the development of proprietary products and expanding geographically outside of Canada. Grand US has, for many years distributed products for Toy Biz Inc. and Toy Biz Worldwide, an entity controlled by Mr. Hsieh, including the Marvel line of products, the largest source of Grand US' revenues prior to 2004. Toy Biz s arrangement to distribute the marvel line of products in Canada will terminate in 2006.

Grand US' and its subsidiaries business consists of five areas of operation:

.

distribution of proprietary and licensed toys to the mass and specialty retail market in North America;

.

importing and distributing throughout North America, on an exclusive and non-exclusive basis, a wide variety of well-known toy and leisure products and ancillary items, including party goods, stationary and accessories;

.

selling toy products and ancillary items featuring popular characters and brands licensed to Grand US and its subsidiaries;

.

earning commissions on the sale of products represented by Grand US and its subsidiaries and shipped directly from an overseas vendor to North American customers; and

.

developing proprietary products, such as arts and crafts, puzzles, mobiles, and gift-related items for sale.

Hua Yang

Hua Yang is a Cayman Islands company which, through its operating subsidiaries and predecessors in Hong Kong and China, has engaged since 1935 in specialty printing for children s books and games, and produces toy and gift marketing-related specialty printing and packaging. Hua Yang has an established track record in the printing and packaging business and is recognized as a high-quality industry leader in southern China. Its two operating segments can be broken into sub-segments, as follows:

Books and Board Games:

.

Design and production of a range of paper-based novelty items such as pop-up books, touch-and-feel books, and board books for major publishers in the U.K., U.S. and Europe; and

.

Production of jigsaw puzzles and board games primarily on an OEM basis (For example: Cranium™).

Packaging Products:

.

Design and production of high-end promotional parfumerie packaging, value-added gift packaging, fashion packaging, and confectionary packaging for luxury branded goods customers such as LVMH; and

.

Design and production of low-end packaging of toy products for the mass market (for example: Barbie™ and Leap Frog™).

In February 2005, Hua Yang acquired the business and assets of Eastern Raiser Printing Co Ltd, a former subcontractor of Hua Yang which specializes in printing and packaging of toys, action figures, games, recreational products and other toy-related products for third parties.

Kord Holdings Inc.

Kord Holdings, Inc. is a British Virgin Islands company which, through its Hong Kong operating subsidiaries, is one of the largest party good manufacturers in the world with over 3,000 employees and over 500,000 square feet of manufacturing space. Founded in 1972, Kord produces a broad range of party and paper goods and offers comprehensive lines of party products and accessories to major importers and superstores overseas, either under its own KORD brand (approximately 50% of sales) or on a OEM basis (approximately 50% of sales).

Kord has over 20,000 designs in key product groups including generic party products, decorative products, disposable products and latex masks. Generic, decorative, and disposable products account for more than 90% of total sales and include paper cups, paper plates, table covers, napkins, hats, horns, banners, invitations and decorations.

Kord is also a licensed manufacturer of party products related to certain Disney-branded characters. Kord works closely with importers, distributors, party superstores and international retail chains on ODM and OEM projects all over the world.

Recent Developments

The information on the Company contained in this Item 4 of the Company s Report on Form 20-F is based on the business of the Company through December 31, 2005. Since January 1, 2006, the Company announced a number of changes to its business plan which will significantly alter the Company s business and strategy for years beginning after December 31, 2005. The following information and the discussion set forth under the caption The Company is undergoing a restructuring to eliminate unprofitable operating divisions and focus on profitable divisions which, in the immediate future, will result in significant restructuring costs and impact the Company s profitability and earnings per ADS in the Risk Factors section of Item 1 should be carefully considered in understanding the discussion set forth in this Item 4:

In June 2006, the Company terminated the operations of Playwell s subsidiary, Gatelink. Gatelink manufactured moulds for products developed by Playwell and on an OEM basis for third parties. Historically, a significant portion of Gatelink s operations involved making moulds for Marvel product lines licensed by Toy Biz Worldwide Limited. For the year ended December 31, 2004 and 2005, Gatelink s operations generated income of $857,088 and $581,301, respectively. The lower net income resulted from a decrease in the number of Marvel products introduced in 2005. Toy Biz Worldwide Limited no longer has the rights to develop and distribute the Marvel line of products which eliminated Gatelink s primary source of revenue. In order to develop new business required to operate Gatelink profitably, the Company would have had to invest significant capital in new tooling equipment for Gatelink. Management concluded that such an investment is not in the best interests of the Company as future profitability was uncertain and even if profits were generated from future operations, they might not be sufficient to offset the investment costs. The termination of Gatelink s operations will result in approximately $100,000 of charges for fiscal 2006 and this will be funded with cash generated from operations.

In July 2006, the Company decided not to renew an existing license agreement with Binney & Smith for the Crayola dough product line beyond December 2006. The Crayola dough line was a key element of the Company s plan to enter the US mass market for toys. The product line has been unprofitable, and the Company could not foresee this changing in the near future. The Company is also discontinuing certain other product lines targeted towards the US mass market and, in the future, the Company may de-emphasize its efforts to enter the US mass market for toys. The termination of the Binney & Smith license as well as the other product lines has resulted in a write-off of goodwill of approximately $10.5 million and an acceleration of amortization of intangibles relating to the Binney & Smith license of approximately $2.0 million in 2005. The Company estimates that this discontinuance of business will result in additional charges in 2006; however these charges are not yet quantifiable as the Company continues to negotiate certain settlements on outstanding minimum royalty obligations for certain licenses for which we may not reach the minimum guarantees. The Company expects to be able to fund these settlements with cash generated from operations and the existing or future working capital facilities

In October 2006, the Company decided to discontinue distributing toy and toy-related products to the mass market in Canada and cease the operations of its Canadian subsidiary, Grand Toys Ltd. (Grand Canada), which conducted the Company s Canadian mass market sales efforts, at the end of 2006. For the year ended December 31, 2005, Grand Canada s sales were approximately $7.7 million and the operations resulted in a loss of $334,000. Management determined that future profitability of its Canadian mass market operations was uncertain. The Company expects that the costs to close this operation, which include employee severance costs, and amounts relating to the lease in

Montreal, could be as high as $1.2 million in 2006 and 2007. The Company expects that funds received from selling existing inventory and collecting all receivables will be sufficient to cover the closing costs indicated above.

In October 2006, the Company began to consider terminating the operations of HKTC and Asian World. HKTC designs, develops and distributes plastic and wooden toys in the infant, preschool and activity toy categories, using the Playwell brand and other third-party licensed brands. Asian World holds licenses to develop toy and toy-related products, most of which are further sublicensed to, and manufactured and sold by, HKTC. HKTC s market is highly competitive and has not been able to successfully capitalize on its licensed properties. HKTC s revenues for the years ended December 31, 2004 and December 31, 2005 were $22.6 million and $12.1 million, respectively. HKTC s operating income (loss) for the years ended December 31, 2004 and December 31, 2005 were $1.8 million and ($2.7 million), respectively.

On November 6, 2006, the unpaid balance of approximately $4.5 million on the Hua Yang term loan from the Industrial and Commercial Bank of China was assumed by Jeff Hsieh. The new term loan between Hua Yang and Hsieh will be repaid in monthly installments beginning January 2007 and ending June 2008 and at an interest rate of prime plus 1%. The Company believes that Hua Yang can support the loan repayment with cash generated from operations and existing and future working capital facilities.

Management believes that the termination of these operations should allow Grand to focus on the profitable operations of IPI, Hua Yang and Kord going forward. Thus, the Company s revised business strategy into 2007 is expected to be the growth and expansion of: toy distribution to the specialty retail market in North America; the printing and packaging businesses; and the party goods development and manufacturing businesses, with significantly less emphasis on toy development, licensing, and sales, particularly for the mass marketplace.

Global Business Strategy

The Company's goal is to be a leading seller of toy and toy-related products for children ranging from infants to pre-teens. The Company s recent acquisitions of Hua Yang and Kord have expanded the Company into different niches both within and beyond the toy-related industries. Hua Yang s printing division gives the Company a presence in children s books and puzzles and allows the Company to package the toys that the Company manufactures. Hua Yang s business also offers the Company other specialty packaging opportunities. Kord s party goods business allows the Company to reach its core demographic with different product lines. Both Hua Yang and Kord enable the Company to approach licensors and retail stores as a more diversified company that can provide more services, goods and opportunities to our customers. The Company seeks to maximize its potential with its new product base and continues to look for other opportunities that will further expand its product base within the toy and toy-related industry.

For purposes of clarity, we separate the discussion of the Company s business into:

- Toy products (Playwell & Grand US)
- Printing and packaging (Hua Yang)
- Party goods (Kord)

Toy Products (Playwell and Grand US)

Business Strategy

In the toy-products area, the Company looked for opportunities that would help it achieve a premiere status in the toy industry. To achieve its goals, the Company s strategy called for increasing cooperation with proprietary toy concept licensors, diversifying its product range, strengthening its marketing network and relationships with its multi-national customers, expanding its distribution channels and increasing and diversifying its customer base.

Develop Cooperative Relationships with Toy Industry Licensors

The Company has discontinued its pursuit to develop licensing relationships with top toy industry licensors, in order to focus on those existing relationships for the specialty toy market. Historically, the Company has licensed the toy concept, developed the toy with the approval of the licensor and sold the product through the Company s distribution channels.

Competitive Strengths

The Company believes that its main competitive strengths in the toy products area include:

.

its international distribution network;

.

its vertical integration of capabilities throughout the toy production cycle;

.

its executives' extensive experience in the toy industry and familiarity with the United States, Canadian, European and Chinese markets;

.

its client service expertise and competitive pricing ability;

.

its stable relationships with licensors of proprietary names, characters and other toy industry intellectual properties;

.

its demonstrated cost-management abilities;

.

its diversified core product base; and

.

its flexibility in adapting to the fast changing and trend-based toy industry.

Products, Markets & Marketing Channels

The Company distributes toy, toy related and recreational products through HKTC and Grand US to retailers and consumers.

The Company s toy product segment s three largest customers are: Toys R Us, Mamas & Papas Ltd. and Eveil & Jeux, which for the year ended December 31, 2005 accounted for approximately 4%, 1% and 1%, respectively, of the Company s gross sales. No other customer in the toy product segment accounted for more than 1% of the Company s gross sales in 2005.

Net sales of toy products by geographical areas were as follows:

		2005		2004		2003
				(as restated)		
US	$	27,530,502	$	13,944,721	$	21,182,664
Asia		9,703,972		8,131,198		390,156
Europe		8,943,318		6,170,641		8,559,424
Canada		2,070,183		3,511,606		4,911,115
Africa		234,756		479,495		18,402
Other		142,594		402,885		2,382,004
Total net sales	$	48,625,325	$	32,640,546	$	37,443,765

HKTC

HKTC is an international designer and supplier of plastic and wooden toys in the infant, preschool and activity toy categories, with distribution capabilities in key markets worldwide. It also supervises outsourced manufacturing of toy products of its own design for sale under the "Playwell" brand or designed by its customers for sale under those customer's own brand names.

HKTC supplies several lines of plastic toys - toys for preschool children, water toys and toys for infants. Many of these plastic toys require sophisticated injection-mold production of specialty cartoon characters, such as Disney and Crayola licensed characters. These character replicas come in various scales and are medium and high-feature products that must meet exacting standards. Many of these character replicas have complex designs, which require high-quality workmanship and decorative details. HKTC also supplies wooden toys, doll furniture, children's furniture and rockers. HKTC sells its products directly to over 30 retailers in the U.S. and the U.K. and to approximately six distributors worldwide. HKTC has 10 dedicated sales staff and it also has a long standing commission-based network of sales representatives in Europe and the U.S and access to another sales network in the U.S.

Grand US

Grand US, including its subsidiaries, IPI and Grand Toys Ltd., distributes a broad range of toys for infants through teenagers primarily to the consumer mass and specialty markets in North America. Grand US s mission is to develop and distribute innovative and entertaining products with integrity, superior play value and child developmental qualities. Grand US s offerings include puzzles, games, infant and preschool toys, dolls and girls products, educational toys and activity toys.

Grand US buys finished goods from various Asian manufacturers and ships the goods to its warehouses in Parsippany, New Jersey or Dorval, Quebec. The goods are then shipped to over 3,000 customer locations.

Grand US employs a sales and marketing staff of ten, including two senior managers, five employee sales representatives and independent sales agents who make on-site visits to customers for the purpose of soliciting orders for products. Grand US markets products at major and regional toy trade shows in the United States, Canada and Hong Kong. In addition, Grand US maintains showrooms in New Jersey, Dorval, Quebec and Hong Kong. Purchasers of the products include mass retailers, regional retail stores, toy specialty stores and wholesalers.

Grand US, in its regular business operations, does not have long term order commitments from its customers. The Company sells to its customers on open account, allowing customers to purchase products up to certain pre-established credit limits.

Grand US enters into one-year term agreements with the majority of its customers. These agreements stipulate payment terms, shipping terms, allowances and rebates (i.e., advertising allowances, allowances for defective product returns or volume allowances, as applicable). Payment terms typically vary between 30 and 90 days. Allowances and rebates are deducted from gross sales.

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 in selling such excess inventory by offering discounts or accepting returns. A portion of firm orders, by their terms, may be canceled if the shipment is not made by a certain date. The Company attempts to minimize the related costs of such discounts and returns by engaging personnel to visit selected customers and assist in the management of its product returns. The Company establishes sales reserves at the time of sale based on historical experience of discounts and returns on related products. The return of non-defective product occurs infrequently in the U.S. In the U.K. market, accepting returns of non-defective product is regular industry practice and the Company establishes a return provisions on such sales based on experience. Customers receiving defective products (in accordance with their term agreements) would claim product returns against the rebates. If a defective return is material, Grand US has recourse against the manufacturer of the product.

Grand US directly, or through outside salespersons, accepts written orders for products from customers and submits the orders to Grand US s vendors who then arrange for manufacture of the products. Customer order cancellations are generally made in writing and Grand US will then notify the appropriate vendors of customer cancellations who in turn notify the manufacturers. This procedure allows Grand US to avoid adding products to inventory as a result of customer cancellations of orders. Customers generally have the right to cancel purchase orders for which goods have been purchased. Grand US attempts to minimize this possibility by ensuring that customer orders are matched to product purchases.

Design and Development

Through 2005, the Company's development department at HKTC designs new toys using the various toy designs. Once the initial design is completed, the development department will work with HKTC's engineering department to test the feasibility of the new development. The new development is then put through a cost analysis to determine the actual cost of its mass production and a model of the new toy is produced by hand. All the data generated and produced in this process is then analyzed by the Company s management to decide whether to launch the new toy. The Company's research and development is heavily oriented toward market demand. Based on its ongoing contact with consumers, retailers and distributors worldwide, the Company s sales and marketing departments seek to understand and assist the product development personnel in responding to consumer and retailer preferences. The marketing department, along with the sales department, also targets certain retail price points for new products which drive the Company s product development, with designs, features, materials, manufacturing and distribution all developed within the parameters of the target retail price.

Once a toy product is developed and the Company decides to launch the product, a product sample is commissioned. The sample is shown at the various toy fairs around the world and through the Company s sales network. The Company generally receives indications of interest for its toy products through these channels and after confirming the cost structure of product production, will start manufacturing the mould at Gatelink, if applicable, and accepting purchase orders from customers. Until purchase orders are formally accepted, the indications of interest may be cancelled at any time. Accordingly, HKTC generally operates without a significant backlog of regular orders. The time required for the process of showing various new toy concepts or models and taking it through to actual production on average is approximately three to six months.

HKTC has introduced new products to refresh and extend its product line each year. Traditionally, new product introductions are concentrated in the second and third quarters of the year in anticipation of the year-end holiday shopping season.

In addition the Company receives and develops new concepts in other ways including:

.

consideration of numerous concepts from unaffiliated third parties for new products. If it accepts and develops an inventor s concept for a new product, it will pay royalties to the inventor generally based on sales from that product; and

.

internal staff development of new concepts by attending tradeshows worldwide, reading industry publications and communicating with our existing vendors and customers.

All safety testing of the Company s products is done by the manufacturers at the manufacturers factories and is designed to meet safety regulations imposed by the various governmental authorities in the countries where the Company s products are distributed. The Company also monitors quality assurance procedures of the manufacturers for the Company s products for safety purposes at the Company s warehouse facilities.

Intellectual Property

The Company owns various trademarks, including the "Playwell" trademark. It will apply for intellectual property registrations on new products as it deems necessary. The Playwell trademark is registered in the main territories in which the Company operates or distributes its products.

Sources of Product

Approximately 24% of the Company s toy product gross sales in 2005 were from products supplied by the following five vendors: Hop Cheong, Hang Fang Paper, Toy Biz, Zhejiang Playwell and Epoch. These products accounted for 11%, 4%, 3%, 3% and 3%, respectively, of 2005 toy product gross sales. Other than the products from the above-mentioned vendors, no products from any other vendor or from the Company s proprietary products accounted for more than 3% of the Company s toy product gross sales in 2005.

The products distributed by the Company are manufactured for the Company by affiliated and unaffiliated third parties principally located in China, Hong Kong, Mexico, Spain, the U.S. and the U.K. Historically, HKTC manufactures a majority of its plastic products in China in factories in China operated by companies controlled by Mr.

Hsieh; however, Mr. Hsieh discontinued his manufacturing facilities in early 2006, so all future toy manufacturing will be with unaffiliated companies.

For its proprietary product lines, the Company orders products from its vendors which in turn select product manufacturers on the basis of factors standard in the toy industry including price, payment terms, product quality, reliability and the ability of a manufacturer to meet delivery requirements. For products using licensed properties, the licensors may have the right to approve the manufacturers selected by the vendors. The use of third-party manufacturers enables the Company to avoid incurring fixed manufacturing costs, but also reduces its ability to control the timing and quality of the manufacturing process.

For the product lines distributed for third parties, the Company does not supervise the day-to-day manufacturing of these products. However, prior to the commencement of manufacturing, the Company, the vendor and the manufacturer work together to design a prototype of the specific product and its packaging. The manufacturer is contractually obligated to manufacture the products in accordance with those prototype specifications. For licensed products, some licensors may be required to approve the prototype prior to production.

Overseas manufacturers are generally paid by either letter of credit or wire transfer. Payment is made only upon the proper fulfillment of terms established by the Company for each purchase order. These terms include adherence to product quality, design, packaging and shipping standards, as well as proper documentation relating thereto. Most product purchases are paid for in U.S. dollars.

The Company is not a party to any long-term supply or requirements agreements with any specific manufacturer.

Materials

The principal raw materials used in the production and sale of the Company s products are plastic, printed fabrics and paper. These are all commodity products readily available at reasonable prices from a variety of sources.

Licensing and Distribution Agreements

Character Licenses

The Company s product lines include products featuring well-known character properties created by others. In order to obtain the right to manufacture and sell products featuring such character properties, the Company enters into license agreements with the owners of such properties. Under the terms of the license agreements, the Company pays royalties to licensors that generally range from 5% to 20% of net sales of the products carrying these character properties.

Generally, the Company s character property license agreements provide the Company with the exclusive or non-exclusive right to sell only specific products featuring the particular character, have a term of between one to eight years and are generally renewed upon payment of certain minimum guarantees or the attainment of specified sales levels.

No particular character property license resulted in sales in excess of 10% of the Company s total sales revenues for the year ended December 31, 2005. The loss of any one of the licensed products would not have a material adverse effect on the Company s operations.

Many of Grand US s products are based on properties licensed from third parties. Pursuant to agreements under which properties are licensed, Grand US obtains either the exclusive or non-exclusive right to import and distribute the products selected throughout North America, depending on the contract terms. License agreements generally have terms of one to eight years and are usually exclusive for a specified product or product line within a specific territory.

Generally, under Grand US s distribution agreements Grand US is responsible for paying shipping and other related costs upon the purchase of goods from the vendor.

Seasonality

The Company s toy business is seasonal, with a majority of sales occurring during the period from September through December in advance of the holiday season. Therefore the toy product segment s annual operating results will depend, in large part, on its sales during the relatively brief holiday season.

Further, this seasonality is increasing as large retailers become more efficient in their control of inventory levels through quick response management techniques. These retailers are timing reorders so that they are being filled by suppliers closer to the time of purchase by retailer, rather than maintaining large on-hand inventories throughout the year to meet consumer demand. While these techniques reduce a retailer's investment in inventory, they increase pressure on suppliers like the Company to fill orders promptly and shift a significant portion of inventory risk and carrying costs to the supplier. The limited inventory carried by retailers may also reduce or delay retail sales. Additionally, the logistics of supplying more and more product within shorter time periods increase the risk that the Company may fail to achieve tight and compressed shipping schedules.

Management of the Company attempts to offset the seasonal nature of the industry by seeking out non-seasonal product lines. The addition of the year-round specialty retail business from IPI and product lines such as Soccer and Pirates of the Caribbean have helped to offset the typical sales and inventory concentration for the third and fourth quarters.

Toy Products Competition

The toy products industry in which the Company competes is highly competitive. The Company competes with many larger toy companies in the design and development of new toys, the procurement of licenses and for adequate retail shelf space for its products. The larger toy companies include Hasbro Inc., Mattel Inc., Playmates Inc. and Bandai Co. The Company also faces competition from retailers who buy directly from the vendors rather than from a distributor like the Company. The Company remains competitive by offering full service to its customers, including marketing programs and customer service. The toy industry s highly competitive environment continues to place cost pressures on manufacturers and distributors. Discretionary spending among potential toy consumers is limited and the toy industry competes for those dollars along with the makers of computers and video games.

PRINTING AND PACKAGING (HUA YANG)

Hua Yang, through its subsidiaries manufacturing facilities located in Shenzhen, China, is a contract manufacturer of a variety of paper and board products, including books, specialty packaging and other paper products.

Products

Books

Hua Yang book manufacturing capabilities include the following types of books:

.

"Pop-up" books containing custom die-cut, folded and glued paper pieces that, when the book is opened, "pop" out of the book in three dimensions. These products typically retail in the U.S. for between $5 and $50. Most of Hua Yang's "pop-up" books are targeted at children, but there is a small segment that targets the adult and young adult markets.

.

Novelty books, sometimes also referred to as "book-plus", incorporate an extra or unusual element. These elements often make the book interactive or provide play value. For example, novelty books may include an electronic device, a noisemaker, plastic, vinyl, textured or scented materials, or a plush toy.

.

Board books are usually die-cut or punched into an unusual shape, thus requiring hand-assembly. These books are made of heavyweight, stiff paperboard, are durable in nature, and usually target the children's market. Often board books come in a set of three or more titles and are grouped together in a hand-assembled slip case, sleeve or custom made box.

Hua Yang s books are sold through toy and bookstores, authorized dealers and other channels.

Specialty packaging

Specialty packaging includes paperboard and corrugated boxes and, to a lesser extent, blister cards and inserts. Box packaging often requires advanced printing techniques, including five- and six-color printing, foil hot stamping, spot or total coating, varnishing, embossing and lamination. After printing, boxes are die-cut to shape with a dropout window often including PVC sheets, which also are cut to shape and often incorporate some silk screen printing, are glued in place by hand in the dropout windows. Blister cards are simple backing boards used in a plastic blister pack while insert cards are printed pieces of board used as backing or filler inside a larger packaging box.

Specialty packaging is produced to protect products during shipment and to exhibit products for sale in retail stores.

Other paper products

Other paper products manufactured by Hua Yang include puzzles, board games, photo albums, stationery sets and activity packs, all of which require hand assembly.

These products are targeted at children, young adults and adults. These products are sold through hobby shops, authorized dealers, book and gift stores, as well as through other channels.

Market for Products

Sales of Hua Yang s products are divided equally among Hong Kong, the United States and Europe. Major customers for Hua Yang include Cranium Inc., PR Services, Early light, Macmillan and Mattel.

The buying and ordering cycles for specialty packaging and books differ. With regard to specialty packaging, in November or December, Hua Yang reviews with its core packaging customers anticipated packaging needs for the upcoming year. By the beginning of the calendar year, the core customers will provide Hua Yang with dollar and unit allocations for the year. These allocations will be based on Hua Yang's past performance, capacity and technical capability vis-a-vis the designs requested by the customer. Every week thereafter, Hua Yang will receive purchase orders covering the next four to six weeks. Firm orders and packaging planning rarely extend beyond six weeks.

The buying and ordering cycles for books varies and is generally much longer than specialty packaging, with most activity grouped around the Frankfurt Book Fair held in Germany every October and the Children's Book Fair held in Bologna, Italy every April. The fairs are a time for customers of Hua Yang to present their new book concepts to potential buyers and confirmed sales are usually realized three to six weeks after each fair. Once these customers have confirmed sales, they turn to contract printers, such as Hua Yang, to reserve production capacity. Orders for reprints of old titles, however, can be booked anytime during the year, but generally fall outside of the peak summer production months.

Competitive Advantages

Hua Yang believes its customers seek suppliers that can manufacture high-quality products in both large quantities and limited runs in a timely and cost-effective manner. These customers seek to eliminate the cost, time and complexity of identifying and managing multiple vendors to develop and produce a product. For example, book customers often must turn to trading houses, brokers or service intermediaries for component sourcing, product development and engineering. The need to coordinate several different companies in the manufacturing process can cause production delays, inefficiencies in the management of multiple contractors and quality and reliability problems. Hua Yang's full service approach to manufacturing offers the following solutions to addresses these customers needs:

High-quality production

Hua Yang uses modern computer-aided design and manufacturing equipment to produce high-quality products. Hua Yang also employs a highly trained workforce, including skilled, technically trained craftsmen and other competent but relatively inexpensive laborers for its manufacturing and assembly operations under the guidance of experienced management. Hua Yang ensures quality through rigorous quality control procedures at each step of the production process. Hua Yang has an employee training program geared specifically toward inspection and quality control.

Turnkey manufacturing service

Hua Yang offers a fully integrated turnkey manufacturing service. Hua Yang integrates component sourcing, product development and engineering, design, model and mould making, and manufacturing, assembling and packaging of the finished product. This enables Hua Yang to meet all of a customer's needs and eliminates the need for intermediaries. This integrated approach allows Hua Yang to shorten the lead-time from design to product delivery and to lower product cost while maintaining high quality and reliability.

Commitment to efficiency

Hua Yang continually strives to increase efficiency and reduce costs for the benefit of Hua Yang and its customers. To date, Hua Yang has been able to achieve efficiencies by locating its production facilities in the PRC, vertically integrating its production processes and working in close cooperation with its customers.

Business Strategy

Hua Yang s goal is to be the leading contract manufacturer of books, specialty packaging and other paper products for the premier designers and marketers of these items. Hua Yang s strategy calls for continuous strengthening of its relationships with its multi-national customers and increasing and diversifying its customer base. To achieve these goals, Hua Yang has focused on the following:

Developing additional major customers

Currently, Hua Yang has a core group of large customers, but it also manufactures products for many other smaller customers. Hua Yang expects that it may be able to develop several of these smaller customers into major customers as they become familiar with the benefits of Hua Yang s turnkey manufacturing service. Hua Yang offers major customers a dedicated production team and dedicated production space, which can provide such customers with attractive advantages. For example, Hua Yang can customize its production facilities to meet the specific needs of its customers, and the customers are able to exercise greater control over the production process, thereby enhancing quality control and cost efficiency, increasing confidentiality and expediting scheduling and delivery timetables. Hua Yang believes that its ability to offer such dedicated production services has led to enhanced relationships with its core customer base.

Diversifying product offerings

Hua Yang intends to diversify its product offerings to include the manufacture of other consumer products that utilize its current competitive advantages and production expertise. Further, new product lines are expected to decrease seasonality that Hua Yang has historically experienced. By diversifying into product lines in which the demand timing is seasonal, the utilization of manufacturing facilities can improve, thereby improving profitability.

Deploying advanced management information systems

Hua Yang seeks to enhance its manufacturing and business processes by deploying advanced management information systems that enable the real-time monitoring and management of its operating and financial performance and resources.

Seasonality

Hua Yang s operating results in the past have fluctuated in part based on seasonal factors and this seasonality likely will continue in the future.

Hua Yang ceases production for a two-week period during January or February of each year due to the Chinese New Year holiday, which is partially responsible for net sales during the first fiscal quarter of each year being lower than net sales during the other three fiscal quarters.

Hua Yang may also experience fluctuations in quarterly revenues and related net income due to the timing of receipt of orders from customers and the shipment of products. Sales of books are weighted toward the Christmas season; as a result, book sales in the second half of the fiscal year are generally higher than in the first half.

Manufacturing

Hua Yang's manufacturing operations are conducted in a production facility located in Shenzhen, PRC. The Shenzhen Facility includes: a pre-press area, press rooms and print finishing area, die-cut, trimming, guillotining and punching areas, packaging and book hand assembly areas, a warehouse and dormitory and dining facilities. The press rooms operate on a two-shift basis with seven advanced German presses delivering up to six-color printing capability. The die-cut department also runs on a two-shift basis during the peak season. Hand assemblers for both packaging and books generally work one shift, adding an additional shift during the peak season. Packaging and books account for most of the total work force and production areas.

In addition, Hua Yang has a production facility in Dongguan, PRC that is used mainly for manufacturing specialty packaging.

Raw Materials

Paper, ink and glue are the principal raw materials used by Hua Yang. Hua Yang uses many types of coated paper and board in a variety of grades, depending on customers' quality and price requirements. Hua Yang purchases a majority of its paper from U.S., Asian and European suppliers, but generally places orders through trading companies or agents in Hong Kong Additionally, Hua Yang acquires a small amount of paper from local sources in Hong Kong and PRC. Ink and glue are ordered locally in Hong Kong.

Intellectual Property

Hua Yang has no registered trademarks in respect of its manufacturing businesses. Hua Yang owns a utility patent in the U.S. on a novelty book product.

Books and Specialty Product Packaging Competition

Hua Yang faces significant competition in its business. In "pop-up" books, Hua Yang competes with contract manufacturers located in Southeast Asia and South America. In novelty and board books as well as specialty packaging, Hua Yang competes with contract manufacturers located in Hong Kong and other parts of the PRC. In addition, certain of Hua Yang s customers have the capability to manufacture their products internally.

Hua Yang believes that there are several factors that provide the basis of competition in the manufacturing of its products, including: price, quality, technical capabilities, production capabilities and on-time delivery. Hua Yang believes that it can maintain its competitive advantage through the effective use of its facilities. Hua Yang also expects increased competition from other industry participants that may seek to enter one or more of Hua Yang's high margin product segments.

Hua Yang does not believe that there are any significant barriers to entry into the light manufacturing business and its business is not based on the ownership of proprietary patents, trademarks or copyright. Accordingly, additional participants may enter the market at any time.

PARTY GOODS (KORD)

Kord is one of the world s largest party goods manufacturers with over 3,000 employees and over 500,000 square feet of manufacturing space.

Products

Kord produces a broad range of party and paper goods and offers comprehensive lines of party products and accessories to major importers and superstores, either under its proprietary Kord brand, or as a contract manufacturer for well known brands. Kord has over 20,000 ready-for-manufacture designs in key product groups, including

.

generic party products like hats, horns, blowouts, noise makers;

.

decorative products like banners, garlands and honeycomb decorations;

.

disposable tableware products like paper cups, paper plates, napkins and table covers; and

.

latex masks.

Kord's proprietary products cover all major party occasions, themes and seasons, including Birthdays, Halloween, Thanksgiving, Christmas, New Year, Valentine s Day, St Patrick's Day and Easter.

The generic, decorative, and disposable products account for more than 90% of total sales. Kord is also a licensed manufacturer of Disney-branded party products. Kord works closely with importers, distributors, party superstores and international retail chains on ODM and OEM projects all over the world.

Market for Products

Approximately 58%, 33% and 9% of Kord s products are distributed in the US, Europe and the rest of the world, respectively. Kord s major customers include Creative Expressions, Glitterwrap, American Greetings and Hallmark.

Business Strategy

Kord s strategy is to develop its own brand party products and to design party products for customers on an OEM basis. Kord has its own in house design department to create new designs. Kord seeks to increase the quality of its products by investing in new equipment, and constantly reviews its own manufacturing processes with a view to making improvements.

Manufacturing

Kord's printing equipment includes Heidleberg and Roland offset printers, gravure printers, flexographic printers, and printing peripherals such as plate making, varnishing, calendaring, laminating, silk screening, pad stamping and hot stamping setups. Kord s equipment enables Kord to add patterns onto a wide range of party items and maintain a high standard of printing quality and short printing lead-time for its products.

Plastic toys and party accessories are manufactured with Kord's injection moulding and blow-moulding machines. Moulds and tooling are also made in house. Polyethylene extruding machines extrude plastic bags and plastic sheets for packaging and products such as tablecovers, lootbags and banners.

Kord uses other specialized equipment to produce paper cups, plates and lunch boxes. Kord also has setups for making latex masks and paper honeycombs and garlands, and special machines for products such as blowouts, Hawaiian leis and serpentines.

Seasonality

Kord s birthday party products enjoy continuous sales throughout the year because birthdays have no seasons. Kord s production peaks in July, August and September in advance of delivery deadlines for Halloween, Christmas and the New Year. With the exception of the Chinese New Year holidays, Kord s sales and production operations are relatively constant during the remaining months of the year.

Raw Materials

Kord s main raw materials are paper, ink, glue, latex, and plastic resin. Different types of paper are used for different products. Paper is purchased by Kord from suppliers in Finland, the US, Japan, Korea, Indonesia and China; plastic resins are sourced from Saudi Arabia and Thailand. Ink and glue are sourced from Japan, Korea and China and latex is supplied from Malaysia.

Intellectual Property

Kord has registered the Kord trademark in the US, Germany, China and Hong Kong. . Kord also has 8 US copyright registrations in respect of party hats, one UK registered design in respect of Party Blowout , and two US Design Patents in respect of noisemakers.

Party Goods Competition

Kord does not believe that its business is currently threatened by any competitor because, as far as it is aware, no other manufacturer has a product range and capacity as large as Kord.

6

= ">

Property Description:

The Company and/or its subsidiaries, occupy the following properties:

Hong Kong

The Company s principal executive offices are located in an approximately 6,308 square foot space located at Room UG202, Floor UG2, Chinachem Golden Plaza, 77 Mody Road, Tsimshatsui East, Kowloon, Hong Kong. The lease for the premises is held in the name of Asian World Enterprises, a subsidiary of Playwell. HKTC occupies a portion of this space pursuant to a facilities sharing agreement. The facilities sharing agreement expires on September 30, 2007 and the current monthly rent is $16,300. The premises are also the principal place of business for Playwell and its subsidiaries.

China

.

Gatelink occupies approximately 65,000 square feet in China. The lease is held by Playwell Industries Limited, an affiliate of the Company s controlling shareholder. Gatelink occupies a portion of this space pursuant to a facilities sharing agreement. The monthly rental cost is approximately $5,600.

.

Hua Yang has two manufacturing locations that include office space. Hua Yang s Shenzhen facility has an aggregate of approximately 451,870 feet of manufacturing space and approximately 248,300 feet of dormitory space. A co-operative joint venture was established between Hua Yang and an entity controlled by a PRC governmental entity to own and operate the Shenzhen facility. Hua Yang leases its factory buildings at the Shenzhen facility from the joint venture. The joint venture has a term of 15 years, expiring in October 2010. Under the joint venture agreement, Hua Yang possesses substantive participating rights and is entitled to all of the joint venture's profits, after paying the joint venture partner a pre-determined annual fee. At the end of the joint venture term, Hua Yang will continue to own the other assets of the joint venture, but the land and factory buildings currently used to conduct the business of the joint venture will revert to Hua Yang s joint venture partner. The term of this lease is from April 2005 to March 2008 and the monthly cost is $83,000. Hua Yang s Dongguan facility is approximately 250,000 square feet and includes office, warehouse and dormitories. The lease expires in July 2010 and the monthly rent is approximately $28,000.

.

Kord maintains five locations in China. The total square footage occupied for office, manufacturing, dormitories and storage is approximately 992,000 square feet for an aggregate monthly rental cost of approximately $83,600. The terms of the leases for the various facilities end between the years 2006 and 2010.

In January 2006, the Company began renting office space from Cornerstone Management (Shenzhen) Limited, an affiliate of the Company s controlling shareholder. The Company s subsidiaries, HKTC and Hua Yang, occupy approximately 9,000 square feet, which represents a portion of the total space pursuant to a facilities sharing agreement. The monthly rent is approximately $11,400 and is based on head count usage. There is no formal written agreement between the parties.

U.S.

IPI maintains an office and warehouse facility in an approximately 119,400 square foot facility at 75D Lackawanna Avenue in Parsippany, New Jersey. The term of the lease, including a renewal period, extends to May 31, 2010. The current monthly rent is $54,700.

Canada

The Company s Canadian subsidiary, Grand Toys Ltd., occupies an approximately 105,000 square foot facility located at 1710 Route Trans-Canada, Dorval, Quebec, Canada. The Company uses the facility for offices, showroom, warehousing and distribution. The lease for the premises expires on September 30, 2009. The current monthly rent is $29,050 and is increased each year by a percentage that is equal to 75% of the percentage increase in the consumer price index for the greater Montreal, Canada area. Since 2004, the Company sub-let approximately 46,000 square feet of this facility in order to maximize facility efficiency and reduce expenses.

The Company believes that its current facilities are adequate for its present needs and that its insurance coverage is adequate for the premises.

Product Liability

The Company maintains product liability coverage for the Company s operations in the aggregate amount of $12,000,000. The Company believes that this coverage is adequate for its risks.

Government Regulation

The Company is subject to the provisions of various laws, including those of Hong Kong, the Federal Government of Canada, the Government of the Province of Quebec, Canada and other Canadian provinces, the EU and the United States Federal Government and various states in the United States.

The Company is subject to the provisions of, among other laws, the U.S. Federal Hazardous Substances Act and the U.S. Consumer Product Safety Act. Those laws empower the U.S. Consumer Product Safety Commission (the CPSC") to protect children from hazardous toys and other articles. The CPSC has the authority to exclude from the market articles that are found to be hazardous. Similar laws exist in Hong Kong and in some states and cities in the United States, Canada and Europe.

The Company is also subject to the Consumer Packaging and Labeling Act enacted by the Government of Canada, which regulates the sale, importation, or advertising in Canada of items, which have misleading information on their label.

For products sold into Canada, the Company is also subject to the Charter of the French Language, which requires that all labeling and instructions appear in the French language, as well as the Upholstery and Stuffed Articles Act, which requires that stuffed articles conform to hygienic norms, and obligates companies to take measures against contamination during transportation and storage. Similar laws exist in several cities and provinces throughout Canada and in many jurisdictions throughout the world.

The Company maintains a quality control program to ensure compliance with all applicable laws in all jurisdictions in which the Company operates.

8

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Item 5. Operating and Financial Review and Prospects:

The following should be read in conjunction with the Company s Audited Financial Statements for the fiscal year ended December 31, 2005, which are included as part of this report, 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. As discussed below, the Company s financial statements for the fiscal year ended December 31, 2004 have been restated to give effect to the acquisition of Hua Yang and Kord.

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.

The transaction consummated on August 16, 2004. For accounting purposes, Playwell was deemed to be the acquirer, therefore the results of Grand US are only included from August 16, 2004 and the 2003 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.

On December 23, 2005, the Company purchased the shares of Hua Yang and Kord, which were owned by Cornerstone Beststep. The Company, Hua Yang and Kord, through Cornerstone Beststep were under the common control of the Company s majority shareholder, Jeff Hsieh, who was the sole beneficial owner of Hua Yang and Kord. The purchase method of accounting for the business combination was used; however, due to the common control of the entities, the Company is required to restate its financial statements back to the date of common control as if Hua Yang and Kord were part of the Company on May 24, 2004 and June 30, 2004, respectively, the dates that they were acquired by Cornerstone Beststep s parent company, Cornerstone. Under this method of accounting, the excess of the value paid to Cornerstone Beststep over the original cost of Hua Yang and Kord is reflected as a non-recurring deemed dividend in the 2005 financial statements. Further, the Company s acquisition costs are treated as restructuring costs and recorded as an expense in the 2005 financial statements.

As a result of these and certain other acquisitions the Company made during 2004 and 2005, any comparison of the year ended December 31, 2005 to the year ended December 31, 2004 must consider the following acquisition dates when the financial performance of each new entity begins to be included in the financial statements of the Company:

.

May 24, 2004 inclusion of Hua Yang

.

June 18, 2004 inclusion of Kord

.

August 16, 2004 inclusion of Grand Ltd., Canadian subsidiary of Grand US

.

February 1, 2005 inclusion of Eastern Raiser, subsidiary of Hua Yang

.

March 1, 2005 inclusion of IPI

Kindly refer to Item 4 Recent Developments for the discussion on 2006 business activities.

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. The cost of goods sold for products at the Company s manufacturing facilities include raw materials, direct labor, machinery depreciation and overhead.

Major components of selling, general and administrative expenses include: payroll and fringe benefits, advertising expenses, 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.

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 for the distribution companies and includes raw materials, sub-assembly and work-in-process for the manufacturing companies.

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, as well as the aging of raw materials in the case of the manufacturing divisions. 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.

Critical Accounting Estimates

The Company s management believes that the accounting estimate related to the valuation of its goodwill is a critical accounting estimate because significant changes in the assumptions used to develop the estimate could materially affect key financial measures, including net income and non-current assets, specifically goodwill. The valuation of goodwill involves a high degree of judgment since the first step of the impairment test required by SFAS No. 142 consists of a comparison of the fair value of a reporting unit with its book value. Based on the assumptions underlying the valuation, impairment is determined by estimating the fair value of a reporting unit and comparing that value to the reporting unit s book value. If the faire value is more than the book value of the reporting unit, an impairment loss is not recognized. If impairment exists, the fair value of the reporting unit is allocated to all of its assets and liabilities excluding goodwill, with the excess amount representing the fair value of goodwill. An impairment loss is measured as the amount by which the book value of the reporting unit s goodwill exceeds the estimated fair value of that goodwill. The Company utilizes the fair value of the cash flows that the business can be expected to generate in the future (Income Approach) to test for impairment. The Income Approach valuation method requires the Company to make projections of revenue, operating costs and working capital investment for the reporting unit over a multi-year period. Additionally, management must make an estimate of its weighted average cost of capital to be used as a discount rate. Changes in these projections or estimates could result in a reporting unit either passing or failing the first step in the SFAS No. 142 impairment model, which could significantly change the amount of any impairment ultimately recorded.

The Company s income tax provision and related income tax assets and liabilities are based on actual and expected future income, various statutory income tax rates and regulations and planning opportunities in the various jurisdictions in which the Company operates. Management believes that the accounting estimates related to income taxes is a critical accounting estimate because significant judgment is required in interpreting tax regulations in all jurisdictions, determining worldwide tax positions, and assessing the likelihood of realizing certain benefits. Actual results could differ materially from those judgments and materially affect the Company s consolidated financial statements. Certain income and expense items are accounted for differently for financial reporting and income tax purposes. As a result the effective tax rate reflected on the Company s consolidated statement of operations is different than that reported in the Company s tax returns filed with the tax authorities. Some of these differences are permanent, such as expenses that are not deductible in the Company s tax return, and some differences reverse over time, such as depreciation expense. These timing differences create deferred income tax assets and liabilities. Deferred income tax assets generally represent items that can be used as a tax deduction or credit in the Company s tax returns in future years for which the Company would record a tax benefit in its consolidated statement of operations. The Company records a valuation allowance to reduce its deferred income tax assets if, based on the weight of available evidence, management believes expected future taxable income is not likely to support the use of a deduction or credit in that jurisdiction. Management evaluates the level of the Company s valuation allowances at least annually, and more frequently if actual operating results differ significantly from forecasted results.

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

9

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Results of Operations

The following table sets forth consolidated operations data as a percentage of net sales for the periods indicated:

	For the Twelve Months Ended December 31,					
	2005		2004 (as restated)		2003	
	$	%	$	%	$	%
Net sales	$ 131,329,529	100.00	$ 75,532,871	100.00	$ 39,375,438	100.00
Cost of goods sold	99,506,552	75.77	60,458,768	80.04	33,538,951	85.18
Gross profit	31,822,977	24.23	15,074,103	19.96	5,836,487	14.82
Other operating income	(1,918,250)	(1.46)	(482,312)	(0.64)	(896,023)	(2.28)
Operating costs and expenses:						
General and administrative	23,492,605	17.89	9,490,171	12.56	2,141,280	5.44
Selling and distribution	9,886,407	7.53	3,317,275	4.39	638,498	1.62
Depreciation and amortization	2,697,431	2.05	1,564,595	2.07	398,478	1.01
Impairment on intangible assets and goodwill	12,487,867	9.50	-	-	-	-
Total operating costs and expenses	48,564,310	36.98	14,372,041	19.02	3,178,256	8.07
Operating (loss) income	(14,823,083)	(11.29)	1,184,374	1.58	3,554,254	9.03
(Loss) earnings before interest, taxes, depreciation and Amortization (EBITDA)	(8,979,016)	(6.84)	4,162,363	5.51	5,231,174	13.29

Non-operating expense						
(income):						
Interest expense	1,937,524	1.48	464,048	0.61	23,835	0.06
Interest income	(53,310)	(0.04)	(45,065)	(0.06)	(5,051)	(0.01)
Impairment loss on						
investment securities						
Total non-operating	25,477	0.02	31,785	0.04	-	-
expense	1,909,691	1.46	450,768	0.59	18,784	0.05
Discontinued operations	-	-	-	-	1,239,236	3.15
(Loss) earnings before						
income taxes	(16,732,774)	(12.74)	733,606	0.99	4,774,706	12.13
Net (loss) earnings						
from operations	(16,968,704)	(12.92)	(58,885)	(0.00)	4,261,366	10.82
Dividends	(14,357,692)	(10.93)	**-**		**-**	**-**
Net (loss) earnings						
applicable						
to shareholders	**$ (31,326,396)**	**(23.85)**	**$ (58,885)**	**(0.00)**	**$ 4,261,366**	**10.82**

Grand discusses financial measures in accordance with GAAP and also on a non-GAAP basis. Grand s definition of EBITDA is (loss) earnings before interest, income taxes, depreciation and amortization. All references in this report to EBITDA are to a non-GAAP financial measure. EBITDA, a measure widely used among toy related businesses, is used because management believes that it is an effective way of monitoring the operating performance of the Company relative to the industry. Additionally, the Company believes that the use of non-GAAP financial measures enables it and investors to evaluate, and compare from period to period, the results from ongoing operations in a more meaningful and consistent manner.

Reconciliations of GAAP to Non-GAAP financial measures are provided below.

Reconciliation of (Loss) earnings before interest, taxes, amortization, depreciation and impairment on assets (EBITDA):

	2005	**2004**	**2003**

Net (loss) earnings from operations	$ (16,968,704)	$ (58,885)	$ 4,261,366
Interest expense, net	1,884,214	418,983	18,784
Depreciation and amortization G&A	2,697,431	1,564,595	398,478
Depreciation Cost of Goods Sold	3,172,113	1,445,179	39,206
Income tax expense	235,930	792,491	513,340
EBITDA	**$ (8,979,016)**	**$ 4,162,363**	**$ 5,231,174**

Comparison of the year ended December 31, 2005 to the year ended December 31, 2004

Net loss available to ADS holders:

Net loss available to ADS holders for 2005 was approximately $31.3 million, as compared to net loss of approximately $59,000 for 2004. Gross margins increased from 20.0% to 24.2%. The 2005 period included various one-time expenses that are unusually high for this period, including:

§

$12.8 million of deemed dividends resulting from the difference between the value of the Series B Preference Shares at the date of issuance plus other value granted to Cornerstone Beststep and the original cost paid by Cornerstone (which subsequently transferred Hua Yang and Kord to its Cornerstone Beststep subsidiary) for the shares of Hua Yang and Kord;

§

$991,000 of deemed dividends resulting from the difference between the conversion price of the Series A Preference Shares into Grand ADSs, based on the average closing stock price for the 40 days preceding the share issuance, and the actual market price on the date of issuance of the Series A Preference Shares;

§

$13.3 million of write-offs due to impairment of assets, mostly from the discontinuance of the Crayola Dough license;

§

$705,000 of expenses relating to an abandoned acquisition;

§

$465,000 of write-offs of prepaid royalties for various license agreements that were terminated;

§

$400,000 of expenses relating to the acquisition of Hua Yang and Kord;

§

$393,000 of severance costs relating to management changes in Hong Kong; and

§

$173,000 of expenses relating to a change of depreciation policy for moulds.

Without these charges, the Company would have had a net loss for 2005 of approximately $2.1 million and the EBITDA would have been approximately $6.4 million.

Net sales:

Net sales increased during 2005 by approximately $55.8 million, or by 73.9%, to $131.3 million from $75.5 million for 2004. The addition of sales from IPI, Hua Yang, Kord and Grand Canada and Grand US s Crayola Dough product line in 2005 more than offset the declining OEM sales for the Toy Biz line by HKTC. The sales breakdown by category for 2005 and 2004 is as follows:

(The amounts in the table below are expressed in thousands)

		2005		**2004**
Books and board Games	$	27,733	$	22,069
Party products and accessories		28,901		13,549
Packaging products		22,691		10,450
OEM products		8,940		16,928
Playwell brand products Plastic toys		2,256		3,479
Playwell brand products Wooden toys		951		1,633
Mould income and other related services		3,379		3,617
North American distribution, net		36,479		3,808
Net sales	$	131,330	$	75,533

Sales from IPI for North American distribution are included from March 1, 2005, the date of the IPI acquisition. IPI net sales for 2005 were approximately $25.5 million. Included in the IPI sales are approximately $105,000 of commission income earned during the year.

For the year 2005, approximately $7.7 million of sales were from Grand Canada. Included in the Canadian distribution sales are approximately $244,000 of commissions earned during the year.

For the year 2005, approximately $50.4 million and $28.9 million of sales were from Hua Yang and Kord, respectively.

OEM product sales decreased 46% from approximately $16.5 million in 2004 to approximately $8.9 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 35% from approximately $3.5 million in 2004 to $2.3 million in 2005 due to no new Playwell plastic toys introduced during the year. The Playwell wooden toy sales decreased by 42% from $1.6 million in 2004 to $951,000 in 2005. The slight decrease in mould income and other related services resulted from a decrease in moulds for Toy Biz and HKTC in 2005.

Gross profit:

Gross profit for the Company increased during 2005 by $16.7 million from $15.1 million to $31.8 million. As a percentage of sales, gross profit increased from 20.0% in 2004 to 24.2% in 2005. The increased margin is due to the shift in product mix from 2004 to 2005. For 2005, Grand US had margins of 38.05%, Hua Yang had margins of 19.4%, Kord had margins of 19.4% and the Playwell and OEM had margins of 16.4%.

Other operating income:

Other operating income increased by $1.4 million to $1.9 million in 2005 from $482,000 in 2004. $339,000 of the increase relates to rental income from Grand Canada received in 2005 while $546,000 of the other operating income is attributable to Hua Yang and $262,000 is attributable to Kord.

General and administrative expenses:

General and administrative expenses increased by approximately $14.0 million to $23.5 million in 2005, from $9.5 million in 2004. The incremental increase (decrease) in these expenses from each operating subsidiary was as follows:

§

$3.3 million for IPI for 10 months in 2005;

§

$1.9 million for full-year operations at Hua Yang;

§

$2.1 million in corporate recurring expenses for full-year operations in 2005;

§

$2.0 million for full-year operations at US mass-market operations;

§

$1.8 million for full-year operations at Kord;

§

$1.5 million for non-recurring corporate expenses in 2005;

§

$1.3 million for full-year operations at Grand Canada;

§

$0.8 million for impairment loss and write-off of fixed assets; and

§

($0.7 million) reduction in costs for Playwell operations.

Selling and distribution expenses:

Selling and distribution expenses increased from $3.3 million in 2004 to approximately $9.9 million in 2005.

The incremental increase (decrease) in these costs derived from each operating subsidiary was as follows:

§

$4.8 million for IPI for 10 months in 2005;

§

$0.6 million for full-year operations at Kord;

§

$0.6 million for full-year operations at Grand Canada;

§

$0.3 million for full-year operations at US mass-market operations;

§

$0.4 million for full-year operations at Hua Yang; and

§

($0.1 million) reduction in costs for Playwell operations in 2005.

Depreciation and Amortization:

Depreciation and amortization increased from $1.6 million in 2004 to $2.7 million in 2005. The incremental increase in these costs derived from each operating subsidiary was as follows:

§

$0.4 million for full-year amortization of Crayola license;

§

$0.1 million for full-year operations at Grand Canada;

§

($0.3 million) reduction for full-year operations at Hua Yang;

§

$0.2 million for full-year operations at Kord;

§

$0.4 million for IPI for 10 months in 2005; and

§

$0.1 million increase in depreciation and amortization for Playwell operations in 2005; and

§

$0.2 million increase for full-year amortization from Grand US intangibles

Interest expense:

Interest expense increased from $464,000 in 2004 to approximately $1.9 million in 2005. The incremental increase in these costs was as follows:

§

$0.2 million for IPI for 10 months in 2005;

§

$1.0 million for full-year operations at Hua Yang;

§

$0.1 million for full-year operations at Kord; and

§

$145,000 for interest on an exchangeable note from March 1, 2005 April 15, 2005 which was issued in connection with the financing of the acquisition of IPI.

Dividends:

Dividends for 2005 include $991,000 of deemed dividends which resulted from the difference between the conversion price of the Series A Preference Shares into Grand ADSs, based on the average closing stock price for the 40 days preceding the share issuance, and the actual market price on the date of issuance of the Series A Preference Shares; and $12.8 million of deemed dividends which resulted from the difference between the total value of the Series B Preference Shares at the date of issuance plus other value granted to Cornerstone Beststep and the original cost paid by Cornerstone for the shares of Hua Yang and Kord.

Also included in 2005 were $572,000 of dividends on the Series A Preference Shares for the period from April 15, 2005 December 31, 2005; and $43,000 of dividends on the Series B Preference Shares for the period December 22, 2005 December 31, 2005.

Comparison of the year ended December 31, 2004 to the year ended December 31, 2003

Net (loss) earnings available to ADS holders:

Net loss available to ADS holders for 2004 was $59,000 as compared to net earnings available to ADS holders of $4.3 million in 2003. Net earnings for the year ended December 31, 2003, included a gain of $1.2 million resulting from discontinued operations. Without this gain, the Company would have realized net earnings of $ 3.0 million for the year ended December 31, 2003.

Gross margins improved significantly from 14.8% to 20.0%. However, net earnings from continuing operations decreased by $3.0 million primarily as a result of increased general and administrative expenses.

Net sales:

Net sales increased in 2004 by approximately $36.2 million, or by 92.0%, to $75.5 million from $39.4 million in 2003. The significant increase is due primarily to the addition of sales from Hua Yang, Kord, Canadian distribution and Crayola Dough product sales in 2004, offset by reduced customer demand for Playwell branded products and OEM sales for Toy Biz products. The sales breakdown by category for 2004 and 2003 is as follows:

(The amounts in the table below are expressed in thousands)

		2004		2003
Books and board Games	$	22,069	$	-
Party products and accessories		13,549		-
Packaging products		10,450		-
OEM products		16,928		25,343
Playwell brand products Plastic toys		3,479		8,679
Playwell brand products Wooden toys		1,633		3,885
Mould income and other related services		3,617		1,468
Canadian and US distribution, net		4,195		-
Net sales	$	75,533	$	39,375

OEM product sales declined due primarily to the end of the lifecycle of various third-party product lines that the Company was servicing. Playwell branded product sales decreased because of the lack of introduction of the new items in 2004.

The Playwell branded products are divided into plastic and wooden toys. The Playwell plastic toy sales decreased by 59.9% from approximately $8.7 million in 2003 to approximately $3.5 million in 2004 due to no new Playwell plastic toys introduced during the period. The Playwell wooden toy sales decreased by 58% from approximately $3.9 million in 2003 to approximately $1.6 million in 2004 due to decreased demand. The OEM product sales decreased by 34.7% from approximately $25.3 million in 2003 to approximately $16.5 million in 2004 due to the decrease in demand of Toy Biz items; Toy Biz items represent approximately $14.1 million, or 18.7% of the 2004 revenues, and $24.6 million, or 62.6% of the 2003 revenue. The increase in mould income and other related services resulted from an increase in moulds for Toy Biz and HKTC in 2004, as well as licensing revenue from Disney product sales earned in 2004.

Due to these Playwell sales declines, 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 internal companies and third parties.

The 2004 period includes approximately $4.2 million of Canadian and US distribution sales from Grand US from the period August 16, 2004 through December 31, 2004, $32.5 million of sales from Hua Yang for the period May 24, 2004 through December 31, 2004 and $13.5 million of sales from Kord for the period June 19, 2004 through December 31, 2004.

Gross profit:

Gross profit for the Company increased in 2004 by $9.3 million from $5.8 million to $15.1 million. As a percentage of sales, gross profit increased from 14.8% in 2003 to 20.0% in 2004.

The increase in margins is due to the 2004 product mix. The Company focused its efforts on more profitable sales, which resulted in the greater margins. For 2004, the Canadian and US distribution sales by Grand US contributed margins of

26.4%, the Playwell and OEM business contributed margins of 26.6%, Hua Yang contributed margins of 15.9% and Kord contributed margins of 18.5%.

Other operating income:

Other operating income decreased by $414,000 to $482,000 in 2004 from $896,000 in 2003. The decrease is a result of reduced commission income from an affiliated company which was approximately $0.4 million in 2003.

General and administrative expenses:

General and administrative expenses increased by $7.4 million to $9.5 million, in 2004, from $2.1 million in 2003. The increase was due to the Company s strategy to build up overhead to transition and manage the planned expansion of the Company through acquisitions. Specifically, the increase resulted from the following: $1.5 million in corporate expenses, consisting primarily of salaries, insurance, professional fees and a $0.2 million write-off of professional costs relating to an abandoned acquisition; $2.9 million in expenses related to Hua Yang, $1.4 million in expenses related to Kord, $1.1 million in expenses related to the Canadian distribution business, which includes a one-time litigation settlement of $0.3 million; and increased overhead for the expanded Hong Kong operations.

Selling and distribution expenses:

Selling and distribution expenses increased from $638,000 in 2003 to $3.3 million in 2004. The increase relates to the additional costs from Hua Yang, Kord and the Canadian distribution business, which is offset partly by a reduction in the sales volume in the Playwell operations.

Depreciation and Amortization:

Depreciation and amortization increased from $398,000 for the year ended December 31, 2003 to $1.6 million for the year ended December 31, 2004. Approximately $399,000 of the increase is due to amortization of the intangibles acquired in the reorganization merger and Playwell acquisition. The balance of the increase relates to additional depreciation from the Playwell assets, the purchase of new tooling for Disney products and the newly acquired assets from Hua Yang, Kord and the Canadian distribution business.

Liquidity and Capital Resources

The Company generally finances its operations through its cash flow from operations and the existence of working capital facilities in North America and in Hong Kong.

Net cash used for operating activities was approximately $4.5 million in 2005 compared to $6.0 million in 2004. This improvement primarily resulted from the inclusion of IPI, a cash generating operation, in 2005 and the inclusion of the full year activities of Hua Yang and Kord in 2005. Cash used for additions to equipment and leasehold improvements was $2.6 million in 2005 compared to $3.0 million in 2004. Cash used for acquisitions was approximately $7.5 million in 2005, mostly for the acquisition of Eastern Raiser and was approximately $2.2 million in 2004, mostly for the Grand/Playwell merger. Net cash provided by financing activities was approximately $9.2 million in 2005 compared to $15.3 million in 2004.

North America:

The Company finances its North American operations through a $15.0 million revolving credit facility agreement with Citibank N.A., expiring on June 30, 2006. The borrower on this facility is IPI and the facility includes a $2.0 million sub-limit for Grand Toys Ltd., Grand US s Canadian subsidiary. 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 a $4.3 million (CA$ 5.0 million) guarantee from Grand Toys Ltd. 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 December 31, 2005, the amount outstanding was approximately $5.7 million.

Prior to October 2005, IPI had a $10.0 million limit on its revolving facility and Grand Canada had a line of credit with Montcap Financial to finance its inventory and accounts receivable for advances of up to $3.0 million (CA$3.5 million). The Grand Canada receivable line had a discount fee of 2.0% of invoice amount purchased and the inventory line bore interest at Canadian prime plus 7.5%. The line of credit was secured by a lien on the assets of Grand Toys Ltd. and had no debt covenants or cross-default provisions. As of December 31, 2004, the amount outstanding with Montcap was approximately $352,000.

IPI failed to satisfy certain covenants of the credit facility on December 31, 2005 and received a waiver from Citibank through May 15, 2006. As of May 15, 2006, the covenants were not satisfied and on June 30, 2006 Citibank stated that they will not extend the revolving credit facility and Citibank issued a reservation of rights letter on July 21, 2006. In the reservation of rights letter, Citibank stated that at this time, they will not demand immediate repayment of all sums owing under the credit facility. The balance of $10,484,000 was all converted to a prime rate loan with a maturity date of September 30, 2006 and remains outstanding as of November 15, 2006 as the Company seeks alternative financing for its North American operations. The Company has identified several alternative financing options for its North American facility and expects to replace the Citibank facility in the near future. The terms of the replacement facility have not yet been finalized.

Hong Kong and China:

The Company finances its Hong Kong and China operations through facilities at Industrial and Commercial Bank of China (Asia) Limited, (ICBC), DBS Bank (Hong Kong) Limited, Hang Seng Bank Limited and East Asia GE Commercial Finance.

Bank borrowings of the Hong Kong subsidiaries are secured by guarantees by each of their respective subsidiaries, as well as guarantees by the Company, Cornerstone and Mr. Hsieh, certain inventories acquired and released under the trust receipt loans, pledge of bank deposits of $27,048 (2004 - $597,464), and monies debentures over certain assets and certain properties. ICBC ceased extending credit to Hua Yang at the time of the Company s acquisition of Hua Yang, but ICBC agreed to allow Grand to gradually pay down the existing balances by October 2006. These amounts are being repaid through cash generated from operations and through replacement facilities at other banking institutions. As of October 31, 2006, the $2.6 million outstanding balance on an overdraft facility with ICBC was linked with availability on another facility at ICBC used by Jeff Hsieh with the understanding that this would be paid down by the end of 2006. As of November 6, 2006, the $4.5 million balance on the ICBC term loan was assumed by Jeff Hsieh for a loan to be repaid in monthly installments beginning January 2007 and ending June 2008 at an interest rate of prime plus 1%.

As of December 31, 2005, the Hong Kong-based subsidiaries had approximately $16.7 million of short-term bank indebtedness outstanding and approximately $5.1 million of long-term debt. As of December 31, 2004, the Hong Kong-based subsidiaries had approximately $11.8 million of short-term bank indebtedness outstanding and approximately $789,000 of long-term debt.

Accounts receivable at December 31, 2005 were $27.5 million compared to $17.8 million at December 31, 2004. Inventory at December 31, 2005 increased to $20.4 million from $11.0 million at December 31, 2004. The levels of accounts receivable and inventory are higher due to the inclusion of the assets from IPI in 2005 resulting from the acquisition of IPI in March 2005.

Working capital decreased from $9.0 million at December 31, 2004 to $4.8 million at December 31, 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.

The Company has financed its recent acquisitions, in part, through borrowings and the sale of Preference Shares and the issuance of its equity securities. The purchase price for the acquisition of IPI on March 1, 2005 was approximately $8.9 million, of which $7.3 million was paid in cash and $1.6 million was paid by the delivery of 582,730 ADSs. Acquisition costs relating to this acquisition 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 an Exchangeable Note in the principal amount of $7.675 million for proceeds of $7.4 million. The Exchangeable Note was sold at a $275,000 discount in order to compensate Mr. Hsieh 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 Preference Shares of the Company when the issuance of the Series A Preference Shares was approved by the Company s shareholders at the Company s 2005 Annual General Meeting on April 15, 2005.

The acquisition of Hua Yang and Kord on December 23, 2005 was accomplished through the issuance of 10,840,598 Series B Preference Shares of the Company and an offset of approximately $2.4 million of related-party receivables and did not involve any cash payments to Cornerstone Beststep. Acquisition costs relating to this acquisition were approximately $400,000.

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 2006 forecasts, the existing and proposed credit facilities appear to be sufficient to meet the Company s financial needs.

Contractual Obligations

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

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

(b) The amount of the capital commitment is in respect of property, plant and equipment.

Contractual Obligations	**Within 1 year**	**1 3 years**	**4 5 years**	**More than 5 years**	**Total**
Operating lease obligations	$ 2,543,074	$ 6,056,131	$ 346,467	$ -	$ 8,945,672
Capital Commitment	1,838,932	-	-	-	-
Operating lease obligations under joint venture agreement for Shenzhen Hua Yang	547,208	1,810,730	664,916	-	3,022,854
Minimum guarantee of royalties	4,052,272	583,619	-	-	4,635,891

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 is 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 supersedes 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 fiscal year that begins after June 15, 2005. In accordance with the standard, the Company will adopt SFAS No. 123R effective January 1, 2006.

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 asset exchanges that do not have commercial substance. The provisions in SFAS No. 153 are effective for non-monetary assets 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 issues SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 . This statement supersedes APB Opinion No. 20, Accounting changes and SFAS No. 3, Reporting Accounting changes in Interim Financial Statements . SFAS No. 154 requires retrospective application to prior periods financial statements of changes in accounting principles, unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. APB Opinion No. 20 Accounting Changes, previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Item 6. Directors, Senior Management and Employees

Directors:

Set forth below is the name, age, principal occupation and other information concerning each director. The information presented with respect to each director has been furnished by that person.

Name	Age	Director Since
Jeff Hsieh Cheng	56	December 2005
Elliot L. Bier	56	August 2004
David J. Fremed	46	April 2005
Allen Perl	46	April 2005
Douglas Van	49	April 2005
Jack W. Flader, Jr.	43	December 2005

Jeff Hsieh Cheng has served as Chief Executive Officer of the Company since December 2005. Mr. Hsieh is the beneficial owner of a majority of the Company s ADSs. Mr. Hsieh has over twenty-five years of experience in the toy and toy-related business. Mr. Hsieh is the owner of various PRC-based manufacturing operations, including Playwell Industry Limited, Zhejiang Playwell Toy Co Ltd., and is also the owner of various retail operations in the PRC and various toy distribution companies throughout the world. Mr. Hsieh holds a bachelor s degree from Soochow University.

Elliot L. Bier has served as Chairman of the Board of the Company since December 2005. Prior thereto, Mr. Bier held the position of Vice Chairman of the Board of the Company from August 2004 to December 2005 and as Deputy Executive Director of the Company since September 2004. For the 25 years prior to that, Mr. Bier practiced law at the law firm of Adessky Poulin in Montreal, most recently as senior partner. Adessky Poulin was Canadian legal counsel to the Company and, since 1991, Grand US. Mr. Bier has practiced law for the last 28 years. From November 16, 2000 until August 16, 2004, Mr. Bier served as Chairman of Grand US, and currently serves as a director of Grand US. From January 1, 2004 until August 16, 2004, Mr. Bier served as a paid consultant to Cornerstone. From May 2001 to June 2003, Mr. Bier served as the Chief Operating Officer of Polystar Inc., a Montreal-based plastics company. Mr. Bier is, or has served as, a director of a number of public, quasi-public, private and charitable companies and or institutions, including Capital Trust Corporation, Mount Sinai Hospital Foundation, Pursuit Financial Management Corporation, JB Oxford Corp. and Federation CJA. He is currently Chairman and President of Mount Sinai Hospital in Montreal. Mr. Bier is a graduate of Long Island University where he also received a master s degree in business administration. He received his bachelors of civil law and common law from McGill University.

David J. Fremed has served as Executive Vice President and Chief Financial Officer of the Company since August 16, 2004. From February 2004 to August 2004, Mr. Fremed was a consultant to Cornerstone, an affiliate of Grand, serving in the role of its principal financial officer. Prior to being engaged by Cornerstone, Mr. Fremed was the chief financial officer of Atari, Inc., a Nasdaq listed company, from May 2000 to February 2004, where he was responsible for all treasury, budgeting, SEC reporting and compliance functions. In addition, Mr. Fremed was responsible for seeking potential acquisition candidates, negotiating terms of acquisition transactions, and integrating the newly acquired companies into Atari. From 1990 to 2000, Mr. Fremed held various financial positions at Marvel Enterprises, Inc., including serving as its chief financial officer, where he was responsible for arranging both debt and equity financings as well as managing the financial reporting, MIS, tax, and human resource departments. Mr. Fremed is a certified public accountant and holds a Masters of business administration degree from New York University and a bachelor of science degree from Albany State University

Allen S. Perl, CPA is currently the managing partner of Perl, Grossman & Associates, LLP a public accounting firm in Lake Success, New York. Mr. Perl's firm specializes in closely held corporations and high net worth individuals. From 1982 to 2002, Mr. Perl practiced accounting at the firm of Kafitin & Negrin, CPAs, most recently as the managing partner. In addition to his accounting practice, Mr. Perl serves as the President of the Board of Directors of Nassau Suffolk Services for Autism, an organization dealing with children with autism and their families. Mr. Perl is a certified public accountant with a Bachelor of Science degree in economics from State University of New York at Albany, and graduate work in the field of accounting from Adelphi University.

Douglas Van has, since 1988, operated a venture company and acted in a capacity of advisor, fund raiser, project financing, asset management and investor for projects and ventures ranging from real estate in the United States and China to manufacturing projects in China across different industries. Until 1988, Mr. Van worked for Exxon Chemicals in Hong Kong and the United States in various disciplines ranging from sales and marketing, plant operations and research and development. Mr. Van attended Wah Yan College in Hong Kong before attending McGill University in Montreal, Canada, where he received a Bachelor of Science degree in chemical engineering. Mr. Van also has a masters of business administration degree from University of Michigan, Ann Arbor.

Jack W. Flader, Jr. has, since May 2006, been managing director of Global Consultants & Services Limited, a Hong Kong-based company that provides fiduciary services. Mr. Flader, an attorney, is a member of the Hong Kong General Chamber of Commerce, the American Bar Association, International Bar Association, Center for International Legal Studies, the International Tax Planning Association and the Hong Kong Securities Institute. Mr. Flader was managing director at Zetland Financial Group from 1997 to 2006. Mr. Flader has juris doctor, masters of business administration and bachelor of arts degrees from University of Pacific, McGeorge School of Law, Golden Gate University and Rollins College, respectively.

There are no family relationships among any of our directors and executive officers.

Executive Officers and Senior Management

Our executive officers and other members of senior management are:

Name	Age	Title
Jeff Hsieh Cheng	56	Chief Executive officer
Elliot L. Bier	56	Deputy Chief Executive Officer and Chairman of the Board
David J. Fremed	46	Executive Vice President and Chief Financial Officer
Roger Bildsten	56	President, Grand US
Kevin Murphy	47	President and Chief Executive Officer, Hua Yang
Li San Tung	61	President, Kord

Roger Bildsten has been the President of Grand US since July 2005. Prior thereto, Mr. Bildsten served for 6 years as Chief Executive Officer of Manhattan Group, a toy company, and 10 years as Vice President of Anagram International, Inc.

Kevin Murphy has been the President and Chief Executive Officer of Hua Yang since November 2001 and was Vice President of Operations from 1998 to 2001. Prior thereto, Mr. Murphy was Managing Director of a Malaysian production facility.

Li San Tung is the founder of Kord and currently serves as its President. Mr. Li began the business in 1972 and grew Kord from a one-man start-up to a 2,000 employee company supplying local and international customers.

Compensation

All directors of the Company receive an annual director s fee of $25,000 and quarterly grants of options to purchase 1,250 ADSs, or 5,000 options per year, at an exercise price equal to the market price of the ADSs on the date of grant. In addition, non-employee directors receive additional quarterly grants of options to purchase 6,250 ADSs, or 25,000 options per year, at an exercise price equal to the market price of the ADSs on the date of grant. The quarterly director option grants during 2005 were: March 31st @ $2.50, June 30th @ $2.00, September 30th @ $1.90 and December 31st @ $1.50. Except for the foregoing, directors receive no other regular compensation for serving as a director. During the year ended December 31, 2005, the Company paid $25,000 to each of Messrs. Kron, Laverdure and Mitchell for serving on a special committee in connection with the acquisitions of Hua Yang and Kord.

The aggregate direct compensation paid or accrued on behalf of all directors and executive employees as a group during 2005 was $3,045,889. This amount includes directors fees and expenses for non-employee directors of $81,250. This amount does not include expenses (including business travel, professional and business association dues and expenses) reimbursed to officers and directors and other fringe benefits commonly reimbursed. None of the non-employee directors have agreements with the Company that provide for benefits upon termination of service.

The Company has adopted a number of stock option programs in the past covering ADSs. All employees of the Company are eligible to participate in the Company s stock option programs. In 2005 the Company s directors and executive officers were granted options to purchase an aggregate of 490,906 ADSs, at an average exercise price of $1.91 per ADR and all of which will expire in 2015. During the first six months of 2006, the Company s directors and executive officers were granted options to purchase an aggregate of 365,000 ADSs, at an average exercise price of $1.50 per ADR and all of which will expire in 2016.

As of December 31, 2005, options for an aggregate of 2,574,350 shares, with an average exercise price of $2.19 per share, are outstanding under the Company s stock option programs, with options for an aggregate of approximately 1,215,242 shares available for future grant. For further information regarding the Company s outstanding options, see Note 8 to the Notes to Consolidated Financial Statements.

Board Practices and Procedures

The Company s board of directors is currently comprised of 6 persons, of which three, Messrs. Perl, Van and Flader have been determined to be independent within the meaning of applicable Nasdaq regulations. The Company s Board is not comprised of a majority of independent directors as required by Nasdaq Marketplace Rule 4350(c)(i) because it is exempt from the requirement by virtue of the fact that it is a controlled company within the meaning of Nasdaq Marketplace Rule 5350 (c)(5) as a result of Mr. Hsieh s beneficial ownership of more than 50% of the Company s ordinary shares. All directors are entitled to review and retain copies of the Company s documentation and examine the Company s assets, as required to perform their duties as directors and to receive assistance, in special cases, from outside experts at the expense of the Company (subject to approval by the Board or by court).

The Company s Board members are elected for terms of one year. The Company believes that shareholders should have the opportunity to elect or re-elect all directors at each annual general meeting and that annual election of directors is an effective way to maintain and enhance the accountability of the Board.

No director has a contract with the Company providing for benefits upon termination, except for Messrs. Bier and Fremed whose employment agreements provide for severance payments upon termination of employment. The severance provisions are described in Item 7 below.

Board Meetings

Meetings of the board of directors are held throughout the year, with additional special meetings scheduled when required. The Board held six meetings in 2005 and acted by unanimous written consent on four occasions.

Executive Sessions of the Board

The independent members of the Board met in executive session (without management or non independent directors participation) one time during 2005. They will continue to meet in executive session on a regular basis.

Home Country Practice

The Company is in compliance with corporate governance standards as currently applicable to the Company under Hong Kong, U.S., SEC and Nasdaq laws and regulations. As further described below, the Company has adopted an audit committee charter formalizing its procedures and duties, each pursuant to applicable laws and regulations.

Communications with the Board

Any holder of ADSs who desires to communicate directly with the Board may do so by mail addressed to any individual director, a group of directors, the Board or any Committee by either name or title at c/o Grand Toys International Limited, Room UG202, Floor UG2, Chinachem Golden Plaza, 77 Mody Road, Tsimshatsui East, Kowloon, Hong Kong.

Committees of the Board

Audit Committee

The Board has a standing Audit Committee that is chaired by Mr. Perl. The committee currently includes Mr. Van and Mr. Flader. The Board determined that Mr. Perl qualified as an audit committee financial expert as defined in Item 401(h) of Regulation S-K of the Exchange Act.

The Audit Committee s primary purpose is to assist the Board in fulfilling its oversight responsibilities with respect to the annual financial statements of the Company; the system of internal accounting and financial controls; the compliance by the Company with legal and regulatory requirements; and the internal and external audit process. The Audit Committee oversees the performance of independent accountants and internal auditors, monitors the financial reporting process and makes reports and recommendations to the Board. In connection with the exercise of its duties, the Audit Committee has the authority to engage independent accountants for special audits, review and other procedures and to retain special counsel and other experts or consultants. The Audit Committee also conducts an annual review of its charter and responsibilities.

Compensation Committee

The Board had a Compensation Committee that was comprised of its independent directors. The Board terminated the charter of the Compensation Committee at a meeting held on 21st April, 2005, after determining that, by virtue of Mr. Hsieh s beneficial ownership of more than 50% of the Company s outstanding ordinary shares, it is a Controlled Company within the meaning of Nasdaq Marketplace Rule 4350(c)(5), and therefore, it was exempt from the requirement of Nasdaq Marketplace Rule 4350(c)(3) requiring the committee. Instead, the Company relies on the Board as a whole for review of all senior executive compensation packages and the Company s independent directors will participate in regularly scheduled executive sessions.

Corporate Governance and Nominating Committee

The Board had a Corporate Governance and Nominating Committee that was comprised of its independent directors. The Board terminated the charter of the Corporate Governance and Nominating Committee at a meeting held on March 23, 2005, ordinary shares , it is a Controlled Company within the meaning of Nasdaq Marketplace Rule 4350(c)(5), and therefore exempt from the requirement of Nasdaq Marketplace Rule 4350 (c)(4) requiring the committee. Instead, the Company will rely on applicable Hong Kong law regarding the nomination of directors. During the fiscal year ended December 31, 2005, the Corporate Governance and Nominating Committee did not hold any meetings.

Employees

As of December 31, 2005, the Company employed 5,284 full-time persons. Of the total employees, 79 are located in Hong Kong, 4,913 are located in China, 51 are located in the United States and 20 are located in Canada. None of the Company's employees are subject to a collective bargaining agreement and the Company has never experienced a work stoppage. The Company s management believes that its employee relations are satisfactory.

Share Ownership

As of September 30, 2006, all the directors and executive officers as a group beneficially held 14,438,951 ADS and options to exercise ADSs (approximately 82.5% of the Company s outstanding ADSs and options).

The ownership and ownership percentages as of September 30, 2006, for the directors and executive officers are:

Name	Beneficial ownership	% Ownership
Jeff Hsieh Cheng	44,766,401 (a)	90.54 %
Elliot L. Bier	601,750	3.33 %
David J. Fremed	407,293	2.28 %
Allen Perl	43,682	0.25 %
Douglas Van	43,682	0.25 %
Jack W. Flader Jr.	22,500	0.13 %
Roger Bildsten	200,000	1.13 %
Kevin Murphy	300,000	1.69 %
Li San Tung	818,716 (b)	4.68 %

(a)

includes 12,814,795 ADSs and 2,000,000 Series A Preference shares convertible into 2,804,600 ADSs and 10,840,598 Series B Preference Shares convertible into 29,147,006 ADSs and 3,750 options

(b)

Li San Tung holds promissory notes that allow him to receive 818,716 Grand ADSs from Cornerstone

Directors:

Pursuant to the Grand Toys International 2004 Stock Option Plan, in consideration for serving as a director, all directors were automatically granted total options to purchase 1,250 ADSs at the end of each quarter. The non-employee directors earn an additional grant to purchase 6,250 ADS each quarter. The price of the option grants for 2005 and 2006 are: March 31, 2005 - $2.50, June 30, 2005 - $2.00, September 30, 2005 - $1.90, December 31, 2005 - $1.50, March 31, 2006 - $1.74, June 30, 2006 - $1.41 per ADS, and have a term of ten years from the date of grant. On December 20, 2005, each of Messrs. Bier and Fremed were granted additional options to purchase 100,000 ADSs at a price of $1.65. The terms of their respective option grants are described under the caption Major Shareholders and Related Party Transactions appearing elsewhere in this Report.

Executives:

Options were issued to the executives pursuant to their employment contracts. On September 6, 2005, Roger Bildsten received options to purchase 200,000 ADSs at an exercise price of $2.23, vesting over three years. On January 6, 2006, Kevin Murphy received options to purchase 300,000 ADSs at an exercise price of $1.36, vesting over three years.

Item 7. Major Shareholders and Related Party Transactions

Major Shareholders

As of September 30, 2006 Mr. Jeff Hsieh beneficially owned 12,814,795 Grand ADSs (approximately 73.25% of the Company s outstanding ADSs), 2,000,000 Series A Preference Shares (representing all of the outstanding Series A Preference Shares) which are convertible into 2,804,600 Grand ADSs (approximately 16.03% of the Company s current outstanding ADSs) and 10,840,598 Series B Preference Shares (representing all of the outstanding Series A Preference Shares) which are convertible into 29,147,006 Grand ADSs (approximately 166.61% of the Company s current outstanding ADSs). 10,196,915 of the ADSs beneficially owned by Mr. Hsieh were acquired by Centralink on August 16, 2004, all of the Series A Preference Shares beneficially owned by Mr. Hsieh were acquired by Centralink on March 1, 2005 and all of the Series B Preference Shares beneficially owned by Mr. Hsieh were acquired by Cornerstone Beststep on December 23, 2005. On a fully diluted basis, Mr. Hsieh s beneficially ownership interest in the Company s ADSs has increased from 62.43% on August 16, 2004 to 85.47% on September 30, 2006. To the best knowledge of the Company, as of September 30, 2006, no other shareholder beneficially owned 5% or more of the Company s ordinary shares.

The provisions of the Preference Shares contain provisions protective to Centralink and Cornerstone Beststep, including, in the case of the Series A Preference Shares, a right of pre-emption in relation to any new securities offered by the Company to any third party. The Preference Shares are entitled to vote together with the holders of ordinary shares on an as converted basis.

Related Party Transactions

As of September 30, 2006 Mr. Jeff Hsieh beneficially owned 12,814,795 Grand ADSs (approximately 73.25% of the Company s outstanding ADSs), 2,000,000 Series A Preference Shares which are convertible into 2,804,600 Grand ADSs (approximately 16.03% of the Company s current outstanding ADSs) and 10,840,598 Series B Preference Shares which are convertible into 29,147,006 Grand ADSs (approximately 166.61% of the Company s current outstanding ADSs). 10,196,915 of the ADSs beneficially owned by Mr. Hsieh were acquired by Centralink on August 16, 2004, all of the Series A Preference Shares beneficially owned by Mr. Hsieh were acquired by Centralink on March 1, 2005 and all of the Series B Preference Shares beneficially owned by Mr. Hsieh were acquired by Cornerstone Beststep on December 23, 2005. To the best knowledge of the Company, as of September 30, 2006, no other shareholder beneficially owned 5% or more of the Company s ordinary shares.

The Company also has business transactions with entities owned or controlled by Mr. Hsieh. The terms of these transactions are as favorable to the Company as could be obtained with unrelated third parties. Mr. Hsieh s relationship to these entities is as follows:

12

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Name of related party	Relationship
Cornerstone Overseas Investments, Limited	Majority shareholder/Director
Playwell Toy (China) Ltd.	Majority shareholder/Director
Sunny Smile International Ltd.	Majority shareholder/Director
Toy Biz Worldwide Limited	Majority shareholder/Director
Playwell Industry Limited	Majority shareholder/Director
Dongguan Bailiwei Plaything Co. Ltd.	Majority shareholder/Director
Brand Management Ltd.	Majority shareholder/Director
Guangzhou Playwell Trading Co. Ltd.	Director
Hua Yang Printing Holdings Co. Ltd.	Majority shareholder/Director
China Retail Management	Majority shareholder/Director
Great Asian Development Inc.	Majority shareholder/Director
Long Sure Industries Ltd.	Director
Dongguan Playwell Products Co. Ltd.	Majority shareholder/Director
Zhejiang Playwell Toy Co Ltd.	Majority shareholder/Director
Playwell Industry Ltd.	Majority shareholder/Director
Centralink Investments Limited	Majority shareholder/Director
Hong Kong Toy USA	Majority shareholder/Director
Playwell Toy S.a.	Majority shareholder/Director
Playwell International L.L.C.	Majority shareholder/Director
Zizzle (Hong Kong) Limited	Majority shareholder/Director
Hero Crown Limited	Majority shareholder/Director
New Enlarge Industrial Limited	Majority shareholder/Director
Kord Industrial (China) Company Limited	Majority shareholder/Director

The related party balances and transactions were as follows:

Name of related party		**December 31, 2005**		**December 31, 2004 (as restated)**
a) Amount due from related party:				
Cornerstone Overseas Investments, Limited	$	-	$	1,293,273
Playwell Toy (China) Ltd.		-		1,005,687
Sunny Smile International Ltd.		-		997,917
Toy Biz Worldwide Limited		2,441,640		1,023,345
Playwell Industry Limited		507,079		581,941
Dongguan Bailiwei Plaything Co. Ltd.		-		351,293
Brand Management Ltd.		-		164,438
Guangzhou Playwell Trading Co. Ltd.		390,566		155,238
New Adventures Corporation		-		31,945
China Retail Management		-		3,570
Great Asian Development Inc.		-		1,271
Long Sure Industries Ltd.		434		1,042
Dongguan Playwell Products Co. Ltd.		-		156
Playwell France		61,846		-
Zizzle (Hong Kong) Limited		114,953		-
Hero Crown Limited		-		6,211
New Enlarge Industrial Limited		-		496
Kord Industrial (China) Company Limited		-		7,377
Total due from related party	**$**	**3,516,518**	**$**	**5,625,200**
b) Amount due to related party:				
Zhejiang Playwell Toy Co Ltd.	**$**	859,250	**$**	1,008,705
Cornerstone Overseas Investments, Limited		-		1,050,535
Playwell Industry Ltd.		1,476,400		380,928
Centralink Investments Limited		-		304,765
Directors/Shareholders		28,758		256,478
Toy Biz Worldwide Limited		464,297		147,341
Hong Kong Toy USA		-		115,289

Total due to related party	**$**	**2,828,705**	**$**	**3,264,041**

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

	For the years ended December 31,		
Playwell International Limited	**2005**	**2004**	**2003**
		(as restated)	
Sales			
Toy Biz Worldwide Limited	$ 197,331	$ 12,562,418	$ 20,422,681
Playwell Industry Ltd.	146,574	-	-
Dongguan Bailiwei Plaything Co Ltd.	-	198,116	2,341,868
	343,905	12,760,534	22,764,549
Purchases			
Playwell Industry Ltd.	4,008,122	12,661,125	26,553,005
Zhejiang Playwell Toy Co., Ltd.	4,851,388	3,962,882	5,319,659
Dongguan Playwell Products Co Ltd.	-	23,409	-
	8,859,510	16,647,416	31,872,664

Mould income			
Toy Biz Worldwide Limited	3,136,890	1,711,807	1,088,409
Playwell Industry Ltd.	(34,211)	494,491	31,322
	$ 3,102,679	$ 2,206,298	$ 1,119,731
Commission income			
Playwell Industry Ltd.	-	115,182	684,690
Royalty income			
Guangzhou Playwell Trading Co. Ltd.	234,283	155,074	51,883
Other income			
Toy Biz Worldwide Limited	74,228	145,292	127,288
New Adventures Corporation	25,273	40,658	-

Playwell Industry Ltd.	20,500	1,746	-
	120,001	187,696	127,288
Other expenses			
Playwell Industry Ltd.	6,051	60,227	30,771
Purchase of fixed asset			
Playwell Industry Ltd.	7,377	-	-

14

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Grand US		December 31, 2005		August 16-December 31 2004		December 31, 2003
Purchases						
Toy Biz Worldwide Limited	$	1,612,472	$	416,653	$	-
Zizzle (Hong Kong) Limited		480,000		-		-
		2,092,472		416,653		-
Commissions						
Toy Biz Worldwide Limited		19,429		15,618		-
Zizzle (Hong Kong) Limited		797		-		-
		20,226		15,618		-
Other income						
New Adventures Corporation		-		16,125		-

Hua Yang		December 31, 2005		May 25-December 31 2004		December 31, 2003
Sales						
Toy Biz Worldwide Limited	$	5,744,435	$	646,037	$	-
Playwell Industry Ltd.		405,465		82,584		-
Zizzle (Hong Kong) Limited		464,732		-		-
		6,614,632		728,622		-
Rental income						
Playwell Industry Ltd.		55,561		-		
		55,561		-		-

Kord		December 31, 2005		July 01-December 31 2004		December 31, 2003
Sales						
Playwell Toy S.A.	$	444,674	$	-	$	-
Playwell International Company L.L.C		16,592		-		-
China Retail Management		14,424		-		-

475,690	-	-

On November 14, 2003, Grand US and Centralink, a company wholly beneficially owned by Mr. Hsieh, entered into the Subscription and Exchange Agreement pursuant to which, among other matters, the Company acquired from Centralink all of the issued and outstanding share capital 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. The Company received an opinion of an independent valuation firm that the transactions were fair to the shareholders of the Company from a financial point of view.

In connection with the Company s acquisition of the assets of IPI and to provide ongoing working capital for IPI s business, pursuant to a Subscription Agreement, dated 28th February, 2005, by and between the Company and Centralink, the Company issued and sold to Centralink an Exchangeable Note in the principal amount of $7,675,000 for which the Company received cash proceeds of $7,400,000. The Exchangeable Note was sold at a $275,000 discount in order to compensate Mr. Hsieh for providing IPI with the option to require Mr. Hsieh to purchase, after the first anniversary of the closing of the acquisition, the Company ADSs received by IPI as partial consideration for its assets. The Exchangeable Note was subsequently exchanged for 2,000,000 of the Company s Series A Preference Shares. The Series A Preference Shares are convertible into 2,804,600 Ordinary Shares which will be represented by an equivalent number of the Company s ADSs. The Company received an opinion of an independent valuation firm that the transactions were fair to the shareholders of the Company from a financial point of view.

In addition, Cornerstone Beststep, a company wholly beneficially owned by Mr. Hsieh, sold the entire issued share capitals of Hua Yang and Kord to the Company in December 2005 for a net purchase price of US$41,601,000. Such net purchase price was satisfied by issuing to Cornerstone Beststep 10,840,598 Series B Preference Shares. Since the Company, Hua Yang and Kord were under common-control by Mr. Hsieh prior to the Company s acquisition of Hua Yang and Kord, a deemed dividend of US$12,751,758 resulted for the year ended December 31, 2005. Such deemed dividend was determined as being the market value of the Series B Preference Shares (as if they had been converted into ordinary shares/ADSs on the date of issuance, December 23, 2005), net of US$2,399,000, representing intercompany indebtedness between the Company and its subsidiaries on the one hand and Hua Yang and Kord and their respective subsidiaries on the other hand, and Cornerstone Beststep s parent company, Cornerstone s, original aggregate acquisition cost for Hua Yang and Kord of US$31,193,000. The Company received an opinion of an independent valuation firm that the transactions were fair to the shareholders of the Company from a financial point of view.

The Company s principal executive offices at Room UG202, Floor UG2, Chinachem Golden Plaza, 77 Mody Road, Tsimshatsui East, Kowloon, Hong Kong are subject to a facilities sharing agreement whereby the Company shares space with three companies controlled by Mr. Hsieh.

Jeff Hsieh is the chief executive officer of the Company and he does not have an employment agreement with the Company.

Elliot L. Bier is party to an amended and restated consulting agreement with the Company. Under Mr. Bier's consulting agreement, Mr. Bier serves as a director and deputy chief executive officer of the Company and as the vice-chairman of the board. In December 2005, Mr. Bier was elected to serve as Chairman of the Board. Mr. Bier's consulting agreement with the Company entitles him to receive an annual consulting fee of $300,000 and annual guaranteed bonuses and he is eligible to receive performance bonuses based upon transactions successfully completed by the Company. Mr. Bier has been granted options to purchase 300,000 of the Company s ADSs at an exercise price of $2.95 per ADS. The options will vest as to 100,000 ADSs on each of the first two anniversaries of the effective date of his consultancy and as to the last 100,000 Grand HK ADSs on the last day of the initial term of Mr. Bier's consulting agreement. However, if there is a change of control of the Company and Mr. Bier's employment is terminated for any reason other than for cause or his employment is terminated at any other time and such termination is not made by Mr. Bier voluntarily or by the Company for cause, or by reason of Mr. Bier's death or disability, all of the options will immediately vest. Mr. Bier is also eligible to participate in the various retirement, welfare and fringe benefit plans, programs and arrangements of the Company afforded to similarly situated senior executives of the Company and its subsidiaries, in accordance with the terms of such plans, programs and arrangements.

The agreement provides for a term of consultancy until the Company s 2007 annual general meeting of shareholders. However, the agreement will terminate upon Mr. Bier's death or disability and may be terminated at any time by the Company with or without cause. In the event Mr. Bier is terminated by the Company without cause and not due to his death or disability, Mr. Bier will continue to receive his consulting fee plus benefits until the earlier to occur of the scheduled expiration of the term of the agreement or the first anniversary of the termination of his employment. Mr. Bier shall also be entitled to any transaction bonuses accrued during this period.

Mr. Bier's employment agreement also provides that, during its term and for one year following the termination of Mr. Bier's employment, unless Mr. Bier's termination is not for cause and except in connection with the practice of law, Mr. Bier may not become associated with competitive entities that are actively engaged in the Company 's business, solicit the business of any company that was a customer or client of the Company or its affiliates during the six-month period prior to Mr. Bier's termination date, or solicit any person that was a management or sales employee of the Company or its affiliates during the six-month period prior to Mr. Bier's termination date. The consulting agreement contains provisions requiring Mr. Bier to maintain the confidentiality of proprietary information of the Company and its affiliates.

In connection with an amendment to Mr. Bier s consulting agreement, he was granted options to purchase an additional 100,000 ADSs at a price of $2.20 per ADS, which represented the last sale price of the ADSs on Nasdaq on 31st August, 2004. All such options immediately vested and are exercisable.

David J. Fremed is party to an employment agreement with the Company. Under Mr. Fremed's employment agreement, Mr. Fremed is employed as executive vice president and chief financial officer of the Company. Mr. Fremed's employment agreement with the Company entitles him to receive an annual base salary of $330,000 and a guaranteed bonus each year for the first three years of his employment, which will be equal to 40% of the base salary he would have received for that year. Mr. Fremed has been granted options to purchase 300,000 of the Company s ADSs at a price of $2.50 per ADS, which price is equal to the closing market price of the Company s ADSs on the last trading day prior to the date of the grant. The options will vest as to 100,000 ADSs on each of the first three anniversaries of the effective date of his employment unless there is an earlier change of control of the Company and Mr. Fremed ceases to act in the capacity of Chief Financial Officer of the Company, other than due to a termination for cause, then all of these options shall immediately vest. Mr. Fremed is also eligible to participate in the fringe benefit plans and arrangements of the Company made available to similarly situated senior executives of the Company and its subsidiaries with a certain guaranteed minimum level of benefits prior to establishment of benefit plans available to U.S. employees.

The agreement provides for a term of employment until Grand HK's 2007 annual general meeting of shareholders. However, the agreement will terminate upon Mr. Fremed's death or disability and may be terminated at any time by the Company with or without cause. In the event Mr. Fremed's employment is terminated by the Company without cause and not due to his death or disability, Mr. Fremed will continue to receive his base salary and guaranteed bonus until the earlier to occur of the scheduled expiration of the term of his employment agreement or six months after the date of termination of his employment and his options shall continue to vest during this period as if his employment was not terminated.

Mr. Fremed's employment agreement also provides that, during its term and for two years following the termination of Mr. Fremed's employment, Mr. Fremed may not become associated with competitive entities that are actively engaged in the Company 's business, solicit the business of any company that was a customer or client of the Company or its affiliates, or solicit any person that is or was an employee of the Company during the six-month period prior to the solicitation. The employment agreement contains provisions requiring Mr. Fremed to maintain the confidentiality of proprietary information of the Company and other companies in the Company s group of companies.

Roger Bildsten is party to an employment agreement with the Grand Toys International, Inc. subsidiary of the Company. Under Mr. Bildsten's employment agreement, Mr. Bildsten is employed as president of Grand Toys International, Inc. Mr. Bildsten's employment agreement with the Company entitles him to receive an annual base salary of $225,000 and a bonus of $100,000 payable on March 31, 2006. For each year beginning January 1, 2006, Bildsten will be eligible to receive a bonus under any incentive bonus plan adopted by the Board of Directors of the Company for the benefit of senior executives of the Company. Mr. Bildsten has been granted options to purchase 200,000 of the Company s ADSs at a price of $2.23 per ADS, which price is equal to the closing market price of the Company s ADSs on the last trading day prior to the date of the grant. The options will vest as to 66,667 ADSs on each of the first and second anniversaries of the option grant date and the balance of the ADSs on the third anniversary of such date and shall expire on the tenth anniversary of such date. Mr. Bildsten is also eligible to participate in the fringe benefit plans and arrangements of the Company made available to similarly situated North American senior executives of the Company and its subsidiaries.

The agreement provides for a three year term of employment until July 17, 2008. However, the agreement will terminate upon Mr. Bildsten's death or disability and may be terminated at any time by the Company with or without cause. In the event Mr. Bildsten's employment is terminated by the Company without cause and not due to his death or disability, Mr. Bildsten will continue to receive his base salary plus benefits until the earlier to occur of the scheduled expiration of the term of his employment agreement or six months after the date of termination of his employment.

Mr. Bildsten's employment agreement also provides that, during its term and for one year following the termination of Mr. Bildsten's employment, Mr. Bildsten may not become associated with competitive entities that are actively engaged in the Company 's business, solicit the business of any company that was a customer or client of the Company or its affiliates, or solicit any person that is or was an employee of the Company during the six-month period prior to the solicitation. The employment agreement contains provisions requiring Mr. Bildsten to maintain the confidentiality of proprietary information of the Company and other companies in the Company s group of companies.

Kevin Murphy is party to an employment agreement with Cornerstone Overseas Investments, Limited dated November 2004 that was assumed by Grand Toys International Limited with the acquisition of Hua Yang in December 2005. Under Mr. Murphy's employment agreement, Mr. Murphy is employed as president and chief executive officer of Hua Yang Printing Holdings Co., Ltd. Mr. Murphy's employment agreement with the Company entitles him to receive an annual base salary of $250,000 and a bonus equal to 2% of the annual audited earnings before interest and taxes of the Hua Yang group. Upon the transfer of Hua Yang into the Company, Mr. Murphy was granted options to purchase 300,000 of the Company s ADSs at a price of $1.36 per ADS, which price is equal to the closing market price of the Company s ADSs on the last trading day prior to the date of the grant. The options will vest as to 100,000 ADSs on each of the first, second and third anniversaries of the option grant date and shall expire on the tenth anniversary of such date. Mr. Murphy is also given the use of a car and driver for business use in China, mobile phone and participation in medical insurance plan.

The agreement provides for a five year term of employment until May 26, 2009. However, the agreement can be terminated at any time by Mr. Murphy by giving one month s written notice, or by the Company without cause by giving seven month s written notice.

Mr. Murphy's employment agreement also provides that, during its term and for one year following the termination of Mr. Murphy's employment, Mr. Murphy may not become associated with competitive entities that are actively engaged in the Company 's business.

Li San Tung is party to an employment agreement with Kord Holdings Inc. dated July 30, 2004 that was assumed by Grand Toys International Limited with the acquisition of Kord in December 2005. Under Mr. Li's employment agreement, Mr. Li is employed as managing director of Kord Holdings, Inc. Mr. Li's employment agreement with the Company entitles him to receive an annual base salary of $277,000 and a performance-based annual bonus at the discretion of the Board. Mr. Li is also entitled to participate in any pension or medical insurance plan operated by Kord.

The agreement provides for a five year term of employment until July 30, 2009 and shall continue thereafter unless and until terminated by either the Company or Mr. Li giving to the other such period of notice in writing as may be mutually agreed between the parties, but not on or before July 30, 2006.

Mr. Li's employment agreement also provides that, during its term and for two years following the termination of Mr. Li's employment, Mr. Li may not become associated with competitive entities that are actively engaged in the Company 's business.

In conjunction with Cornerstone s acquisition of Kord Holdings, Inc. from Li San Tung in June 2004, Cornerstone issued a promissory note to Mr. Li in the principal amount of HK$23.3 million (US$3.0 million) which is convertible into 746,795 Grand ADSs that are owned by a Cornerstone subsidiary. Subsequent to the acquisition of Kord, on March 14, 2005, audited accounts revealed a purchase price adjustment which resulted in Cornerstone issuing an additional promissory note to Mr. Li in the principal amount of HK$2,243,941 (US$288,000) which is convertible into 71,921 Grand ADSs owned by a Cornerstone subsidiary. These promissory notes have a maturity date of July 30, 2006. As of October 15, 2006, Mr. Li has not exercised the notes and converted them into Grand ADSs.

As of October 31, 2006, the $2.6 million outstanding balance on an overdraft facility, for Hua Yang, with ICBC was linked with availability on another facility at ICBC used by Jeff Hsieh with the understanding that this would be paid down by the end of 2006. As of November 6, 2006, the $4.5 million balance on the ICBC term loan, for Hua Yang, was assumed by Jeff Hsieh for a loan to be repaid in monthly installments beginning January 2007 and ending June 2008 at an interest rate of prime plus 1%.

Item 8A. Financial Statements:

The consolidated financial statements of the Company, including the notes thereto, together with the report of independent certified public accountants thereon, are presented beginning at page F-1.

Selected Quarterly Financial Data:

For the fiscal year 2005: (figures in 000)

	March 31	June 30	September 30	December 31
			(in 000s)	
Net sales	$ 20,561	$ 29,954	$ 44,981	$ 35,834
Gross profit	4,580	8,009	11,232	8,002
Dividends	991	168	202	12,997
Net (loss) earnings applicable to shareholders	(2,667)	(647)	1,151	(29,163)
Earnings(loss) per share:				
Basic	$ (0.16)	$ (0.04)	$ 0.07	$ (1.85)
Diluted	(0.16)	(0.04)	0.06	(1.85)

For the fiscal year 2004: (figures in 000)

	March 31	June 30	September 30	December 31
			(in 000s)	
Net sales	$ 6,631	$ 13,664	$ 30,479	$ 24,759
Gross profit	1,578	3,195	7,909	2,392
Dividends	-	-	-	-
Net earnings (loss) applicable to shareholders	842	1,364	3,042	(5,307)
Earnings(loss) per share:				
Basic	$ 0.08	$ 0.14	$ 0.24	$ (0.34)
Diluted	0.08	0.14	0.24	(0.34)

Legal Proceedings

Grand Toys Ltd., a Canadian subsidiary of Grand US, 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.

On March 3, 2006, Grand Toys International Limited was named in a lawsuit for an alleged breach of a business advisory agreement. This suit is expected to be settled for a payment of $67,500 and this expense will be reflected in the 2006 financial statements.

In July 2006, two Hong Kong based employees were terminated for cause and the Company sued the employees for misconduct. The employees sued the Company for the balance of payments on their contracts. One employee subsequently withdrew his claim and the remaining employment claim is for approximately $150,000. Both cases are still pending. If the employees are found guilty of misconduct, the claim for unpaid salary is invalid.

The Company believes that the ultimate resolution of any of these actual or threatened legal proceedings will not have a material adverse effect on the Company s liquidity, financial condition or results of operations.

Dividend Policy

The Company has not paid and the directors of the Company have no current plans to recommend paying dividends on the Company s ordinary shares. The Company intends to retain earnings, if any, for use in its business. Any dividends for ordinary shares that may be declared in the future will be determined by the Board of Directors based upon the Company s financial condition, results of operation, market conditions and other factors that the Board deems relevant. The Company is required to pay dividends on its Preference Shares. The holders of the Preference Shares have agreed to accept additional ADSs (representing ordinary shares) in lieu of cash dividends on the Preference Shares.

Significant Changes

See the Company s consolidated financial statements included in this report regarding the restatement of its financial statements for the year ended December 31, 2004 and the discussion of the Company s operating and financial review and prospects set forth in Item 5.

Item 9. The Offer and Listing

The Company s ADRs have, since August 16, 2004, traded on the NASDAQ Small Cap Stock Market (NASDAQ) under the symbol GRIN . The Bank of New York serves as Depositary for the ADSs. Each ADS represents beneficial ownership of one ordinary share. The following table sets forth the range of high and low closing representative bid prices for the Company s ADSs from August 16, 2004 through November 14, 2006 as reported by NASDAQ. The figures in U.S. Dollars represent prices between dealers, do not include retail mark-ups, markdowns or commissions and may not represent actual transactions.

Annually:

ADS		Representative Bid Prices	
		High ($)	Low ($)
August 16, 2004	December 31, 2004	3.48	1.60
January 1, 2005	December 31, 2005	3.30	1.25

15

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Quarterly:

ADS	Representative Bid Prices	
	High ($)	Low ($)
2004		
Third quarter (from August 16, 2004	2.68	1.6
Fourth quarter	3.48	1.99
2005		
First quarter	3.30	2.31
Second quarter	3.16	1.77
Third Quarter	2.40	1.40
Fourth Quarter	2.76	1.25
2006		
First quarter	2.38	1.10
Second quarter	1.99	1.25
Third quarter	1.50	0.83
Fourth quarter thru to the 14^{th}	2.25	0.51

Monthly:

ADS	Representative Bid Prices	
	High ($)	Low ($)
2006		
January	1.60	1.10
February	2.38	1.40
March	2.10	1.60
April	1.99	1.61
May	1.80	1.48
June	1.60	1.25
July	1.41	1.15
August	1.50	0.83
September	1.11	0.83
October	2.25	0.51
November thru to 14^{th}	1.36	0.79

On November 14, 2006, the last reported sales price for the Company s ADSs on NASDAQ was $1.08 per share.

Item 10. Additional Information

Memorandum and articles of association

Register

The Company s registration number at the Hong Kong Companies Registry is 866120.

Powers and Purposes

Under the Companies Ordinance (Ch. 32 of the Laws of Hong Kong) (the Companies Ordinance), the Company is not obliged to state, and has not stated, in its memorandum of association the objects for which it has been incorporated or its ancillary powers.

Directors Powers

Under the Company s articles of association:

.

a director shall not vote at any directors meeting in respect of any contract or proposed contract (being a contract of significance in relation to the Company s business) or arrangement with the Company in which he or she is, directly or indirectly, interested. If such director does so vote, his or her vote shall not be counted. In addition, he or she shall not be counted in the quorum present at the meeting. Such prohibitions do not apply to (1) arrangements for giving security or indemnity to any director in respect of money lent by him or her to, or obligations undertaken by him or her for the benefit of, the Company, (2) arrangements for the giving by the Company of any security to a third party in respect of a debt or obligation of the Company for which a director has assumed responsibility in whole or in part under a guarantee or indemnity or by deposit of a security, (3) any contract by a director to subscribe for or underwrite shares or debentures, and (4) any contract or arrangement with any other company in which he or she is interested only as an officer or the Company or as holder of shares or other securities;

.

a director shall not vote at any directors meeting on his or her own appointment to hold any office or place of profit under the Company or the arrangement of the terms of such appointment, but he or she may be counted in the quorum present at any such meeting and may vote on the appointment of any other director to hold any such office or place of profit and the arrangement of the terms thereof;

.

the directors of the Company may exercise all the powers of the Company to borrow money, and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and to issue debentures, debenture stock, and, subject to Section 57B of the Companies Ordinance, convertible debentures and convertible debenture stock, and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party. Such powers may be varied by means of amendment of the relevant provisions in the Company s articles of association;

.

there are no age limit requirements as to retirement or non-retirement of directors; and

.

the shareholding qualification for directors may be fixed by the Company at a general meeting, and unless and until so fixed no qualification is required. No such qualification has been fixed.

Description of the Company s Share Capital

The articles of association of the Company and the Companies Ordinance govern the rights, preferences and restrictions of each class of shares in the capital of the Company. The following discussion is a summary of the rights, preferences and restrictions attaching to the classes of shares currently in issue.

General

Authorized Share Capital

The authorized share capital of the Company is HK$100,000,000 divided into 100,000,000 shares of HK$1.00 each. The Company has the power, by ordinary resolution, to increase its authorized share capital by such sum, divided into shares of such amount, as the resolution shall prescribe.

Issue of Shares

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share in the Company may be issued with such preferred, deferred or other special rights or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the shareholders of the Company may by ordinary resolution determine. The directors of the Company may not exercise any power conferred on them to allot shares without the prior approval of shareholders of the Company at a general meeting where such approval is required by Section 57B of the Companies Ordinance.

Changes to Rights of a Class or Series

The Company s articles of association provide that, if at any time the share capital of the Company is divided into different classes of shares, the rights attached to any class may, whether or not the Company is being wound up, be varied with the consent in writing of the holders of 75% in nominal value of the issued shares of that class, or with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class.

Liability for Further Calls or Assessments

Unless any shares have been issued as nil or partly paid shares, the Company does not have the legal right to levy further calls or assessments on its existing shareholders.

Compulsory Acquisition of Shares Held by Minority Shareholders

An acquiring party would, in principle, be able to acquire compulsorily the shares in the Company held by minority shareholders in one of the following ways:

.

By a procedure under the Companies Ordinance known as a scheme of arrangement. Such an arrangement would be proposed by the Company to its shareholders at a general meeting ordered by the Hong Kong Court of First Instance (the Court). . If a majority in number representing three-fourths in value of the shareholders of the Company present and voting either in person or by proxy at the meeting were to agree to the arrangement, the arrangement would, if subsequently sanctioned by the Court, be binding on all the shareholders of the Company and on the Company itself. Under such an arrangement, minority shareholders of the Company could be compelled to sell their shares;

.

If another company were to make an offer to shareholders of the Company and, within four months of making the offer, acquired not less than 90% of the shares in the Company for which the offer was made, the offeror could, at any time not later than five months after making the offer, give a written notice to non-accepting shareholders of its desire to purchase their shares in the Company. Such non-accepting shareholders would then be bound to sell their shares in the Company on the terms of the offer. A non-accepting shareholder would have a period of two months from the date of such written notice to apply to the Court for an order that he shall not be bound to sell shares in the Company or to order terms of acquisition different from those of the offer.

Ordinary Shares

Voting

On a show of hands at any general meeting of the Company, every holder of ordinary shares present in person shall have one vote. On a poll every such holder shall have one vote for each ordinary share held by him.

Dividend Rights

The Company shall not pay dividends unless they are paid out of profits available for the purpose in accordance with the provisions of Part IIA of the Companies Ordinance. Subject to such limitation, the Company may at a general meeting declare dividends, but no dividend shall exceed the amount recommended by the directors. The directors may from time to time pay to the holders of ordinary shares such interim dividends as appear to the directors to be justified by the profits of the Company. Any general meeting declaring a dividend may direct payment of such dividend wholly or partly by the distribution of specific assets.

Redemption and Conversion

Outstanding ordinary shares of the Company are not, by their terms of issue, convertible into shares of any other class or series or subject to compulsory redemption either by the Company or the holders of such shares.

Preemptive Rights

Holders of ordinary shares have no preemptive or preferential right to purchase any other securities of the Company.

Repurchase Rights

Subject to compliance with the relevant provisions of the Companies Ordinance, the Company may purchase its own shares.

Preference Shares

Dividends

Holders of Series A Preference Shares have the right to receive cumulative preferred dividends at the rate of ten and one-half percent (10.5%) per annum on the amount of $3.8375 per Series A Preference Share. Holders of Series B Preference Shares have the right to receive cumulative preferred dividends at the rate of four and three-quarters percent (4.75%) per annum on the amount of $3.8375 per Series B Preference Share. Dividends are payable semi-annually on each of 30th June and 31st December, and can be paid in either the Company ADSs (representing ordinary shares) or cash.

Voluntary Conversion

Holders of Series A Preference Shares have the right to convert the whole (and not part only) of their Series A Preference Shares into ordinary shares at any time. Such ordinary shares would be represented by an equivalent number of the Company ADSs. The conversion rate is 1.4023 ordinary shares/ADSs for each Series A Preference Share (the Series A Conversion Rate), or 2,804,600 ordinary shares/ADSs for 2,000,000 Series A Preference Shares. The Series A Conversion Rate is based upon a conversion price of $2.7365 per Series A Preference Share (the Series A Conversion Price), which Series A Conversion Price equaled the average closing price of the Company ADSs for the 40 consecutive trading days ending on 28th February, 2005.

Holders of Series B Preference Shares have the right to convert the whole (and not part only) of their Series B Preference Shares into ordinary shares at any time. Such ordinary shares would be represented by an equivalent number of the Company ADSs. The conversion rate is 2.6886899 ordinary shares/ADSs for each Series B Preference Share (the Series B Conversion Rate), or 29,147,006 ordinary shares/ADSs for 10,840,598 Series B Preference Shares. The Series B Conversion Rate is based upon a conversion price of $1.427275 per Series B Preference Share (the Series B Conversion Price), which Series B Conversion Price equaled the average closing price of ADSs for the 30 consecutive trading days ending on 29th November, 2005.

Upon the conversion of Preference Shares, the Company is required to pay all accrued and unpaid dividends due in respect of the shares so converted; provided, however, that in lieu of paying cash dividends, the Company shall have the right to satisfy the accrued dividends by issuing such number of ordinary shares, to be represented by an equivalent number of Grand ADSs (representing ordinary shares), as is determined by dividing the amount of the accrued dividends by, in the case of the Series A Preference Shares, the average closing price of Grand ADSs on the Nasdaq SmallCap market for the forty (40) consecutive trading days immediately prior to the conversion of the preference shares and, in the case of the Series B Preference Shares, $1.543.

Conversion by the Company

Grand has the right to require the conversion of the whole (and not part only) of preference shares held by any person if (i) Grand ADSs have traded at 105% of the Conversion Price, or $2.8733 or higher per Grand ADS, for at least 45 days prior to the date on which the Company gives notice requiring conversion and (ii), in the case of the Series A Preference Shares, the Company shall have paid aggregate cash dividends of $767,500 to the holders thereof ; provided, however, that the requirement in item (i) shall not apply after the occurrence of a public offering of securities by the Company resulting in proceeds of not less than $50,000,000.

Liquidation Preference

Upon a liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, the holders of Preference Shares will have rights preferential to those of holders of ordinary shares. Upon a liquidation, dissolution or winding up of the Company, the assets of the Company available for distribution shall be applied:

.

first, to pay the holders of Series A Preference Shares an amount equal to $3.8375 per Series A Preference Share, and if the assets of the Company are insufficient to pay such amount, then pro rata to the holders (if more than one) of the Series A Preference Shares;

.

second, to pay to holders of Series A Preference Shares all arrears and accruals of preferential dividends;

.

third, to pay the holders of Series B Preference Shares an amount equal to $3.8375 per Series B Preference Share, and if the assets of the Company are insufficient to pay such amount, then pro rata to the holders (if more than one) of the Series B Preference Shares;

.

fourth, to pay to holders of Series B Preference Shares all arrears and accruals of preferential dividends ; and

.

fifth, to pay the holders of ordinary shares any surplus assets which shall be distributed ratably amongst such holders according to the amounts paid up thereon.

Preemptive Rights

As long as there are more than 100,000 Series A Preference Shares outstanding, holders of Series A Preference Shares will have preemptive rights to purchase up to their respective pro rata shares of any securities offered by the Company to any third party, at the same price and on the same terms and conditions as the Company shall offer such securities to such third parties. Such pre-emptive rights shall not apply to the issuance by the Company of ordinary shares, or by any depositary of Grand ADSs representing the same, or the grant of options in respect thereof, pursuant to any employee share option scheme in force at any time while such number of Preference Shares is outstanding.

Voting Rights

On a vote taken at any general meeting of the Company on a show of hands, holders of Preference Shares present in person shall be entitled to vote in the same manner as any holder of ordinary shares. On a poll, holders of Preference Shares present in person or by proxy shall be entitled to such number of votes as is equal to the number of ordinary shares into which such Preference Shares are then convertible. The holder of 2,000,000 Series A Preference Shares shall be accordingly entitled to have 2,804,600 votes. The holder of 10,840,598 Series B Preference Shares shall be accordingly entitled to have 29,147,006 votes.

Meetings of Shareholders

Under the Companies Ordinance and the Company s articles of association, the Company is required in each year to hold a general meeting as its annual general meeting in addition to any other meetings in that year and shall specify the meeting as such in the notices calling it. Not more than 15 months shall elapse between the date of one annual general meeting of the Company and that of the next. The annual general meeting shall be held at such time and place as the directors of the Company shall appoint. Additional general meetings may be convened by the directors of the Company or by written request of shareholders holding not less than one-twentieth of the paid-up capital of the Company which carries the right of voting at general meetings of the Company.

Quorum Requirements

Under the Company's articles of association, a quorum for all general meetings shall be two shareholders, present in person or by proxy and holding at least 51% of the paid-up capital of the Company.

Actions by Written Consent

The Companies Ordinance provides that shareholders may generally take any action otherwise requiring a resolution in general meeting by written resolution signed by all such shareholders. The Company s articles of association expressly authorize actions by such written resolutions of its shareholders.

Right of Non-Hong Kong Shareholders to Vote

No limitations are imposed by Hong Kong law or the Company s articles of association on the right of persons who are not Hong Kong residents to hold any class of shares in the Company or exercise voting rights in respect thereof.

Change of Control Transactions

The Companies Ordinance does not provide a statutory merger framework or procedure with regard to changes in control. However, in connection with a reconstruction or amalgamation of any company or companies, a scheme of arrangement may be proposed to shareholders or creditors or any class of either and must be approved by a majority in number of such shareholders or creditors or relevant class of either who must, in addition, represent three-fourths in value of the shareholders, creditors or relevant class of either present and voting either in person or by proxy at any meeting convened for the purpose. The convening of any such meeting and subsequently the proposed arrangement must be ordered or sanctioned by the Hong Kong Court of First Instance. The court order must then be delivered to the Hong Kong Registrar of Companies and annexed to the relevant company s articles of association. Thereafter, the scheme of arrangement will be binding on all shareholders or creditors of the company (or relevant class of either).

Material Contracts

For a summary of any material contract entered into by the company or any of its consolidated subsidiaries outside of the ordinary course of business during the last two years, see Item 4. Information on the Company , Item 5. Operating and Financial Review and Prospects and Item 7. Major Shareholders and Related Party Transactions .

Exchange Controls

No Hong Kong laws or regulations restrict the import or export of capital or affect the payment of dividends to non-resident holders of ordinary shares.

Taxation

U.S. Holders

Distributions

Subject to the discussion below under "Passive Foreign Investment Company Considerations," the gross amount of any distribution by the Company to its shareholders of cash or property (other than certain distributions, if any, of ordinary shares distributed pro rata to all shareholders with respect to the Company s ADSs will be includible in a shareholder s income as dividend income to the extent such distributions are paid out of the current or accumulated earnings and profits of the Company as determined under U.S. federal income tax principles. Such dividends generally will not be eligible for the dividends received deduction allowed to U.S. holders that are corporations, but (provided the Company s ADSs are traded on a U.S. exchange) such dividends paid to U.S. holders through 2010 will be eligible for the special 15% U.S. federal income tax rate applicable to qualifying dividends received by U.S. holders, if you are a non-corporate U.S. holder who satisfies certain holding period requirements as to the Company s ADSs. Subject to the discussion below under "Passive Foreign Investment Company Considerations," to the extent that the amount of any distribution by the Company exceeds the Company s current and accumulated earnings and profits as determined under U.S. federal income tax principles, the excess distribution will be treated first as a tax-free return of a U.S. holder s adjusted tax basis in the Company s ADSs and thereafter as capital gain.

Amounts taxable to a U.S. holder as dividends generally will be treated as foreign source income for purposes of calculating a U.S. holder s foreign tax credit limitation.

Sale or Exchange of the Company s ADSs

Subject to the discussion below under "Passive Foreign Investment Company Considerations," a U.S. holder will generally will recognize gain or loss on a sale or exchange of the Company s ADSs equal to the difference between the amount realized on such sale or exchange and such holder s adjusted tax basis in such Company ADSs. Such gain or loss will be capital gain or loss. For a non-corporate U.S. holder, the maximum marginal U.S. federal income tax rate applicable to such gain will be lower than the maximum marginal U.S. federal income tax rate applicable to ordinary income if such holder s holding period for ADSs exceeds one year. Gain or loss, if any, recognized by a U.S. holder generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes. The deductibility of capital losses is subject to limitations.

Passive Foreign Investment Company Considerations

A non-U.S. corporation like the Company will be classified as a passive foreign investment company (which is referred to as a PFIC) for U.S. federal income tax purposes in any taxable year in which, after applying certain look-through rules, either at least 75% of its gross income is passive income or at least 50% of the gross value of its assets is attributable to assets that produce passive income or are held for the production of passive income. Passive income for this purpose generally includes dividends, interest, royalties, rents, and gains from commodities and securities transactions.

The Company believes that it will not be classified as a PFIC for its current taxable year. The Company s status in future years will depend on its assets and activities in those years. The Company has no reason to believe that its assets or activities will change in a manner that would cause it to be classified as a PFIC. However, the tests for determining PFIC status are applied annually, and it is difficult to accurately predict the Company's future income and assets, which are relevant to this determination. Accordingly, although not anticipated, the Company cannot assure you that it will not become a PFIC. If The Company s were to become a PFIC, then, subject to the discussion below, U.S. holders would be subject to imputed interest charges and other disadvantageous tax treatment with respect to any gain from the sale or exchange of, and certain distributions with respect to, the Company ADSs.

Alternatively, U.S. holders generally could elect, subject to certain limitations, to annually take into gross income the appreciation or depreciation in the value of the Company s ADSs during the tax year (which is referred to as the mark-to-market election). If a U.S. holder makes the mark-to-market election, such holder will not be subject to the above-described rule, but will recognize each year an amount equal to the difference as of the close of the taxable year between the value of the Company s ADSs and such holder s adjusted tax basis in the Company s ADSs. Losses would be allowed only to the extent of net gain previously included by a U.S. holder under the mark-to-market election for prior taxable years. Amounts included in or deducted from income under the mark-to-market election and actual gains and losses realized upon the sale or disposition of the Company s ADSs would be treated as ordinary income or loss.

Information Reporting and Backup Withholding Tax

Distributions with respect to the Company s ADSs and the proceeds from the sale or redemption of the Company s ADSs are subject to U.S. backup withholding tax and information reporting rules.

In general, information reporting requirements will apply to dividends or sale proceeds paid within the U.S. and in some cases, outside of the U.S., to U.S. holders other than certain exempt recipients, such as corporations. In addition, backup withholding at the then applicable rate will apply to these payments unless a U.S. holder provides an accurate taxpayer identification number in the manner required by U.S. law and applicable regulations, certifies that it is not subject to backup withholding, and otherwise complies with applicable requirements of the backup withholding rules. Amounts withheld under the backup withholding rules may be credited against a U.S. holder s federal income tax liability, and a U.S. holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

Non-U.S. holders

Distributions and Dispositions

In general, and subject to the discussion below under Information Reporting and Backup Withholding Tax, a non-U.S. holder will not be subject to U.S. federal income or withholding tax on distributions with respect to, or gain upon the disposition of, the Company s ADSs, unless either (1) the income or gain is effectively connected with such holder s conduct of a trade or business in the U.S. or (2) in the case of gain realized by an individual non-U.S. holder upon a disposition of the Company s ADSs, such holder is present in the U.S. for 183 days or more in the taxable year of the sale and certain other conditions are met.

In the event that clause (1) in the preceding paragraph applies, such income or gain generally will be subject to regular U.S. federal income tax in the same manner as if such income or gain, as the case may be, were realized by a U.S. holder. In addition, if a non-U.S. holder is a corporation, such income or gain may be subject to a branch profits tax at a rate of 30%, although a lower rate may be provided by an applicable income tax treaty. In the event that clause (2), but not clause (1), in the preceding paragraph applies, the gain generally will be subject to tax at a rate of 30%, or such lower rate as may be provided by an applicable income tax treaty.

Information Reporting and Backup Withholding Tax

If the Company s ADSs are held through a non-U.S. and non-U.S. related broker or financial institution, information reporting and backup withholding generally would not be required with respect to distributions on and dispositions of the Company s ADSs. Information reporting, and possibly backup withholding, may apply if the Company s ADSs are held through a U.S. or U.S.-related broker or financial institution and the non-U.S. holder fails to provide appropriate information. The amount of any backup withholding from a payment to a non-U.S. holder will be allowable as a refund or credit against such holder s U.S. federal income tax liability, provided that the requested information or appropriate claim for refund is furnished to the IRS.

Hong Kong Tax Consequences to Holders of Grand HK ADSs.

Holders will generally not be liable for Hong Kong profits or withholding taxes, on dividends received with respect to the Company s ADSs or on capital gains realized upon the sale of the Company s ADSs. However, Hong Kong profits taxes may apply to holders who are engaged in Hong Kong in the trade or business of buying and selling shares.

Documents on Display

The Company files annual and special reports and other information with the SEC. These reports may be inspected and copied at the public reference facilities maintained by the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such material can be obtained from the SEC at prescribed rates by writing to the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

The SEC maintains an Internet website at http://www.sec.gov that contains reports, proxy statements, information statements and other material that are filed through the SEC s Electronic Data Gathering, Analysis and Retrieval (EDGAR) system. The Company began filing through the EDGAR system beginning in February 2004.

The Company s ADRs are quoted on the Nasdaq SmallCap Market.

Information about the Company is also available on its website at http//www.grand.com. Such information on its website is not part of this annual report.

Item 11. Quantitative and Qualitative Disclosures about Market Risk

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

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

FOREIGN CURRENCY RISK

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

Item 13. Defaults, Dividend Arrearages and Delinquencies

The Company maintains working capital facilities for its operations. All of the Company s loan facilities are uncommitted and the lenders have the right to withhold extending credit in their sole discretion. In addition, these facilities have certain financial covenants that must be maintained. As of December 31, 2005, IPI was not in compliance with certain covenants and received a temporary waiver of these compliance requirements until May 15, 2006. As of May 15, 2006, the covenants were not satisfied and on June 30, 2006 Citibank stated that they will not extend the revolving credit facility and Citibank issued a reservation of rights letter on July 21, 2006. In the reservation of rights letter, Citibank stated that at this time, they will not demand immediate repayment of all sums owing under the credit facility. The balance of $10,484,000 was all converted to a prime rate loan with a maturity date of September 30, 2006 and remains outstanding as of November 15, 2006 as the Company seeks alternative financing for its North American operations. The Company has identified several alternative financing options for its North American facility and expects to replace the Citibank facility in the near future. The terms of the replacement facility have not yet been finalized.

PART II

Item 15. Controls and Procedures

(a) The Company s senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (the Exchange Act)) designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, with the participation of the Chief Executive Officer and Chief Financial Officer, as well as other key members of the Company s management, of the effectiveness of the Company s disclosure and procedures as of the end of the period covered by this report. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that information required to be disclosed in the Company s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

(c) The Company, as a foreign-filer, is not required to obtain the attestation report of a registered public accounting firm until after December 31, 2007.

(d) No change occurred in the Company s internal controls concerning financial reporting during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

Item 16A. Audit Committee Financial Expert

The Board of Directors has determined that Allen Perl qualifies as an audit committee financial expert as defined in Item 401(h)(2) of Regulation S-K of the Securities and Exchange Act of 1934, as amended.

Item 16B. Code of Ethics

The Company has adopted a code of ethics that applies to its chief executive officer and senior financial officers, a copy of which will be provided upon written request to Tania M. Clarke, 1710 Route Transcanadienne, Dorval, Quebec, Canada, H9P 1H7. A copy of the Code of Ethics can be found in Item 19, Exhibits.

16

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Item 16C. Principal Accountant Fees and Services

Summary of DELOITTE Touche Tohmatsu Fees For
Professional services rendered
Years Ended December 31,

		2005		2004
Audit & audit related fees	$	676,400	$	523,300
Tax fees		-		26,000
All other fees		48,616		26,518

Audit Fees. The aggregate fees billed by Deloitte Touche Tohmatsu for the audit of the Company s annual financial statements and services provided in connection with statutory or regulatory filings or engagements were $676,400 and $523,300 in the fiscal years ended December 31, 2005 and 2004, respectively.

Audit-Related Fees. There were no fees billed by Deloitte Touche Tohmatsu for assurance and related services that were reasonably related to the performance of the audit or review of the Company's financial statements for the fiscal years ended December 31, 2005 and 2004, respectively.

Tax Fees. The aggregate fees billed by Deloitte Touche Tohmatsu for professional services rendered for tax compliance, tax advice and tax planning were $nil and $26,000 for the fiscal years ended December, 31, 2005 and 2004, respectively. The nature of the services performed for these fees was tax planning and advice.

All Other Fees. The aggregate fees billed by Deloitte Touche Tohmatsu for other fees were $48,616 and $26,518 for the fiscal years ended December 31, 2005 and 2004, respectively. The nature of the services performed for those fees was related to acquisitions and Sarbanes Oxley consulting. There were no other fees billed by Deloitte Touche Tohmatsu for the fiscal year ended December 31, 2005.

Audit Committee Pre-Approval Policy

The Audit Committee has established policies and procedures regarding pre-approval of all services provided by independent auditors. It is the policy of the Company that all services provided by the independent auditors shall be pre-approved by the Audit Committee and that the Company only engage the independent auditors to perform permissible non-audit services proscribed by law or regulation. Pre-approval must be detailed as to the particular services to be provided. The Audit Committee may give pre-approval of audit and permitted non-audit services at any time up to one year before the commencement of such services. The Chairman of the Audit Committee shall have, and the Audit Committee may delegate to any other member of the Audit Committee, the authority to grant pre-approval of permitted non-audit services between Audit Committee meetings, in which case, such decisions shall be presented to the full Audit Committee at its next scheduled meeting.

GRAND TOYS INTERNATIONAL LIMITED AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Grand Toys International Limited

We have audited the accompanying consolidated balance sheets of Grand Toys International Limited and subsidiaries (the Company) as of December 31, 2005 and 2004 and the related consolidated statements of operations, shareholders equity and comprehensive income and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits include consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Grand Toys International Limited and subsidiaries as of December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 24 to the financial statements, the Company is in the process of discontinuing the operations of a subsidiary manufacturing moulds in the People s Republic of China and certain toy and toy related products distribution in the United States of America and Canada. In addition, the Company undergoes loans refinancing with financial institutions and its major shareholder.

/s/DELOITTE TOUCHE TOHMATSU

Hong Kong

November 15, 2006

17

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Financial Statements

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

Part I. Financial Information

Item 1. Consolidated Financial Statements

Consolidated Balance Sheets

	December 31, 2005	December 31, 2004 (as restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 4,688,246	$ 8,523,656
Pledged bank deposit	27,048	597,464
Investment securities (note 2(l))	6,387	31,859
Accounts receivable (net of allowance for doubtful accounts of $4,643,598; 2004 - $4,394,673)	27,457,316	17,844,344
Inventory (note 2(h))	20,335,067	11,008,050
Due from related companies (note 20)	3,516,518	5,625,200
Note receivable (note 4)	266,312	138,440
Deferred tax asset (note 12 (c))	-	-
Income tax recoverable	88,715	
Prepaid royalties (note 2(i))	2,024,993	2,251,695
Other prepaid expenses and current assets (note 5)	3,728,655	2,405,439
Total current assets	62,139,257	48,426,147
Fixed assets, net (note 6)	21,096,642	18,050,231
Goodwill (note 2(m))	26,017,533	29,197,018

Prepaid land lease (note 2(i))		89,787		60,814
Intangibles, net (note 7)		9,040,576		10,013,483
Note receivable (note 4)		244,464		400,396
Total assets	$	118,628,259	$	106,148,089

19

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

Consolidated Balance Sheets

		December 31, 2005		December 31, 2004 (as restated)
Liabilities and Shareholders' Equity				
Current liabilities:				
Bank indebtedness (note 8)	$	22,342,696	$	12,629,046
Trade accounts payable		16,938,467		10,339,909
Accrued payroll and related costs		2,105,788		1,065,469
Other accounts payable and accrued liabilities		10,133,977		9,188,553
Obligations under capital leases (note 9)		2,404,573		2,413,167
Due to related parties (note 20)		2,828,705		3,264,041
Income taxes payable		633,941		515,180
Total current liabilities		57,388,147		39,415,365
Long term debt (note 8)		5,110,663		788,992
Note payable (note 22)		703,964		-
Deferred tax (note 12 (c))		3,311,252		3,079,309
Obligations under capital leases (note 9)		3,452,152		4,434,073
Commitments and contingencies (notes 17 and 18)				
Shareholders' equity:				
Capital stock (note 10):		2,120,360		2,026,346
Voting ordinary shares, $0.13 par value				
100,000,000 ordinary shares authorized				
16,310,467 ordinary shares issued and outstanding				
(2004 15,587,282)				
Preference stock (note 10)				

2,000,000 Series A preference shares , $0.13 par value (2004 Nil)		260,000		-
10,840,598 Series B preference shares , $0.13 par value (2004 Nil)		1,409,278		-
Deferred non-voting stock (note 10)				
2 deferred non-voting share, $0.13 par value		-		-
Additional paid-in capital		69,826,118		50,331,294
(Accumulated loss) retained earnings		(25,549,243)		5,777,153
Accumulated other comprehensive income-cumulative currency translation adjustment		595,568		295,557
Total shareholders equity		48,662,081		58,430,350
Total liabilities and shareholders' equity	$	118,628,259	$	106,148,089

See accompanying notes to audited consolidated financial statements.

20

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31		
	2005	**2004**	**2003**
		(as restated)	
Net sales			
- External	$ 120,792,623	$ 59,722,236	$ 14,806,468
- Affiliated companies	10,536,906	15,810,635	24,568,970
Total net sales	131,329,529	75,532,871	$ 39,375,438
Cost of goods sold	99,506,552	60,458,768	33,538,951
Gross profit	31,822,977	15,074,103	5,836,487
Other operating income	(1,918,250)	(482,312)	(896,023)
Operating costs and expenses:			
General and administrative	23,492,605	9,490,171	2,141,280
Selling and distribution expenses	9,886,407	3,317,275	638,498
Depreciation and amortization	2,697,431	1,564,595	398,478
Impairment on intangible assets and goodwill	12,487,867	-	-
Total operating costs and expenses	48,564,310	14,372,041	3,178,256
Operating (loss) income	(14,823,083)	1,184,374	3,554,254
Non-operating expense (income):			
Interest expense	1,937,524	464,048	23,835
Interest income	(53,310)	(45,065)	(5,051)
Impairment loss on investment securities	25,477	31,785	-
	1,909,691	450,768	18,784

Total non-operating expense (income)			
(Loss) earnings before income taxes	(16,732,774)	733,606	3,535,470
Income taxes:			
Current	549,521	727,385	536,045
Deferred	(313,591)	65,106	(22,705)
Total income taxes	235,930	792,491	513,340
Net (loss) earnings from continuing operations	(16,968,704)	(58,885)	3,022,130
Discontinued operations:			
Earnings from operations of distributed			
subsidiaries	-	-	1,239,236
(Loss) earnings from operations	$ (16,968,704) $	(58,885) $	4,261,366
Dividends (note 10(h))	(14,357,692)	-	-
Net (loss) earnings available to ADS shareholders	$ (31,326,396) $	(58,885) $	4,261,366

See accompanying notes to audited consolidated financial statements.

GRAND TOYS INTERNATIONAL LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS, CONTINUED

		Years ended December 31	
	2005	**2004**	**2003**
		(as restated)	
(Loss) earnings per American			

Depositary Shares (ADS):			
Weighted average ADS outstanding:			
Basic	16,137,667	12,092,592	10,000,000
Diluted	18,191,015	12,807,160	10,000,000
Net (loss) earnings - Continuing operations:			
Basic	$ (1.94)	$ (0.00)	$ 0.30
Diluted	(1.94)	(0.00)	N/A
Net earnings - Discontinued operations:			
Basic	-	-	0.13
Diluted	-	-	N/A
Net (loss) earnings available to ADS shareholders			
Basic	(1.94)	(0.00)	0.43
Diluted	(1.94)	(0.00)	N/A

N/A refers to not applicable

See accompanying notes to audited consolidated financial statements.

21

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

Consolidated Statements of Shareholders Equity and Comprehensive Income

	Preference Stock	Capital Stock	Additional Paid in Capital	Retained Earnings	Accumulated other comprehensive income	Total
January 01, 2003	$ -	$ 13	$ -	$ 24,382,458	$ 286	$ 24,382,757
Net earnings for the period				4,261,366		4,261,366
Foreign currency adjustment					21,514	21,514
Total comprehensive income				4,261,366	21,514	4,282,880
Distribution of subsidiaries to holding companies				(22,807,786)		(22,807,786)
December 31, 2003	-	13	-	5,836,038	21,800	5,857,851
Share purchase on merger		2,025,418	26,628,377			28,653,795
Hua Yang and Kord acquisition			23,699,206			23,699,206

Net earnings for the period				(58,885)		(58,885)
Foreign currency adjustment					273,757	273,757
Total comprehensive income				(58,885)	273,757	214,872
ADSs issued on option exercises		915	5,633			6,548
Compensation expense			(1,922)			(1,922)
December 31, 2004, as restated	-	2,026,346	50,331,294	5,777,153	295,557	58,430,350
Net loss for the period				(16,968,704)		(16,968,704)
Foreign currency adjustment					300,011	300,011
Total comprehensive income				(16,968,704)	300,011	(16,668,693)
Issue of (note 10):						
Series A Preference Shares	260,000	92,031	10,540,757			10,892,788
Series B Preference Shares	1,409,278		8,943,273			10,352,551
Dividends on (note 10):						
Series A Preference Shares				(571,198)		(571,198)
Deemed dividend				(991,426)		(991,426)
Series B Preference						

Shares				(43,310)		(43,310)
Deemed dividend				(12,751,758)		(12,751,758)
ADSs issued on option exercises		1,983	15,130			17,113
Compensation expense			(4,336)			(4,336)
December 31, 2005	$ 1,669,278	$ 2,120,360	$ 69,826,118	$ (25,549,243)	$ 595,568	$ 48,662,081

See accompanying notes to audited consolidated financial statements.

22

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

Consolidated Statements of Cash Flows

	For the years ended December 31		
	2005	**2004**	**2003**
		(as restated)	
Cash flows from operating activities:			
Net (loss) earnings from continuing operations	$ (16,968,704)	$ (58,885)	$ 3,022,130
Adjustments for:			
Depreciation and amortization General and administrative	2,697,431	1,564,595	398,478
Depreciation and amortization Cost of goods sold	3,172,113	1,445,179	39,206
Impairment loss and write off of fixed assets	765,712	-	-
Impairment on intangible and goodwill	12,487,867	-	-
Income taxes	549,521	727,385	536,045
Deferred income taxes	(313,591)	65,106	(22,705)
Product development write-off	-	7,790	-
Assets write-off	203,834	2,217	-
(Gain) loss on disposal of fixed assets	(131,224)	129,586	20,452
Compensation expense	(4,336)	(1,922)	-
Impairment loss on investment securities	25,477	31,785	-
Net change in operating working capital			
items (note 14)	(6,985,030)	(9,959,611)	(2,977,037)
Net cash (used for) provided by operating activities			
from continuing operations	(4,500,930)	(6,046,775)	1,016,569
Net cash provided by operating			
activities from discontinued operations	-	-	2,747,246
Net cash (used for) provided by operating activities	(4,500,930)	(6,046,775)	3,763,815
Cash flows from investing activities:			
Proceeds from disposal of equipment	180,149	579	21,160

Decrease (increase) in pledged time deposit	570,484	(597,464)	-
Acquisition of business, net of cash acquired	(7,546,084)	1,268,786	-
Settlement of note receivable	827,017	-	-
Increase in other assets	-	(356,524)	-
Settlement of note receivable	-	63,301	-
Increase in intangibles	(3,244)	(20,428)	-
Additions to equipment and leasehold improvements	(2,583,542)	(2,971,297)	(449,291)
Net cash used for investing activities			
from continuing operations	(8,555,220)	(2,613,047)	(428,131)
Net cash used for investing activities			
from discontinued operations	-	-	(33,887)
Net cash used for investing activities	(8,555,220)	(2,613,047)	(462,018)
Cash flows from financing activities:			
Increase (decrease) in bank indebtedness	12,814,943	7,191,161	(2,615,643)
Repayment of bank indebtedness	(2,100,000)	-	-
Decrease in amount due to ultimate holding company		1,050,535	
Issuance of share capital on merger	-	8,700,000	-
Repayment of obligation under a capital lease	(2,829,052)	(1,400,221)	(54,218)
Proceeds from ADSs exercise	17,113	1,914	-
Increase (decrease) in trust receipt loans	1,199,401	(235,985)	-
Other	118,335	(45,636)	33,570
Net cash provided by (used for) financing activities			
from continuing operations	9,220,740	15,261,768	(2,636,291)
Net cash provided by (used for) financing activities			
from discontinued operations	-	-	(8,594,624)
Net cash provided by (used for) financing activities	9,220,740	15,261,768	(11,230,915)
Net (decrease) increase in cash and cash equivalents	(3,835,410)	6,601,946	(7,929,118)
Cash and cash equivalents, beginning of period	8,523,656	1,921,710	9,850,828
Cash and cash equivalents, end of period	$ 4,688,246	$ 8,523,656	$ 1,921,710

See accompanying notes to audited consolidated financial statements.

Supplemental disclosure of cash flow information (note 15) and major non-cash transactions (note 16)

23

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

GRAND TOYS INTERNATIONAL LIMITED

Notes to audited Consolidated Financial Statements

Grand Toys International Limited (the Company), a Nasdaq SmallCap listed company, is organized under the laws of the Hong Kong Special Administrative Region of the People s Republic of China (Hong Kong). The Company s main operating subsidiaries are Hua Yang Holdings Co., Ltd. (Hua Yang), Kord Holdings, Inc. (Kord), and Playwell International Limited (Playwell), which are organized under the laws of Hong Kong, and Grand Toys International, Inc. (Grand US), which is organized under the laws of Nevada, United States of America (US). The Company, through its Hong Kong, US and Canadian operating subsidiaries, develops, manufactures and distributes toy and toy related products, prints and assembles books and specialty packaging and manufactures, distributes paper party goods and other licensed products throughout the world.

The Company was formerly a subsidiary of Grand US. It became the parent of Grand US on August 16, 2004, pursuant to a reorganization merger. Immediately after the reorganization merger, the Company acquired Playwell. For accounting purposes, the acquisition has been accounted for as a reverse acquisition, in which Playwell was the acquirer.

On March 1, 2005, Grand US acquired International Playthings Inc. (IPI), a New Jersey, US toy distributor (see note 22(b)). The operating results for IPI have been included in the consolidated results of the Company since March 1, 2005.

On December 23, 2005, the Company purchased the shares of Hua Yang and Kord, which were owned by Cornerstone Beststep International Limited (Cornerstone Beststep), a subsidiary of Cornerstone Overseas Investments Limited (Cornerstone). Hua Yang and Kord were acquired by Cornerstone on May 24, 2004 and June 18, 2004, respectively, and were subsequently transferred to Cornerstone Beststep. The Company, Hua Yang and Kord were under the common control of the Company s main shareholder, Jeff Hsieh, who owned beneficially 62% of the Company s outstanding shares and was the sole beneficial owner of Hua Yang and Kord. The purchase method of accounting for the business combination was used; however, due to the common control of the entities, the Company has restated its financial statements back to the date of common control as if Hua Yang and Kord were part of the Company on the dates that they were acquired by Cornerstone (see note 22(c)). Under this method of accounting, the excess of the value paid to Cornerstone Beststep over the original cost of Hua Yang and Kord is reflected as a non-recurring deemed dividend in the 2005 financial statements. Further, the Company s acquisition costs are treated as restructuring costs and recorded as an expense in the 2005 financial statements.

Through Hua Yang, on February 1, 2005 the Company acquired Eastern Raiser, a PRC company which engages in the printing and assembling of books and specialty packaging (see note 22(a)).

Except as otherwise indicated, references to the Company include Grand Toys International Limited and its subsidiaries and the variable interest entities in which the Company is deemed to be the primary beneficiary.

Consolidated principal subsidiaries and variable interest entities at December 31, 2005 are as follows:

Name of subsidiary	Place of incorporation registration and Operations	Proportion ownership Interest held by the Company Directly %	Indirectly %	Principal activities
Playwell International Limited:		100	-	Investment holding
Great Wall Alliance limited	British Virgin Islands	-	100	Playwell registration
Asian World Enterprises Co. Limited	Belize	-	100	Licenses holding
Hong Kong Toy Center Limited	Hong Kong	-	100	Distribution
Gatelink Mould Engineering Limited	Hong Kong	-	100	Manufacturing of moulds
Grand Toys International Inc:	United States	100	-	Distribution
Grand Toys (US) Ltd	United States	-	100	Investment holding
Grand Toys Ltd	Canada	-	100	Distribution
Ark Creations, Inc	United States	-	100	Dormant
Grand Toys (HK) Limited	Hong Kong	-	100	Distribution
International Playthings Inc.	United States	-	100	Distribution
Hua Yang Holdings Co., Limited:	Cayman Islands	100	-	Investment holding
Hua Yang Printing Holdings Company Limited	Hong Kong	-	100	Printing operations
Dong Guan Hua Yang Printing Products Company Ltd	People s Republic of China	-	100	Factory
Shenzhen Hua Yang Printing Products Company Ltd	People s Republic of China	-	100	Factory
Hua Yang (UK) Limited	United Kingdom	-	100	Sales liaison
Hua Yang USA, Inc	United States	-	100	Sales liaison
Kord Holdings, Inc.:	British Virgin Islands	100	-	Investment holding
Kord Printing Company Limited	Hong Kong	-	100	Printing operations
Kord Gifts Manufactory Limited	Hong Kong	-	100	Printing operations
Kord Plastic Manufactory Company Limited	Hong Kong	-	100	Printing operations

Kord Party Favour Manufactory Limited	Hong Kong	-	100	Printing operations
Variable Interest entities				
Kord (Qing Xin) Packing products Limited	People s Republic of China	-	100	Subcontracting work for printing operations
Dongguan Kord Packing products Limited	People s Republic of China	-	100	Sales and manufacturing
QingXin Kord Gifts Manufactory Company Limited	People s Republic of China	-	97	Subcontracting work
Sun Tat Toys Manufactory	Hong Kong	-	100	Subcontracting work
Sun Tat Toys Factory	People s Republic of China	-	100	Subcontracting work
Sun Tat Plastic Manufactory	Hong Kong	-	100	Subcontracting work
Sun Tat Plastic Factory	People s Republic of China	-	100	Subcontracting work

1.

Restatement of prior year consolidated financial statements:

The Company acquired the shares of Hua Yang and Kord on December 23, 2005 from a related company, which was under the common control of the Company s majority shareholder, Jeff Hsieh Cheng. As a result of the transaction, the Company s consolidated financial statements for the year 2004 presented have been restated by including the results of the two subsidiaries as if they had been part of the consolidated group since the date that they were acquired by Cornerstone.

Following is a summary of significant balance sheet and income statement captions, earnings per share and also statements of shareholders equity and comprehensive income before and after the restatement:

(a)

Consolidated Balance Sheet:

December 31, 2004

As restated

			As originally reported
Current assets	$	48,426,147 $	20,456,349
Fixed assets, net		18,050,231	2,251,824
Prepaid land lease		60,814	-
Goodwill		29,197,018	14,736,315
Intangibles, net		10,013,483	6,627,184
Note receivable		400,396	-
Total assets	$	106,148,089 $	44,071,672
Current liabilities		39,415,365	7,420,313
Deferred tax		3,079,309	1,381,167
Long term Debt		788,992	-
Obligations under capital leases		4,434,073	-
Total liabilities	$	47,717,739 $	8,801,480
Shareholders equity			
Capital stock		2,026,346	2,026,346
Additional paid-in capital		50,331,294	26,632,088
Retained earnings		5,777,153	6,344,586
Accumulated other comprehensive income-cumulative			
currency translation adjustment		295,557	267,172
Total shareholders equity		58,430,350	35,270,192
Total liabilities and shareholders equity	$	106,148,089 $	44,071,672

(b)

Consolidated Statement of Operations and earnings per share

		For the year ended December 31, 2004	
		As restated	As originally reported
Net sales	$	75,532,871 $	29,464,959
Cost of goods sold		60,458,768	21,627,695
Gross profit		15,074,103	7,837,264
Other operating income		(482,312)	(304,842)
Total operating costs and expenses		14,372,041	7,099,774
Operating income		1,184,374	1,042,332
Non-operating expenses (income)		450,768	(14,307)
Earnings before income taxes		733,606	1,056,639

Income taxes		792,491		548,091
Net (loss) earnings from continuing operations		(58,885)		508,548
Earnings per ADS:				
Net (loss) earnings available to ADS shareholders				
- basic	$	0.00	$	0.04
- diluted		0.00		0.04

(c)

Consolidated Statement of Shareholders equity and comprehensive income

	December 31, 2004			
	$	As restated	$	As originally reported
Capital stock		2,026,346		2,026,346
Additional paid-in capital		50,331,294		26,632,088
Retained earnings		5,777,153		6,344,586
Accumulated other comprehensive income		295,557		267,172
Total shareholders equity		58,430,350		35,270,192

(d)

Consolidated Statement of Cash Flows

	For the year ended December 31, 2004			
	$	As restated	$	As originally reported
Net cash used for operating activities		(6,046,775)		(1,109,320)
Net cash used for investing activities		(2,613,047)		(2,065,091)
Net cash used provided by financing activities		15,261,768		7,138,008
Net increase in cash and cash equivalents		6,601,946		3,963,597
Cash and cash equivalents, beginning of period		1,921,710		1,921,710
Cash and cash equivalents, end of period		8,523,656		5,885,307

2.

Significant accounting policies:

a)

Principles of consolidation:

The consolidated financial statements include the financial statements of the Company and all its majority-owned subsidiaries and the variable interest entities in which the Company is deemed to be the primary beneficiary. All significant intercompany accounts, transactions and cash flows have been eliminated on consolidation.

b)

Revenue recognition:

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

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

Cooperative advertising expense for the years ended December 31, 2005, 2004 and 2003 were $420,215, $60,146 and $nil, respectively, and are shown as a reduction of gross sales in the financial statements.

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

c)

Cost of goods sold:

Cost of goods sold includes cost of merchandise, royalties, duties, brokerage fees, inbound freight, packaging, product development, provision on slow-moving inventory, mould amortization and depreciation on manufacturing equipment.

d)

General and administrative costs:

General and administrative costs include rent, insurance costs, administrative salaries and related costs, travel and entertainment, utilities, courier, repairs and maintenance, communications expenses, office supplies, professional fees, dues and memberships, bank charges and property taxes.

e)

Selling and distribution expenses:

Selling and distribution expenses include sales salaries and fringe benefits, sales commissions, advertising and promotion and outbound shipping and handling costs.

For the years ended December 31, 2005, 2004 and 2003, freight out was $4,337,258, $2,217,339 and $304,610, respectively.

Media advertising expense for the years ended December 31, 2005, 2004 and 2003 were $478,877, $48,265 and $7,992, respectively.

f)

Earnings per American depositary share (ADS):

In accordance with Financial Accounting Standards Board Statement (SFAS) No. 128, the weighted average shares outstanding, for purposes of presenting comparative earnings per ADS, is retroactively restated to January 1, 2002 in order to reflect the recapitalization that occurred on August 16, 2004. Each ADS represents beneficial ownership interest in one ordinary share of the Company.

i)

Basic earnings per ADS are determined by dividing the weighted average number of ADSs outstanding during the period into net earnings.

ii)

Diluted earnings per ADS give effect to all potentially dilutive ADSs that exist at the balance sheet date. The weighted average number of ADS outstanding is adjusted to include the number of additional ADS that would have been outstanding if the dilutive potential ADS had been issued.

g)

Trade receivables:

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in the Company s existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers.

h)

Inventory:

Inventory, consisting of raw materials, work in progress and finished goods, is valued at the lower of cost, determined by the first in, first out method or market value.

	December 31,			
		2005		**2004**
				(as restated)
Raw materials	$	6,893,270	$	6,929,000

Work in Progress		5,718,946		5,254,338
Finished goods		11,631,375		2,757,349
Less provision		(3,908,524)		(3,932,637)
	$	20,335,067	$	11,008,050

i)

Prepaid expenses:

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

Prepaid royalties relate to licensing agreements for properties licensed from third parties, including character licenses. Some of these contracts extend for up to four years. Total expense for the years ended December 31, 2005, 2004 and 2003 was $2,625,226 $309,578 and $166,178, respectively. For the years ended December 31, 2005, 2004 and 2003, in the consolidated statements of operations, $1,277,222, $247,430 and $166,178, respectively, is shown as part of cost of goods sold, and $1,348,004, $62,148 and $nil, respectively, is shown as part of general and administrative expenses. The amounts expected to be recognized in the statement of operations during the fiscal years ending December 31, 2006, 2007, 2008 and 2009 are $964,406, $436,024, $366,703 and $257,860, respectively.

Prepaid property taxes are amortized on a straight-line basis over the period to which they relate. The amount expected to be recognized in the statement of operations during 2006 is $5,374.

Prepaid land lease payments are stated at cost less accumulated amortization. Amortization is provided over the term of the lease on a straight- line basis.

j)

Fixed assets:

Fixed assets are carried at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. If an item is discontinued, the unamortized portion is written off immediately. During 2005, approximately $969,546 of unamortized moulds for discontinued products were written off. The maximum estimated useful lives of the assets are as follows:

Asset	**Useful Lives (in years)**
Building	50
Leasehold improvements	3 - 10
Plant & machinery	10
Motor vehicles	3-4
Furniture, fixtures and equipment	3 5
Moulds and loose tools	2 - 5

During 2005, the Company revised the estimated useful life of the moulds in order to properly approximate the remaining useful life of these assets, which was based on the revised license term. The additional depreciation resulting from this change is approximately $52,020.

k)

Leased assets:

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the Company. Assets held under finance leases are capitalized at their fair values at the date of acquisition. The corresponding liability to the lessor, net of interest charges, is included in the balance sheet as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the income statement over the period of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

All other leases are classified as operating leases and the annual rentals are charged to the income statement on a straight-line basis over the relevant lease term.

l)

Investment securities:

Investment securities represented investment in listed securities, which the Company has classified as trading securities. Securities classified as trading securities are stated at fair value with unrealized gains and losses credited or charged to the consolidated statement of operations. Realized gains and losses on the sale of the trading securities are determined using the specific-identification method and are reflected in other income (expenses).

	December 31,	
	2005	**2004**
		(as restated)
Equity securities listed in United states	$ 6,387	$ 31,859

Investment securities in 2004 represented 634,921 ordinary shares of a company incorporated in the United States whose shares are listed on The NASDAQ National Market in the United States of America. At 31 December 2005 and 2004, the fair value of this investment, as determined based on the quoted market price which was approximately $6,387 and $31,859, respectively. In the years ended December 31, 2005 and 2004, an impairment loss of approximately $25,477 and $31,785, respectively was recognized.

m)

Goodwill:

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with finite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-lived Assets.

			For the years ended December 31,	
		Date of	2005	2004
Reporting units	**Company acquired**	**Acquisition**		**(as restated)**
Printing services	Hua Yang	May 24, 2004	$ 13,102,610	$ 13,102,610
	Eastern Raiser	February 1, 2005	5,185,174	-
	Sub-total		18,287,784	13,102,610
Party Gift	Kord	June 30, 2004	1,358,093	1,358,093
North America distribution	Grand	August 16, 2004	14,726,933	14,736,315
	IPI	March 1, 2005	2,170,723	-
	Sub-total		16,897,656	14,736,315
	Impairment		(10,526,000)	-
			6,371,656	14,736,315
Total			$ 26,017,533	$ 29,197,018

The management evaluated the impairment of goodwill in two steps: (1) the identification of potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill and (2) the measurement of the amount of goodwill impaired by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill and recognizing a loss by the excess of the latter over the former. For assessment of impairment loss, the Company will measure fair value based either on internal models or independent valuations.

The annual test performed under SFAS No. 142 during 2005 resulted in $10,526,000 of impairment of goodwill relating to the goodwill attributable to the North America distribution due to a reduction in sales forecast for certain product lines held by this reporting unit.

n)

Intangibles:

Intangibles are carried at cost less accumulated amortization. Amortization is calculated on a straight-line basis over the estimated useful lives of the assets. The maximum estimated useful lives of the assets are as follows:

Asset	**Useful Lives (in years)**

License	5
Distribution network	10
Customer relationship	7-15
Trade name for IPI	4-10
Trade name for Grand US	Indefinite
Trademark	6-7
Other acquired rights	0-15

o)

Impairment of long-lived assets:

The Company evaluates the recoverability of long-lived assets with finite lives in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, to be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. During 2005, approximately $2,727,579 of assets was impaired, consisting of:

Asset		**Amount**
License	$	1,961,867
Moulds		765,712
Total	$	2,727,579

Goodwill and intangible assets not subject to amortization are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value.

p)

Incomes taxes:

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

q)

Foreign currency translation:

All transactions in currencies other than functional currencies during the year are translated at the exchange rates prevailing on the respective transaction dates. Monetary assets and liabilities existing at the balance sheet date denominated in currencies other than functional currencies are measured at the exchange rates existing on that date. Exchange differences are recorded in the consolidated statement of operations.

The functional currencies of the Company and its subsidiaries and variable interest entities include Renminbi, Canadian dollars, United States dollars or Hong Kong dollars. The consolidated financial statements of the Company are presented in United States dollars. The financial statements of the Company and all of its subsidiaries and variable interest entities with functional currencies other than the United States dollars, the reporting currency, are translated in accordance with SFAS No. 52, Foreign Currency Translation . All assets and liabilities are translated at the rates of exchange ruling at the balance sheet date and all income and expense items are translated at the average rates of exchange over the year. All exchange differences arising from the translation of financial statements are recorded as a component of accumulated other comprehensive income

r)

Employee stock option plan:

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

The disclosure under SFAS No. 123 (as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure) are as follows:

24

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

	For the years ended December 31,		
	2005	2004	2003
Net (loss) earnings available to ADS shareholders as originally stated	$ (31,326,396)	508,548 $	4,261,366
Less: restated amount for income from Kord and Hua Yang	-	(567,433)	-
Net (loss) earnings available to ADS shareholders, as restated	(31,326,396)	(58,885)	4,261,366
Add compensation income cost resulting from:			
Application of variable accounting to modified awards under APB Opinion No. 25	(4,336)	(1,922)	-
Application of fair value method under SFAS 123	(434,504)	(394,240)	N/A
Pro forma net loss	$ (31,765,236)	(455,047)	N/A
Reported net loss per ADS			
Basic	$ (1.94)	$ (0.00) $	0.43
Diluted	(1.94)	(0.00)	N/A
Pro forma net loss per ADS			
Basic	$ (1.97)	$ (0.04) $	N/A
Diluted	(1.97)	(0.04)	N/A

s)

Comprehensive income:

Comprehensive income consists of net income and cumulative currency translation adjustments and is presented in the consolidated statements of shareholders equity and comprehensive income.

t)

Variable interest entities:

Under US GAAP, when an entity holds a variable interest in another entity and that entity does not have sufficient equity or the equity security lacks decision-making authority or the rights to expected residual returns or exposure to expected losses, the entity is required to consolidate this variable interest entity (VIE) under FASB Interpretation No. 46 Consolidation of Variable Interest Entities (FIN46R). Consolidation under the variable interest model does not consider voting rights or governance provisions and does not require the ownership of any common stock. Where FIN46R is applicable, the holder of a variable interest(s) that shares in the majority of the economic risks and rewards (measured using the expected losses and expected residual returns of the VIE) must consolidate the VIE.

On December 23, 2005, the Company acquired Kord which together with its subsidiaries is principally engaged in trading and manufacturing of party products and accessories. As Kord does not directly own resources to perform the manufacturing process of the party products and accessories, it subcontracts the manufacturing process to five entities which were established in the PRC and are beneficially owned by the related companies of the Company. During the manufacturing process, Kord will provide the machinery and inventories to these entities and also reimburse the direct overhead costs incurred by these PRC entities by means of subcontracting fee. Hence, the losses incurred by these entities are expected to be absorbed by Kord as a result of the sub-contracting arrangement. In view that Kord is the primary beneficiary of these entities and also will absorb the expected losses incurred by these entities, the Company has consolidated these entities since the date that Cornerstone acquired Kord, i.e. July 1, 2004.

u)

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities as of and during the reporting periods. Significant items subject to such estimates and assumptions include the carrying amount of goodwill, fixed assets, intangibles, valuation allowances for receivables, inventories and reserves for warranties and product returns. Actual results may differ from such estimates. Differences from those estimates are recorded in the period they become known.

v)

Cash and cash equivalents:

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

w)

Recent accounting pronouncements:

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 is 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 supersedes 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 fiscal year that begins after June 15, 2005. In accordance with the standard, the Company will adopt SFAS No. 123R effective January 1, 2006.

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 asset exchanges that do not have commercial substance. The provisions in SFAS No. 153 are effective for non-monetary assets 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 issues SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement supersedes APB Opinion No. 20, Accounting changes and SFAS No. 3, Reporting Accounting changes in Interim Financial Statements. SFAS No. 154 requires retrospective application to prior periods financial statements of changes in accounting principles, unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109", or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides accounting guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of FIN 48 on January 1, 2007. The Company is currently in the process of assessing the impact of FIN 48 on its results of operations and financial condition.

3.

Segment information:

(a) Starting in the third quarter of 2004, the Company reported results of operation under two segments: Manufacturing and Distribution. This was how the Company managed its business and how it classified its operations for planning and measuring performance. With the acquisition of Hua Yang and Kord as mentioned in note 1, the segment information for 2004 has been restated. The executive officers of the Company determined that the Company s operations should be classified into the following segments:

(1)Manufacturing segments: (i) Hua Yang Printing which prints and assembles books and specialty packaging; (ii) Kord which manufactures and distributes paper party goods and (iii) Gatelink which manufactures moulds. (2) Distribution segment which is defined as the development for sale to both related parties and third parties, and distributes products developed by the Company and third parties. The Distribution segment is split between (i) North America which consists of Grand US and International Playthings Inc. and (ii) outside North America which defines as Other which includes Playwell subsidiaries, Hong Kong Toy Center and Asian World Enterprises.

	For the years ended December 31,		
	2005	**2004 (as restated)**	**2003**
Net sales:			
Manufacturing - Gatelink	$ 3,538,053	$ 3,622,623	$ 1,939,452
Manufacturing - Hua Yang	83,786,024	60,376,082	-
Manufacturing - Kord	28,901,124	13,548,975	-
Distribution - North America	36,478,857	4,194,948	-
Distribution - Other	12,146,468	22,595,273	38,147,708
Elimination of inter-segment sales	(33,520,997)	(28,805,030)	(711,722)
Total net sales	$ 131,329,529	$ 75,532,871	$ 39,375,438
Operating (loss) income:			
Manufacturing - Gatelink	$ 623,224	$ 561,554	$ 515,908
Manufacturing - Hua Yang	3,543,496	(20,291)	-
Manufacturing - Kord	954,507	162,335	-
Distribution - North America	(16,922,303)	(688,703)	-
Distribution - Other	(2,917,555)	2,716,341	3,038,346
Unallocated Corporate	(104,452)	(1,546,861)	-
Total operating (loss) income	(14,823,083)	$ 1,184,375	$ 3,554,254
Depreciation and amortization:			
Manufacturing - Gatelink	$ 41,909	$ 39,788	$ 39,206
Manufacturing - Hua Yang	2,473,473	1,502,790	-
Manufacturing - Kord	1,285,130	667,761	-
Distribution - North America	1,445,424	297,282	-
Distribution - Other	623,609	502,153	398,478
Unallocated Corporate	-	-	-
Total depreciation and amortization	$ 5,869,544	$ 3,009,774	$ 437,684
Interest income:			
Manufacturing - Gatelink	$ -	$ -	$ -
Manufacturing - Hua Yang	10,421	2,791	-
Manufacturing - Kord	825	194	-

Distribution - North America		20,523		13,879		-
Distribution - Other		7,139		3,100		5,051
Unallocated Corporate		14,402		25,101		-
Total interest income	$	53,310	$	45,065	$	5,051
Interest expense:						
Manufacturing - Gatelink	$	3	$	14	$	6
Manufacturing - Hua Yang		1,436,240		408,689		-
Manufacturing - Kord		89,884		27,586		-
Distribution - North America		243,979		14,122		-
Distribution - Other		4,646		13,637		23,829
Unallocated Corporate		162,772		-		-
Total interest expense	$	1,937,524	$	464,048	$	23,835
Income taxes, net:						
Manufacturing - Gatelink	$	41,920	$	157,831	$	34,543
Manufacturing - Hua Yang		705,758		92,997		-
Manufacturing - Kord		183,272		151,403		-
Distribution - North America		(435,042)		(50,757)		-
Distribution - Other		(259,978)		441,017		478,797
Unallocated Corporate		-		-		-
Total income taxes, net	$	235,930	$	792,491	$	513,340
Net (loss) earnings from continuing operations:						
Manufacturing - Gatelink	$	581,301	$	857,088	$	676,639
Manufacturing - Hua Yang		1,386,442		(550,972)		-
Manufacturing - Kord		682,176		(16,460)		-
Distribution - North America		(16,710,717)		(620,565)		-
Distribution - Other		(2,655,084)		1,811,408		2,345,491
Unallocated Corporate		(252,822)		(1,539,384)		-
Total net (loss) earnings from continuing operations	$	(16,968,704)	$	(58,885)	$	3,022,130
Earnings from discontinued operations:						
Manufacturing - Gatelink	$	-	$	-	$	-
Manufacturing - Hua Yang		-		-		-
Manufacturing - Kord		-		-		-
Manufacturing Playwell Industry		-		-		1,239,236
Distribution - North America		-		-		-
Distribution - Other		-		-		
Unallocated Corporate		-		-		-
Total earnings from discontinued operations	$	-	$	-	$	1,239,236
Net (loss) earnings from						

operations:			
Manufacturing - Gatelink	$ 581,301	$ 857,088	$ 676,639
Manufacturing - Hua Yang	1,386,442	(550,972)	-
Manufacturing - Kord	682,176	(16,460)	-
Manufacturing Playwell Industry	-	-	1,239,236
Distribution - North America	(16,710,717)	(620,565)	-
Distribution - Other	(2,655,084)	1,811,408	2,345,491
Unallocated Corporate	(252,822)	(1,539,384)	-
Total net (loss) earnings from operations	$ (16,968,704)	$ (58,885)	$ 4,261,366

25

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Additions to long-lived assets:			
Manufacturing - Gatelink	$ 14,437	$ 10,300	$ 29,241
Manufacturing - Hua Yang	1,057,169	1,309,720	-
Manufacturing - Kord	967,031	3,111,126	-
Distribution - North America	2,841,187	6,880,669	-
Distribution - Other	868,999	677,275	420,050
Total additions to long-lived assets	$ 5,748,823	11,989,090	449,291

Significant non cash items other than depreciation and amortization:			
(a) Bad debt expense:			
Manufacturing - Gatelink	$ -	$ -	$ -
Manufacturing - Hua Yang	(25,005)	288,033	-
Manufacturing - Kord	-	-	-
Distribution - North America	228,880	189,401	-
Distribution - Other	-	-	-
Unallocated Corporate	-	-	-
Total bad debt expense	$ 203,875	$ 477,434	$ -
(b) Impairment on intangible, goodwill and long-lived assets:			
Manufacturing - Gatelink	$ -	$ -	$ -
Manufacturing - Hua Yang	-	-	-
Manufacturing - Kord	-	-	-
Distribution - North America	12,624,322	-	-
Distribution - Other	629,257	-	-
Unallocated Corporate	-	-	-
Total impairment on assets	$ 13,253,579	$ -	$ -
(c) Impairment loss on investment securities:			
Manufacturing - Gatelink	-	-	-
Manufacturing - Hua Yang	25,477	31,785	-
Manufacturing - Kord	-	-	-
Distribution - North America	-	-	-
Distribution - Other	-	-	-
Unallocated Corporate	-	-	-
Total impairment loss on investment securities	25,477	31,785	-

Assets:			
Manufacturing - Gatelink	$ 4,470,318	$ 3,581,113	$ 2,035,499
Manufacturing - Hua Yang	62,489,281	48,682,590	-
Manufacturing - Kord	14,556,679	13,441,864	-
Distribution - North America	30,418,956	26,876,337	-
Distribution - Other	6,433,915	9,833,793	9,752,436
Unallocated Corporate	259,110	3,776,652	-
Total assets (other than discontinued operation)	$ 118,628,259	$ 106,192,349	$ 11,787,935

Goodwill acquired as a result of the IPI acquisition on March 1, 2005 has been allocated to the Distribution North America segment of the Company. The goodwill acquired as a result of the acquisitions of Hua Yang and Kord and Eastern Raiser acquisition on May 24, 2004, June 18, 2004 and February 1, 2005, respectively, has been allocated to their respective manufacturing segments.

26

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

(b) Geographical information:

Net sales by geographic areas attributable to countries based on the ultimate location of where the products were shipped, are as follows:

	For the years ended December 31,		
	2005	2004	2003
		(as restated)	
US	$ 57,468,434	$ 30,349,606	$ 21,182,664
Europe	33,907,802	22,713,760	8,955,424
Asia	28,568,990	16,975,466	6,238,777
Canada	9,962,644	3,907,474	394,661
Africa	333,456	504,010	92,736
Other	1,088,203	1,082,555	2,511,176
Total net sales	$ 131,329,529	$ 75,532,871	$ 39,375,438

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

	2005	2004	
		(as restated)	
PRC	$ 24,470,195	$ 21,450,947	$
US	2,282,217	6,365,147	
Canada	3,384,809	214,639	
Total long-lived assets	$ 30,137,221	$ 28,030,733	$

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

	For the years ended December 31,		
	2005	2004	2003
		(as restated)	
Books & board games	$ 27,733,443	$ 22,069,360	$ -
Distributed lines	32,147,813	2,576,948	-
Party products & accessories	28,901,124	13,548,976	-
Packaging products	22,691,192	10,449,576	-
OEM and Playwell brand products	8,939,495	16,928,000	25,343,000
Proprietary lines	4,331,044	1,231,000	-
Playwell brand products	3,206,973	5,112,000	12,564,000
Others	3,378,445	3,617,011	1,468,438
Total net sales	$ 131,329,529	$ 75,532,871	$ 39,375,438

27

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

(e) Customer and vendor concentration:

	For the years ended December 31,					
	2005		2004 (as restated)		2003	
	Revenue	%	Revenue	%	Revenue	%
Customer A	$ 9,160,035	6.97	$ 14,101,000	18.67	$ 21,671,000	55.04
B	6,115,787	4.66	6,316,000	8.36	2,345,000	5.96
C	5,548,870	4.23	3,077,000	4.07	1,435,000	3.64
All others	110,504,837	84.14	52,038,871	68.90	13,924,438	35.36
Total net sales $	131,329,529	100.00	$ 75,532,871	100.00	39,375,438	100.00

Sales purchased from the Company's two largest suppliers in aggregate accounted for 15%, 26% and 82% of gross sales for the years ended December 31, 2005, 2004 and 2003, respectively.

4.

Note receivable:

	December 31, 2005	December 31, 2004 (as restated)
Note receivable	$ 510,776	$ 538,836
Less: Amount due within one year under current assets	(266,312)	(138,440)
Amount due after one year	$ 244,464	$ 400,396

Pursuant to settlement agreements entered into between the Company and certain customers, the outstanding trade debts due from these customers were converted into notes receivable. The notes receivable are interest-free, unsecured and repayable by monthly installments. The fair value of notes receivable was approximate to the carrying amounts.

5.

Other prepaid expenses and current assets:

		December 31, 2005		December 31, 2004 (as restated)
Prepaid inventory	$	151,604	$	235,045
Insurance		407,566		513,725
Other current assets		2,157,680		1,159,346
Other prepaid expenses		1,011,805		497,323
Total other prepaid expenses and current assets	$	3,728,655	$	2,405,439

6.

Fixed assets:

		December 31, 2005 Cost		December 31, 2005 Accumulated Depreciation		December 31, 2004 (as restated) Cost		December 31, 2004 (as restated) Accumulated Depreciation
Plant & machinery	$	32,248,362	$	15,113,765	$	26,787,731	$	12,645,665
Furniture, fixtures & equipment		4,651,909		3,077,928		3,883,586		2,527,460
Mould & loose tools		4,556,616		2,920,368		3,823,565		1,770,536
Building		465,026		110,564		422,401		103,486
Leasehold improvements		972,952		706,167		675,604		614,211
Motor vehicle		733,599		603,030		654,495		535,793
Total fixed assets	$	43,628,464	$	22,531,822	$	36,247,382	$	18,197,151
Net book value			$	21,096,642			$	18,050,231

Buildings are situated on land held under medium term leases in Hong Kong.

At December 31, 2005, the carrying value of machinery included an amount of $11,072,705 (2004 - $10,165,717) in respect of assets held under finance leases.

Depreciation of $3,172,113, $1,445,179 and $39,206 has been charged to cost of goods sold for the years ended December 31, 2005, 2004 and 2003, respectively. During the year, the Company has recognized impairment loss on moulds and loose tools amounted to an aggregate of $765,712 based on the forecasted cash inflow to be generated from the respective licensed products. Please refer to note 2(o) for basis of impairment loss.

7.

Intangibles:

				December 31, 2005				December 31, 2004 (as restated)
		Cost		Accumulated Amortization		Cost		Accumulated amortization
Customer relationship	$	4,430,306	$	675,896	$	3,698,435	$	202,801
Distribution network		2,590,000		312,792		1,790,000		67,125
License		2,549,217		587,350		2,545,974		97,288
Impairment		(2,549,217)		(587,350)		-		-
License, net		-		-		2,545,974		97,288
Other acquired rights		2,265,107		971,518		1,549,436		571,152
Trade name		1,396,000		69,583		786,000		-
Trademark		1,247,891		858,939		1,246,173		664,169
Total intangibles	$	11,929,304	$	2,888,728	$	11,616,018	$	1,602,535
Net book value			$	9,040,576			$	10,013,483

Amortization expense for 2005, 2004 and 2003 was $1,873,542, $1,131,914 and $193,623, respectively. Based on current balances and estimated useful lives, the Company expects amortization expense to be $1,375,553, $1,363,403, $1,144,079, $926,006 and $890,673 in, 2006, 2007, 2008, 2009 and 2010, respectively. This would be calculated based on the carrying values as at December 31, 2005 for and the useful lives of each individual intangible.

The impairment of $1,961,867 was the result of the impairment test of intangibles under SFAS No. 142, refer to note 2(o) for additional details.

8.

Bank indebtedness:

The Company s bank indebtedness is as follows:

	December 31, 2005	2004

Unsecured:				
Bank overdrafts	$	4,432,840	$	2,523,979
Term loan		791,105		980,981
Export loan		2,918,370		2,611,090
Other bank borrowings		5,481,537		-
Secured:				
Trust receipt loans		8,143,124		5,704,818
Bills payable with recourse (note a)		-		1,245,608
Other bank borrowings (North America)		5,686,383		351,562
	$	27,453,359	$	13,418,038
Less: amount due within one year shown under				
Current liabilities		22,342,696		12,629,046
Amount due after one year	$	5,110,663	$	788,992

<u>Note</u>:

(a) As of December 31, 2005, Playwell and Hua Yang had $nil (December 31, 2004 - $434,480, and $811,128, respectively) of discounted bills. The amounts are payable by customers banks. The recourse provision provides that if customer banks do not make the required payments, Playwell s and Hua Yang s banks would have recourse to Playwell and Hua Yang for the full amount. In the opinion of management, the likelihood of such occurrence is remote.

<u>North America:</u>

The Company finances its North American operations through a $15.0 million revolving credit facility agreement with Citibank N.A., expiring on June 30, 2006. The borrower on this facility is IPI and the facility includes a $2.0 million sub-limit for Grand Toys Ltd., Grand US s Canadian subsidiary. 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 London Interbank Offered Rate (LIBOR) plus 175 basis points or U.S. prime ½ %, at the Company s election. The loan is collateralized by all of IPI s assets and a $4.3 million (CA$ 5.0 million) guarantee from Grand Toys Ltd. 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 December 31, 2005, the amount outstanding was approximately $5.7 million.

Prior to October 2005, IPI had a $10.0 million limit on its revolving facility and Grand Canada had a line of credit with Montcap Financial to finance its inventory and accounts receivable for advances of up to $3.0 million (CA$3.5 million). The Grand Canada receivable line had a discount fee of 2.0% of invoice amount purchased and the inventory line bore interest at Canadian prime plus 7.5%. The line of credit was secured by a lien on the assets of Grand Toys Ltd. and had no debt covenants or cross-default provisions. As of December 31, 2004, the amount outstanding with Montcap was approximately $352,000.

IPI failed to satisfy certain covenants of the credit facility on December 31, 2005 and received a waiver from Citibank through May 15, 2006. As of May 15, 2006, the covenants were not satisfied and on June 30, 2006 Citibank stated that they will not extend the revolving credit facility and Citibank issued a reservation of rights letter on July 21, 2006. In the reservation of rights letter, Citibank stated that at this time, they will not demand immediate repayment of all sums owing under the credit facility. The balance of $10,484,000 was all converted to a prime rate loan with a maturity date of September 30, 2006 and remains outstanding as of November 15, 2006 as the Company seeks alternative financing for its North American operations. The Company has identified several alternative financing options for its North American facility and expects to replace the Citibank facility in the near future. The terms of the replacement facility have not yet been finalized.

Hong Kong and China:

The Company finances its Hong Kong and China operations through facilities at Industrial and Commercial Bank of China (Asia) Limited, (ICBC), KBC Bank N.V. (KBC), DBS Bank (Hong Kong) Limited (DBS), Hang Seng Banl Limited and East Asia GE Commercial Finance.

Bank borrowings of the Hong Kong subsidiaries are secured by guarantees by each of their respective subsidiaries, as well as guarantees by the Company, Cornerstone and Mr. Hsieh, certain inventories acquired and released under the trust receipt loans, pledge of bank deposits of $27,048 (2004 - $597,464), and monies debentures over certain assets and certain properties. As of December 31, 2005, the Hong Kong-based subsidiaries had approximately $16.7 million of short-term bank indebtedness outstanding and approximately $5.1 million of long-term debt. As of December 31, 2004, the Hong Kong-based subsidiaries had approximately $11.8 million of short-term bank indebtedness outstanding and approximately $789,000 of long-term debt.

Hua Yang:

As at December 31, 2005, Hua Yang has short term indebtedness including bank overdraft, secured trust receipt loans, export loans and unsecured bank loan amount to an aggregate of $19.2 million. The borrowings carry variable-rate interest at Hong Kong Interbank offered Rate (HIBOR) or LIBOR or prime rate plus certain basis points. Interest is re-priced every three months with the range of interest rates at 1.8% to 7% (01.04.2004 to 31.12.2004: 1.3% to 5%). Bank borrowings were secured by the following:

(a) corporate guarantees from the ultimate holding Company, Cornerstone Overseas Investments Limited;

(b) personal guarantees from Jeff Hsieh;

(c) certain inventories acquired and released under the trust receipt loans; and

(d) in the case of certain bank loans, corporate guarantees from Zindart Limited, the previous owner of Hua Yang.

During the year, ICBC ceased extending credit to Hua Yang at the time of the Company s acquisition of Hua Yang, but ICBC agreed to allow Grand to gradually pay down the existing balances by October 2006. These amounts are being repaid through cash generated from operations and through replacement facilities at other banking institutions. Accordingly, the total outstanding balance under such credit facility amounted to $5.5 million. As of October 31, 2006, the $2.6 million outstanding balance on an overdraft facility with ICBC was linked with availability on another facility at ICBC used by Jeff Hsieh with the understanding that this would be paid down by the end of 2006. However, as of November 6, 2006, the $4.5 million balance on the ICBC tem loan was assumed by Jeff Hsieh for a loan to be repaid in monthly installments beginning January 2007 and ending June 2008 at an interest rate of prime plus 1%. Accordingly, $3.1 million and $1.4 million of such loan from Jeff Hsieh will be repayable in 2007 and 2008, respectively. As a result of the refinancing, the obligation has been reclassified as long term.

Kord:

As at December 31, 2005, Kord has short term indebtedness including bank overdraft, secured trust receipt loans and unsecured term loan. The unsecured term loan bears interest rate of 5.75% per annum and repayable by 60 monthly installments commencing from October, 2004. The aggregate annual repayments of the term loan as at the balance sheet dates are as follows:

		2005		**2004**
2005	$	-	$	191,989
2006		194,649		193,995
2007		206,141		205,637
2008		218,312		217,778
2009		172,003		171,582
Total	$	791,105	$	980,981

The trust receipt loans of $1.4 million as at December 31, 2005 were secured by the following:

(a) an unlimited personal guarantee executed by Jeff Hsieh

(b) pledged deposits in the name of Jeff Hsieh; and

(c) a corporate guarantee executed by the ultimate holding company, Cornerstone Overseas Investments Limited

The above variable-rate borrowings carry interest at HIBOR + 1% per annum. The effective interest rate is equal to contracted interest rate.

9.

Obligations under capital leases:

The Company leases certain equipment under capital leases. The capital lease obligations outstanding at December 31, 2005 and 2004 related to certain equipment, which amounted to $5,856,725 and $6,847,240 (restated), respectively. Future minimum lease payments under capital lease obligations as of December 31, 2005 and 2004 were as follows:

December 31, 2005		
2006	$	2,753,297
2007		2,311,462
2008		1,412,167
Total minimum lease payments	$	6,476,926
Less: amounts representing interest		620,201
Present value of minimum lease payments	$	5,856,725
Current portion		2,404,573
Non current portion	$	3,452,152
December 31, 2004		
Present value of minimum lease payments	$	6,847,240

Current portion		2,413,167
Non current portion	$	4,434,073

The lease term ranges from 36 months to 48 months. For the period ended December 31, 2005 and 2004, the average effective borrowing rate was 4%. Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The Company s obligations under capital leases are secured by the lessor s charge over the leased assets which amounted to $11.0 million. The carrying amount of the capital lease obligations at December 31, 2005 approximates their fair value.

10.

Capital stock

a)

ADS

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.

As of December 31, 2005, there were 16,310,467 ordinary shares of the Company issued and outstanding. These ordinary shares are traded in the United States on Nasdaq in the form of ADSs, and are evidenced by ADRs.

b)

Series A Preference shares

On March 01, 2005, the Company entered into a share subscription agreement with IPI. The Series A Preference Shares (Series A Shares) were issued on April 15, 2005.

The key terms of the Series A Shares are as follows:

Dividend:	Cumulative dividends of ten and one-half percent (10.5) per annum.
Dividend Payment:	Preferential dividend shall accrue from day to day until redemption or conversion and be payable to the preference shareholders semi-annually on each of 30th June and 31st December, subject to limitations imposed by law.
Voluntary Conversion:	Holders of the Series A Shares shall have the right to convert the Series A Shares at any time into Ordinary Shares which will be represented by an equivalent number of Grand ADSs. The conversion rate will be 1.4023 Ordinary Shares/Grand ADSs for each Preference Share converted (the Conversion Rate - Series A), or 2,804,600 Ordinary Shares/Grand ADSs in the aggregate. The conversion rate was based upon a conversion price of US$2.7365 per Preference Share (the Conversion Price Series A), which Conversion Price equaled the Average closing price of Grand ADSs for the 40 consecutive trading days ending on 28th February, 2005. Upon the conversion of the Preference Shares, the Company is required to pay all accrued and unpaid dividends on the Preference Shares converted; provided, however, that in lieu of paying cash dividends, the Company shall have the right to satisfy the accrued dividends by issuing such number of Ordinary Shares, to be represented by Grand ADSs, determined by dividing the amount of the accrued dividends by the average closing price of Grand ADSs on the Nasdaq SmallCap market for the forty (40) consecutive trading days immediately

	prior to the conversion of the Preference Shares.
Conversion by the Company:	The Company has the right to require the conversion of the Preference Shares if (i) Grand ADSs have traded at 105% of the Conversion Price- Series A, or US$2.8733 per Grand ADS, for at least 45 days prior to the date the Company determines to require conversion and (ii) the Company shall have paid aggregate dividends on the Preference Shares of not less than US$767,500; provided, however, that the requirement in clause (i) shall no longer apply after the occurrence of a public offering by the Company resulting in proceeds of not less than US$50,000,000.
Liquidation Preference:	Upon a liquidation, dissolution or winding up of the Company, the assets of the Company available for distribution to the Members shall be applied: . first, to pay the Preference Shareholder(s) an amount equal to US$3.8375 per Preference Share, and if the assets of the Company are insufficient to pay such amount, then pro rata to the holders of the Preference Shares; . second, to pay all arrears and accruals of dividends on the Preference Shares; and . third, to pay the holders of Ordinary Shares any surplus assets which shall be distributed ratably amongst such holders of Preference Shares according to the amounts paid up thereon.
Pre-emptive Rights:	As long as there are more than 100,000 Preference Shares outstanding, holders of the

	Preference Shares will have pre-emptive rights with regard to any future issuance of securities
	of the Company on the same price and other terms and conditions of such issuances, other
	than the issue of Ordinary Shares, or of Grand ADSs representing the same, upon the
	exercise of currently outstanding options or the grant of options pursuant to any employee
	share option scheme in force at any time.
Voting Rights:	2,000,000 Preference Shares will entitle the holder(s) thereof to an aggregate of 2,804,600
	votes on a poll.

c)

Series B Preference shares

On December 23, 2005, the Company entered into a share subscription agreement with Cornerstone Beststep. The Series B Preference Shares (Series B shares) were issued on December 23, 2005.

The Key terms of the Series B Shares are as follows:

Dividend:	Cumulative dividends of four and three-quarters percent (4.75%) per annum of the Series B
	Exchange Price.
Dividend Payment:	Semi-annual on each of 30th June and 31st December, subject to limitations imposed by law
	payable, at the option of Grand in cash or Grand ADSs determined by dividing the accrued
	dividend by the Series B Dividend price (i.e.$1.543) for the 30 trading days ending on
	November 29th, 2005, the day prior to the announcement of the acquisition.
Voluntary Conversion:	Holders of the Series B Shares shall have the right to convert the Series B Shares at any time
	after November 30, 2006 into Ordinary Shares which will be represented by an equivalent.

	number of Grand ADSs.
	The conversion rate will be 2.6886899 (i.e. Ordinary Shares/Grand ADSs, for each Series B
	Share converted (the Conversion Rate Series B). The conversion rate was based upon a
	conversion price of US$1.427275 per Series B Share (the Conversion Price), which
	equaled 92.5% of the average closing price of Grand ADSs for the 30 consecutive trading
	days ending on 29th November, 2005.
	Upon the conversion of the Series B Shares, Grand is required to pay all accrued and unpaid
	dividends on the Series B Shares converted in cash or Grand ADSs as provided above.
Conversion by the	The Company has the right to require the conversion of the Series B Shares if Grand ADSs
Company:	have traded at US$2.8733 per Grand ADS, for at least 45 days prior to the date Grand
	determines to require conversion unless has engaged in a public offering resulting in proceeds
	of not less than US$50,000,000, in which case the trading premium shall not apply.

29

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Liquidation Preference:	Upon a liquidation, dissolution or winding up of Grand, whether voluntary or involuntary, the holders of the Series B Shares will have liquidation rights preferential to those of holders of Ordinary Shares but junior to the holders of Grand s Series A Shares. Upon a liquidation, dissolution or winding up of Grand, the assets of Grand available for distribution to the members shall be applied:
	. first, to pay the Series A Shareholder(s) an amount equal to US$3.8375 per Series A Share, and if the assets of Grand are insufficient to pay such amount, then pro rata to the holders of the Series A Shares;
	. second, to pay all arrears and accruals of dividends on the Series A Shares;
	. third, to pay the Series B Shareholder(s) an amount equal to US$3.8375 per Series B Share, and if the assets of Grand are insufficient to pay such amount, then pro rata to the holders of the Series B Shares;
	. fourth, to pay the Series B shareholders all arrears and accruals of dividends on the Series B Shares; and
	. fifth, to pay the holders of Ordinary Shares any surplus assets which shall be distributed ratably amongst such holders according to the amounts paid up thereon.
Voting Rights:	Series B Shares will entitle the holder(s) thereof to 2.6886899 votes on a poll, or a maximum of 30,827,976 votes if all 11,465,798 Series B Shares to be authorized are issued.

d)

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 beneficial ownership of 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 beneficial ownership of 7,038 ordinary shares were issued upon exercise of stock options.

January 2005:

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

March 2005:

250 ADSs representing beneficial ownership 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 as a result of the Company s acquisition of IPI.

April 2005:

30

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

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.

October 2005:

73,030 ADSs representing beneficial ownership of 73,030 ordinary shares were issued in lieu of a cash payment of dividends payable on the Series A Shares.

December 2005:

2,500 ADSs representing beneficial ownership of 2,500 ordinary shares were issued upon exercise of stock options.

e)

Preference shares, dividend, convertible, liquidating, preemptive rights and voting rights:

2,000,000 Series A Shares were issued in exchange for the Exchangeable Note.

10,840,598 Series B Shares were issued in connection with the Hua Yang and Kord acquisitions.

f)

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.

g)

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

	Common Stock	Preference 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	15,587,282	-	2
ADS issuance in consideration for IPI acquisition	582,730	-	-
ADS issuance on settlement of interest on Exchangeable Note	52,175	-	-
ADS issuance on settlement of dividend payable on Series A Shares	73,030	-	-
Option exercises	15,250	-	-
Series A Shares issuance in exchange for Exchangeable Note	-	2,000,000	-

31

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Series B Shares issuance in consideration for Hua Yang and Kord acquisition	-	10,840,598	-
December 31, 2005	16,310,467	12,840,598	2

h) Dividends:

Series A Shares:

.

Deemed dividends of $991,426 (note 22(b)) are based on the difference between the effective conversion price of the Series A Shares and the market price of the ADSs at the March 1, 2005 issuance date of the Exchangeable Note; and

.

Actual dividends of $571,198, of which $168,260 have been satisfied in full by the issuance of 73,030 ADSs in October 2005, and $402,938 which have been accrued at December 31 2005 and will be settled in 2006 through issuance of ADSs.

Series B Shares:

.

Deemed dividends of $12,751,758 (note 22(c)) are based on the difference between the value paid to Cornerstone Beststep for Hua Yang and Kord in December 2005 and the costs that Cornerstone Beststep incurred to acquire Hua Yang and Kord in May 2004 and June 2004, respectively; and

.

Actual dividends of $43,310 have been accrued at December 31 2005.

11.

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 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 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. The options granted in 2005 were granted inside the Old Option Plan or 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, 2004					
Acquired from Grand Toys International Inc.	215,214	196,000	412,143	823,357	$ 2.22
Granted	-	1,096,875	-	1,096,875	2.51
Exercised	(7,038)	-	-	(7,038)	0.93
Cancelled	-	(2,500)	-	(2,500)	87.60
Options and warrants					

32

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

outstanding at						
December 31, 2004	208,176	1,290,375	412,143	1,910,694		2.28
Granted	39,000	645,906	357,143	1,042,049		1.44
Exercised	(13,250)	(2,000)	-	(15,250)		1.12
Cancelled	(6,000)	(6,875)	(357,143)	(370,018)		2.11
Options and warrants outstanding at						
December 31, 2005	227,926	1,927,406	412,143	2,567,475	$	2.19
Options and warrants exercisable at						
December 31, 2005	227,926	782,578	412,143	1,422,647	$	2.20

The following tables summarize information about options and warrants outstanding and exercisable at December 31, 2005:

		Options and warrants outstanding		
Range of exercise prices	Number		Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
$0.01 - $1.98	726,208		1.38	8.08
$2.12 - $3.07	1,827,267		2.41	7.15
$5.62 - $11.00	1,000		7.78	4.57
$16.00 - $87.60	13,000		16.69	3.04
	2,567,475	$	2.19	7.39

		Options and warrants exercisable		
Range of exercise prices	Number		Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
$0.01 - $1.96	324,504	$	1.04	5.76
$2.12 - $3.07	1,084,143		2.37	6.28

$5.62 - $11.00	1,000		7.78	4.57
$16.00 - $87.60	13,000		16.69	3.04
	1,422,647	$	2.20	6.13

Warrants issued in 2005 have a weighted average fair value of $0.87, which is estimated on the date of grant using the Black-Scholes option pricing model with a weighted average expected life of 2 years, risk-free interest rate of 3.90%, and a volatility factor of 77.7%.

For the options and other warrants, the weighted average fair value of options granted in 2005 was $0.87, which is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used:

For the year ended December 31, 2005	
Weighted average expected life (years)	3
Risk-free interest rate, average of grant dates	3.97%
Volatility factor of expected market price of Company s ADSs	62.8%
Dividend rate	-

33

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

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 2(r)).

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 $4,336 was recorded for the year ended December 31, 2005, as a result of the application of variable accounting to modified awards.

12.

Income taxes:

(a)

Income tax expense (recovery)consists of:

Year/Jurisdiction		**Current**		**Deferred**		**Total**
Year ended December 31, 2005:						
Hong Kong	$	540,295	$	130,677	$	670,972
US		9,226		(444,268)		(435,042)
Canada		-		-		-
	$	549,521	$	(313,591)	$	235,930
Year ended December 31, 2004: (as restated)						
Hong Kong	$	727,385	$	115,863	$	843,248
US		-		(50,757)		(50,757)
Canada		-		-		-
	$	727,385	$	65,106	$	792,491
Year ended December 31, 2003:						
Hong Kong		536,045		(22,705)		513,340
	$	536,045	$	(22,705)	$	513,340

(b)

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

	2005	2004	2003
		(as restated)	
	(%)	(%)	(%)
Hong Kong statutory income tax rate	17.5	17.5	17.5
Changes to Hong Kong tax rate resulting from:			
Expenses producing no tax benefit / income not taxable, net	(16.9)	96.1	(1.4)
Effect of different tax rates of subsidiaries			
operating in other jurisdictions	-	(1.6)	-
Valuation allowance	(9.7)	29.3	(0.8)
Change in tax rate			0.5

34

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Overprovision in prior year	-	(7.4)	-
Other	7.7	(25.9)	(1.3)
	(18.9)	90.5	(3.0)
Effective tax rate	(1.4)	108.0	14.5

The components of earnings before income taxes are as follows:

	2005	2004 (as restated)	2003
Year ended December 31:			
Continuing operations:			
Hong Kong	$ 665,807	$ 3,634,306	$ 3,535,470
Hong Kong - Corporate	(615,308)	(2,262,135)	-
US	(15,660,328)	(357,406)	-
Canada	(1,122,945)	(281,159)	-
(Loss) earnings before income taxes	$ (16,732,774)	$ 733,606	$ 3,535,470

The Company has not provided for income taxes on foreign subsidiaries undistributed earnings as of December 31, 2005 and 2004 because the investments in the foreign subsidiaries are essentially permanent in duration.

(c)

The deferred tax liability on the balance sheet was $3,311,252 and $3,079,309 at December 31, 2005 and 2004, respectively.

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31 are presented below:

	December 31 2005	December 31 2004 (as restated)
Deferred tax liabilities:		
Accelerated tax depreciation	$ 2,559,660	$ 1,990,099
Trademark	68,067	101,613

Intangibles		1,304,894		1,752,570
Total deferred tax liabilities	$	3,932,621	$	3,844,282

		December 31 2005		**December 31 2004 (as restated)**
Deferred tax assets:				
Allowance for doubtful debts	$	126,847	$	126,475
Other		-		7,610
Net operating loss carry forwards		6,592,132		4,272,446
Valuation allowance		(6,097,610)		(3,641,558)
Total deferred tax assets	$	621,369	$	764,973
Net deferred tax liability	$	3,311,252	$	3,079,309

35

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

The estimated impact of ownership changes for income tax purposes is reflected in the above numbers.

As of December 31, 2005, the Company has approximately $21,975,000 of consolidated net operating losses available for tax purposes to reduce future taxable income in the respective tax jurisdictions. These losses expire as follows:

36

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

2006	$	658,000
2007		2,015,000
2011		320,000
2018		74,000
2019		346,000
2020		4,034,000
2021		942,000
2022		1,258,000
2023		983,000
2024		620,000
2025		5,310,000
		16,560,000
Hong Kong (non expiring)		5,415,000
	$	21,975,000

Hong Kong:

At December 31, 2005, the Hong Kong companies have unused tax losses of approximately $ 5,415,000 (2004 - $3,242,000) available for offset against future profits in Hong Kong. A deferred tax asset without valuation allowance has been recognized on tax losses of approximately $ 3,334,000 (2004 - $2,977,000). Full valuation allowance has been recognised for deferred tax asset in respect of the tax losses of approximately$ 1,039,000 (2004 - $ 265,000) as it is not more likely than not to be utilized due to the unpredictability of future profit streams.

U.S.:

As of December 31, 2005, Grand US has $12,413,000 of net operating losses available for tax purposes to reduce future taxable income in the United States. These losses expire as follows:

2011	$	29,000
2018		74,000
2019		346,000
2020		4,034,000
2021		942,000
2022		1,258,000
2023		983,000
2024		620,000
2025		4,127,000
	$	12,413,000

Canada:

As of December 31, 2005, Grand Toys Ltd., the Company's Canadian subsidiary, has approximately $4,147,000 of losses carried forward, which can be used to reduce future taxable income. These losses expire as follows:

2006	$	658,000
2007		2,015,000
2011		291,000
2012		1,183,000

$ 4,147,000

13.

Earnings per ADS:

The calculations of basic earnings (loss) per share and diluted earnings per share are computed as follows:

		2005		2004		2003
				(as restated)		
(Loss) earnings from operations	$	(16,968,704)	$	(58,885)	$	4,261,366
Dividends in preference shares		(14,357,692)		-		-
(Loss) earnings from operations available to ADS shareholders		(31,326,396)		(58,885)		4,261,366
Weighted average number of ADS for the calculation of basic earnings (loss) per ADS		16,137,667		12,092,592		10,000,000
Effect of dilutive potential securities						
Preference Shares		2,053,348		-		N/A
Options and Warrants		-		714,568		-
Weighted average number of ADS shares for the purposes of diluted earnings (loss) per ADS share		18,191,015		12,807,160		10,000,000

The Series A and Series B Shares are included in the calculation of the diluted weighted average number of ordinary shares outstanding as each holder of Series A and Series B Shares are entitled to convert at any time and from time to time, subject to the automatic conversion terms, any or all of such holder s Series A Shares and Series B Shares. There is no dilutive effect as the conversion of Company s outstanding Series A and Series B Shares would result in an increase in earnings per share.

For the year ended December 31, 2005, options and warrants to purchase 2,567,475 ADSs (December 31, 2004 - 316,250) were not included in the diluted earnings per ADS calculation as the options exercise price was greater than the average market price of the ADS..

14.

Net change in operating working capital items:

	For the year ended December 31,		
	2005	**2004**	**2003**
		(as restated)	
Continuing operations:			

38

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

(Increase) decrease in accounts receivable	$ (5,817,962)	$ (7,306,082)	$ 3,621,147
Decrease (increase) in note receivable	-	(602,138)	-
Decrease in receivable from related companies	1,006,497	445,229	20,993,418
(Increase) decrease in inventory	(4,847,584)	530,908	(20,095)
Increase in other prepaid expenses and other current assets	(1,380,071)	(1,991,872)	(416,363)
Increase (decrease) in trade accounts payable	6,126,412	(151,136)	(283,735)
Decrease in payable to related companies	(752,986)	(1,845,071)	(24,242,276)
(Decrease) increase in other accounts payable and accrued liabilities	(968,480)	1,867,303	(2,207,834)
Decrease in income taxes payable	(350,856)	(906,752)	(421,299)
Total net change in operating working capital items	$ (6,985,030)	$ (9,959,611)	$ (2,977,037)

15.

Supplemental disclosure of cash flow information:

			For the year ended December 31
	2005	**2004**	**2003**
		(as restated)	
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	$ 1,792,435	$ 464,048	$ 23,835
Income taxes	350,856	906,752	421,299

16.

Major non-cash transactions:

During the year ended December 31, 2005, the Company entered into major non-cash transactions as follows:

.

The Company entered into capital lease arrangements in respect of acquisition of property, plant and equipment. with a capital value at the inception of the lease of $nil (2004 - $3,437,592)

.

Trade debtor of $795,339 (2004 - $602,138) was converted into note receivable, as described in Note 4.

.

Issuance of 2,804,600 Series A Shares and 10,840,598 Series B Shares, as described in note 22(b) and note 22(c)

17.

Commitments:

(a) Capital Commitment

The Company has capital commitment of $ 1,838,932 (2004 - $161,321) in respect of property, plant and equipment

(b) Operating lease Commitments

(i) Under the agreement for the establishment of Shenzhen Hua Yang, the Company has committed to pay a pre-determined amount of annual fee to a third-party for the period from October 1995 to October 2010. As of December 31, 2005, the total future fees under this arrangement are payable as follows:

Year ending December 31,		
2006	$	547,208
2007		574,379
2008		603,098
2009		633,253
2010		664,916

For 2006 and 2007, the annual fee will be paid in form of rent to the third party for the factory and office building provided.

(ii) At December 31, 2005, the Company had commitments for future minimum lease payments under non-cancelable operating leases which fall due as follows:

Year ending December 31,		
2006	$	2,543,074
2007		3,525,353
2008		1,341,345
2009		1,189,433
2010		346,467

These operating leases include manufacturing facilities and office space in Shenzhen and DongGuan, China; showrooms and office space in Hong Kong; and warehouse facilities and office space in Parsippany, New Jersey and Montreal, Canada. Rent expense for the years ended December 31, 2005, 2004 and 2003 amounted to $2,573,063, $974,022 and $203,984, respectively.

The Company s Canadian subsidiary, Grand Toys Ltd., has entered into an operating lease agreement to sub-lease a portion of its warehouse, resulting in a reduction of the minimum annual rental payments presented above of $138,082, $141,931, and $84,710 for the years 2006, 2007 and 2008, respectively.

(c) On December 31, 2005, the Company has license agreements that include the minimum guarantees of royalties for 2006 through 2009. The amounts are $4,052,272, $407,120, $157,499 and $19,000 for 2006 through 2009, respectively.

18.

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 was covered by insurance.

On March 3, 2006, Grand Toys International Limited was named in a lawsuit for an alleged breach of a business advisory agreement. This suit is expected to be settled for a payment of $67,500 and this expense will be reflected in the 2006 financial statements.

In July 2006, two Hong Kong based employees were terminated for cause and the Company sued the employees for misconduct. The employees sued the Company for the balance of payments on their contracts. One employee subsequently withdrew his claim and the remaining employment claim is for approximately $150,000. Both cases are still pending. If the employees are found guilty of misconduct, the claim for unpaid salary is invalid.

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

19.

Employee benefit plan:

Playwell, Hua Yang and Kord have a mandatory provident fund for its Hong Kong employees. It contributes to the fund 5% of the employee member s relevant income up to a maximum of $1,548 per annum. During 2005, Playwell, Hua Yang and Kord contributed $38,532, $360,732 and $57,931 respectively, to the fund and were charged to the consolidated statement of operations.

Grand Toys Ltd., the indirect Canadian subsidiary of the Company, has a deferred profit sharing plan (DPSP) for its Canadian employees. It contributes to the DPSP plan the lesser of (a) 50% of the employee's contribution to this plan; (b) 3% of the employee's gross earnings; or (c) CA$3,000 per employee. During 2005, Grand Toys Ltd. contributed $30,257 to the DPSP and such amount was charged to the consolidated statement of operations.

40

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

IPI, an indirect US subsidiary of the Company, has a 401K plan for its US employees. It matches the employee s contributions up to 3% of the employee s gross earnings. During 2005, IPI contributed $39,421 to the 401K plan and such amount was charged to the consolidated statement of operations.

20.

Related party transactions:

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

		December 31,		
Name of related party		**2005**		**2004**
				(as restated)
a) Amount due from related party:				
Cornerstone Overseas Investments, Limited	$	-	$	1,293,273
Playwell Toy (China) Ltd.		-		1,005,687
Sunny Smile International Ltd.		-		997,917
Toy Biz Worldwide Limited		2,441,640		1,023,345
Playwell Industry Limited		507,079		581,941
Dongguan Bailiwei Plaything Co. Ltd.		-		351,293
Brand Management Ltd.		-		164,438
Guangzhou Playwell Trading Co. Ltd.		390,566		155,238
New Adventures Corporation		-		31,945
China Retail Management		-		3,570
Great Asian Development Inc.		-		1,271
Long Sure Industries Ltd.		434		1,042
Dongguan Playwell Products Co. Ltd.		-		156
Playwell France		61,846		-
Zizzle (Hong Kong) Limited		114,953		-
Hero Crown Limited		-		6,211
New Enlarge Industrial Limited		-		496
Kord Industrial (China) Company Limited		-		7,377
Total due from related party	**$**	**3,516,518**	**$**	**5,625,200**
b) Amount due to related party:				

Zhejiang Playwell Toy Co Ltd.	**$**	859,250	**$**	1,008,705

41

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Cornerstone Overseas Investments, Limited	-	1,050,535
Playwell Industry Ltd.	1,476,400	380,928
Centralink Investments Limited	-	304,765
Directors/Shareholders	28,758	256,478
Toy Biz Worldwide Limited	464,297	147,341
Hong Kong Toy USA	-	115,289
Total due to related party	**$ 2,828,705**	**$ 3,264,041**

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

	For the years ended December 31,		
Playwell International Limited	**2005**	**2004**	**2003**
		(as restated)	
Sales			
Toy Biz Worldwide Limited	$ 197,331	$ 12,562,418	$ 20,422,681
Playwell Industry Ltd.	146,574	-	-
Dongguan Bailiwei Plaything Co Ltd.	-	198,116	2,341,868
	343,905	12,760,534	22,764,549
Purchases			
Playwell Industry Ltd.	4,008,122	12,661,125	26,553,005
Zhejiang Playwell Toy Co., Ltd.	4,851,388	3,962,882	5,319,659
Dongguan Playwell Products Co Ltd.	-	23,409	-
	8,859,510	16,647,416	31,872,664
Mould income			
Toy Biz Worldwide Limited	3,136,890	1,711,807	1,088,409
Playwell Industry Ltd.	(34,211)	494,491	31,322
	$ 3,102,679	$ 2,206,298	$ 1,119,731
Commission income			

Playwell Industry Ltd.	-	115,182	684,690

Royalty income

Guangzhou Playwell Trading Co. Ltd.	234,283	155,074	51,883

Other income

42

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Toy Biz Worldwide Limited	74,228	145,292	127,288
New Adventures Corporation	25,273	40,658	-
Playwell Industry Ltd.	20,500	1,746	-
	120,001	187,696	127,288
Other expenses			
Playwell Industry Ltd.	6,051	60,227	30,771
Purchase of fixed assets			
Playwell Industry Ltd.	7,377	-	-

	December 31,	**August 16-December 31**	**December 31,**
Grand US	**2005**	**2004**	**2003**
Purchases			
Toy Biz Worldwide Limited	$ 1,612,472	$ 416,653	$ -
Zizzle (Hong Kong) Limited	480,000	-	-
	2,092,472	416,653	-
Commissions			
Toy Biz Worldwide Limited	19,429	15,618	-
Zizzle (Hong Kong) Limited	797	-	-
	20,226	15,618	-
Other income			
New Adventures Corporation	-	16,125	-

	December 31,	**May 25-December 31**	**December 31,**
Hua Yang	**2005**	**2004**	**2003**
Sales			
Toy Biz Worldwide Limited	$ 5,744,435	$ 646,037	$ -

Playwell Industry Ltd.	405,465	82,584	-
Zizzle (Hong Kong) Limited	464,732	-	-
	6,614,632	728,622	-
Rental income			
Playwell Industry Ltd.	55,561	-	
	55,561	-	-

	December 31,	**June 19-**

43

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

December 31			**December 31,**	**Kord**		**2005**	
	2004		**2003**	**Sales**			
				Playwell Toy S.A.	$	444,674	$
	-	$	-	Playwell International Company L.L.C		16,592	
	-		-	China Retail Management		14,424	
	-		-			475,690	

Refer to note 22(b) and (c) for related party transactions related to Company s acquisitions.

21.

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 year ended December 31, 2005, approximately 17% (December 31, 2004 22%) of the Company s sales were made to five unrelated companies. Three unrelated customers representing approximately 13% (December 31, 2004 - 16%) of total sales, individually accounted for 2% or more (December 31, 2004 - 3%) 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.

The Company places its cash and cash equivalents with financial institutions with high-credit ratings and quality.

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.

22.

Acquisition:

(a) On February 1, 2005, Hua Yang acquired Eastern Raiser, a PRC printing company.

Pursuant to the purchase agreement, the purchase price for the assets was approximately $7.6 million, of which approximately $6.4 million was paid in cash at closing with the remainder to be paid in cash in 3 equal installments on the first, second and third anniversary of the closing date. Acquisition costs relating to this acquisition were approximately $60,000.

The following table summarizes the fair value of the assets acquired and liabilities:

		(Amounts reported in thousands)
Fixed assets	$	5,156
Intangible assets		476
Goodwill		5,185
Current liabilities		(2,653)

44

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Deferred tax liabilities		(543)
Net assets acquired	$	7,621

The acquired intangible assets consist of:

	(Amounts reported in thousands)	
Customer relationship	$	458
Other acquired rights		18
Total intangible assets	$	476

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

(b) 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 this acquisition 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 Shares of the Company when the issuance of the Series A Shares was approved by the Company s shareholders at the Company s 2005 Annual General Meeting on April 15, 2005.

The conversion feature relating to the preferential conversion price of the Series A 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 Shares and reduces earnings available to the ADS shareholders.

The total amount recorded in additional paid in capital as of December 31, 2005 was as follows:

		(Amounts reported in thousands)
Exchangeable Note	$	7,415
ADSs issued to IPI sellers on Acquisition		1,701
Exchangeable Note features:		
Beneficial conversion feature		991
Fair value of put option		434
Total	$	10,541

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

45

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Long term assets		328
Intangible assets		2,382
Goodwill		2,171
Current liabilities		(3,526)
Net assets acquired	$	10,328

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.

(c) Pursuant to the agreement under which the Company acquired Kord and Hua Yang on December 23, 2005, the purchase price for the shares was $44,000,000, net of the settlement of inter-company balances of $2,399,000 for a net purchase price of $41,601,000. The net purchase price was satisfied by issuing 10,840,598 Series B Shares. The Company s acquisition costs relating to this acquisition were approximately $500,000. Since Hua Yang and Kord were under common-control prior to the Company s acquisition, a deemed dividend of $12,751,758 resulted for the year 2005. The deemed dividend was determined as the fair value of the Series B Shares on the date of the public announcement of the transaction (November 30, 2005), net of the intercompany debt forgiveness and Cornerstone s basis in Hua Yang and Kord.

The following table summarizes the fair value of the assets acquired and liabilities assumed:

	(Amounts reported in thousands)	
	$	
Net tangible assets acquired		6,559
Intangible assets		4,065

Goodwill		14,461
Deferred tax asset		204
Deferred tax liability		(1,590)
Net assets acquired	$	23,699

The acquired intangible assets consist of:

		(Amounts reported in thousands)
Customer relationship	$	2,888
Other acquired rights		1,177
Total intangible assets	$	4,065

The Company engaged American Appraisal Consultants, an independent appraiser, to perform a purchase price allocation review of these transactions.

23.

Pro Forma presentation:

The following unaudited pro forma combined statement of operations gives effect to the business combination of the Company, Grand US, IPI, Hua Yang, Kord and Eastern Raiser. The Eastern Raiser, IPI, Hua Yang and Kord acquisitions which were consummated on February 1, 2005, March 1, 2005 and December 23, 2005, respectively, are 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 year ended December 31, 2005 and December 31, 2004 combine the consolidated statements of operations of the Company, Grand US, IPI, Eastern Raiser, Hua Yang and Kord as if the acquisitions had taken place on January 1, 2005 and January 1, 2004.

For the year ended December 31, 2005, the consolidated statements of operations of Hua Yang and Kord are included in the reported results of the Company due to the restatement of the Company s results as a result of the accounting treatment of these two acquisitions.

For the year ended December 31, 2004, since Hua Yang and Kord, were acquired by Cornerstone on May 24, 2004 and June 30, 2004, respectively, the reported results include the consolidated statement of operations from the dates of acquisition.

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 2 to the audited consolidated financial statements for the year ended December 31, 2005. The pro forma combined statement of operation for the year ended December 31, 2004 give effect to the amortization of intangibles.

Pro Forma Combined Information:

	For the years ended December 31,			
		2005		2004
	(In thousands, except share and per share data)			
Net sales	$	135,211,148	$	132,454,340
Gross profit		33,572,724		36,635,614

(Loss) earnings from continuing operations		$	(17,112,771)	$	1,626,843
Discontinued operations			-		-
Net (loss) earnings available to ADS			(31,470,464)	$	1,626,843
(Loss) earnings per ADS - Continuing:					
	Basic	$	(1.06)	$	0.13
	Diluted		(1.06)		0.13
Weighted average number of ADS:					
	Basic		16,137,667		12,092,592
	Diluted		18,191,015		12,807,160

24.

Subsequent events:

In June 2006, the Company terminated the operations of Playwell s subsidiary, Gatelink. Gatelink manufactured moulds for products developed by Playwell and on an OEM basis for third parties. Historically, a significant portion of Gatelink s

47

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

operations involved making moulds for Marvel product lines licensed by Toy Biz Worldwide Limited (Toy Biz). During the year ended December 31, 2004 and 2005, Gatelink s operations generated income of $857,088 and $581,301, respectively. The lower net income resulted from a decrease in the number of Marvel products introduced in 2005. Toy Biz no longer has the rights to develop and distribute the Marvel line of products which eliminated Gatelink s primary source of revenue. In order to develop new business required to operate Gatelink profitably, the Company would have had to invest significant capital in new tooling equipment for Gatelink. Management concluded that such an investment is not in the best interests of the Company as future profitability was uncertain and even if profits were generated from future operations, they might not be sufficient to offset the investment costs. The termination of Gatelink s operations will result in approximately $100,000 of charges for fiscal 2006 and this will be funded with cash generated from operations..

In July 2006, the Company decided not to renew an existing license agreement with Binney & Smith for the Crayola dough product line beyond December 2006. The Crayola dough line was a key element of the Company s plan to enter the US mass market for toys. The product line has been unprofitable, and the Company could not foresee this changing in the near future. The Company is also discontinuing certain other product lines targeted towards the US mass market and, in the future, the Company may de-emphasize its efforts to enter the US mass market for toys. The termination of the Binney & Smith license as well as the other product lines has resulted in a write-off of goodwill of approximately $10.5 million and an acceleration of amortization of intangibles relating to the Binney & Smith license of approximately $2.0 million in 2005. The Company estimates that this discontinuance of business will result in additional charges in 2006; however, these charges are not yet quantifiable as the Company continues to negotiate certain settlements on outstanding minimum royalty obligations for certain licenses for which the Company may not reach the minimum guarantees. The Company expects to be able to fund these settlements with cash generated from operations and the existing or future working capital facilities.

In October 2006, the Company decided to discontinue distributing toy and toy-related products to the mass market in Canada and cease the operations of its Canadian subsidiary, Grand Toys Ltd. (Grand Canada), which conducted the Company s Canadian mass market sales efforts, at the end of 2006. For the year ended December 31, 2005, Grand Canada s sales were approximately $7.7 million and the operations resulted in a loss of $334,000. Management determined that future profitability of its Canadian mass market operations was uncertain. The Company expects that the costs to close this operation, which include employee severance costs, and amounts relating to the lease in Montreal, could be as high as $1.2 million in 2006 and 2007. The Company expects that funds received from selling existing inventory and collecting all receivables will be sufficient to cover the closing costs indicated above.

On July 18, 2006, the Company received a Nasdaq Staff Determination stating that as a result of its failure to file its Annual Report on Form 20-F by July 15, 2006, the Company was not in compliance with the requirements for continued listing on Nasdaq as set forth in Nasdaq Marketplace Rule 4320(e)(12). As a result, Grand s ADSs would be delisted from the Nasdaq SmallCap Stock Market on July 27, 2006 unless the Company requested a hearing to appeal the delisting determination. The delay was a result of the acquisitions in December 2005 of Hua Yang Holdings Company Limited and Kord Holdings, Inc., which were under common control with the Company, requiring the Company to restate its financial statements back to the date of common control as if Hua Yang and Kord were part of the Company on May 24, 2004 and June 18, 2004, the respective dates that ownership of Hua Yang and Kord was acquired by the Company s controlling shareholder. Due to the complexity of the restatement, the Company has not completed the restated financial statements. The Company appealed the delisting determination and on October 20, 2006 received notification that the Nasdaq Listing Qualifications Panel has determined to grant the Company s request for continued listing on the Nasdaq Stock Market subject to the Company s filing the Form 20-F Annual Report for the fiscal year ended December 31, 2005, and all applicable restatements, on or before November 15, 2006.

On November 6, 2006, the unpaid balance of approximately $4.5 million on the Hua Yang term loan from the ICBC was assumed by Jeff Hsieh. The new term loan between Hua Yang and Jeff Hsieh will be repaid in monthly installments beginning January 2007 and ending June 2008 and at an interest rate of prime plus 1%. The Company believes that Hua Yang can support the loan repayment with cash generated from operations and existing and future working capital facilities.

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Item 19. Exhibits

Exhibit Number	Description of Document
*1.1	Memorandum and Articles of Association of Grand Toys International Limited
**1.2	Amended and Restated By-Laws of Grand Toys International Limited, as amended
*******1.3	Amended Memorandum and Articles of Association of Grand Toys International Limited
***2.1	Form of Deposit Agreement among Grand Toys International Limited, The Bank of New York as depositary, and the holders from time to time of Grand Toys International Limited
****2.2	Form of American Depositary Receipt
*****4.1	Subscription and Exchange Agreement, dated November 14, 2003, by and among Grand Toys International, Inc., Grand Toys International Limited and Centralink Investments Limited, as amended by Amendment No. 1, dated March 6, 2004, Amendment No. 2, dated March 31, 2004, Amendment No. 3, dated May 31, 2004 and Amendment No. 4, dated July 26, 2004.
*****4.2	Amended and Restated Agreement and Plan of Merger between Grand Toys International Limited and Grand Toys International, Inc.
*******4.3	Amended and Restated Consulting Agreement between Elliot L. Bier and Grand Toys International Limited, dated September 1, 2004
****4.4	Form of Employment Agreement between Tania M. Clarke and Grand Toys International Limited
*4.5	Form of Employment Agreement between David J. Fremed and Grand Toys International Limited
4.5a	Form of Employment Agreement between Roger Bildsten and Grand Toys International Inc
4.5b	Form of Employment Agreement between Kevin Murphy and Cornerstone Overseas Investments Limited
****4.6	Form of Employment Agreement between Raymond Chan Hong Leung and Grand Toys International Limited
*******4.7	Amended and Restated Employment Agreement between Henry Hu and Cornerstone Overseas Investments, Ltd., dated October 1, 2004
****4.8	Form of ADR Purchase Agreement, by and among Centralink Investments Limited, Stephen Altro, 2870304 Canada Inc., 136011

Canada Inc., David Mars, 136012 Canada Inc. and 2884330 Canada Inc.

****4.9** Form of Factoring Agreement between Montcap Financial Corporation, Grand Toys Ltd. And Grand Concepts Inc.

****4.10** Form of Inventory and Equipment Loan Agreement between Montcap Financial, Grand Toys Ltd., Grand Concepts Inc. and Grand Toys International Inc

****4.11** Limited Treasures Stipulation of Settlement, dated June 28, 2001

****4.12** Limited Treasures Amendment to Stipulation of Settlement

****4.13** Agreement of Lease Between Storage Leaseholds Inc. and Grand Toys Ltd., dated October 2, 1998

4.13a Agreement of Lease Between Bee Dic Realty Co and IPI Acquisition Corp, dated December 1, 1995

4.13b Assignment and assumption of lease between International Playthings Inc and International Playthings Acquisition Corp, dated January 18, 2005

4.13c Consent to assignment and assumption of lease between International Playthings Inc and International Playthings Acquisition Corp, dated January 27, 2005

4.13d Landlord Estoppel Certificate, dated February 28, 2005

****4.14** Form of Warrant for December 2001 Private Placement

****4.15** Grand Toys International, Inc. Amended and Restated 1993 Stock Option Plan

****4.16** Form of Warrant for Grand US March 2001 Private Placement.

****4.17** Form of letter extending expiration date for March 2001 Private Placement Warrant

*********4.19** Subscription Agreement relating to an Exchangeable Note between Grand Toys international Limited and Centralink Investments Limited, dated February 28, 2005

*********4.20** Securities Put Agreement by and among Tejomi Corporation, Mitejo LLC, Grand Toys International Limited and Jeff Hsieh Cheng, dated March 1, 2005

*********4.21** Asset Purchase Agreement among IPI Acquisition Corp, Grand Toys International Limited, International Playthings,Inc and Cambitoys, LLC and Ted Kiesewetter, Michael Varda and John Jordan, dated February 28, 2005

*********4.22** Employment Agreement between Ted Kiesewetter and International Playthings, Inc., dated March 1, 2005

*********4.23** Loan Agreement between Citibank and International Playthings Inc., dated February 2, 2005

4.23a Credit Agreement between International Playthings Inc and Citibank, dated October, 2005

*********4.24** Employment Agreement between Willie Wong and Grand Toys International Limited, dated August 25, 2004

*********4.26** Grand Toys International Limited 2004 Stock Option Plan

4.27 Agreement of lease between Hollywood Palace Company Ltd. and

Asian World

Enterprises Co.Ltd, dated October 1, 2005

4.28 Letter of credit facility between Hua Yang Printing Holdings Company Limited

and East Asia Heller Limited, dated March 3, 2004

4.29 Amendment to lease agreement between Bee Dic Realty Co. and International

Playthings Inc., dated August 2004

4.30 Deed of Guaranty to Hang Seng Bank Limited

4.31 Amendment to banking facilities between Hua Yang Printing Holdings Company

Limited and East Asia GE Commercial Finance Limted, dated March 10, 2005

4.32 Letter of factoring facility agreement between Kord Party Favour Manufactory

Limited and Hang Seng Bank Limited, dated March 27, 2006

4.33 Letter of factoring facility agreement between Hua Yang Printing Holdings Company Limited and Hang Seng Bank Limited, dated March 27, 2006

4.34 Letter of revised credit banking facilities between Kord Gifts Manufactory Limited

and ICBC(Asia) Limited, dated January 4, 2005

4.35 Letter of revised credit banking facilities between Hua Yang Printing Holdings Company Limited and ICBC(Asia) Limited, dated February 24, 2005

4.36 Letter of revised credit banking facilities between Kord Gifts Manufactory Limited

and ICBC(Asia) Limited, dated April 30, 2005

4.37 Letter of revised credit banking facilities between Hua Yang Printing Holdings Company Limited and ICBC(Asia) Limited, dated January 31, 2005

4.38 Letter of revised credit banking facilities between Hong Kong Toy Centre Limited and ICBC(Asia) Limited, dated January 31, 2005

4.39 Letter of banking facilities for Hong Kong Toy Centre Limited, Hua Yang Printing

Holdings Company Limited Kord Gifts Manufactory Limited, Kord Party Favour

Manufactory Limited and Shenzhen Hua Yang Printing Company Limited, dated

March 27, 2006

4.40 Amendment to banking facilities between Hua Yang Printing Holdings Company

Limited and East Asia GE Commercial Finance Limted, dated May 8, 2006

4.41

	Letter of banking facilities variations between Hua Yang Printing Holdings Company
	Limited and DBS Bank(Hong Kong) Limted dated March 01,2004
8	List of Subsidiaries of Grand Toys International Limited
*******11	Grand Toys International Limited Code of Ethics for Senior Financial officers
12.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. 1350
15	Valuation and Qualifying Accounts and Allowances

Legend:

*	Incorporated by reference to Grand Toys International Limited s Registration Statement on Form F-4 filed on April 6, 2004
**	Incorporated by reference to Amendment No. 1 to Grand Toys International Limited s Registration Statement on Form F-4 filed on June 2, 2004
***	Incorporated by reference to Grand Toys International Limited s Registration Statement on Form F-6 filed on April 15, 2004
****	Incorporated by reference to Amendment No. 3 to Grand Toys International Limited s Registration Statement on Form F-4 filed on July 27, 2004
*****	Incorporated by reference to the 424(b)(3) prospectus of Grand Toys International Limited filed on August 6, 2004
*******	Incorporated by reference to Grand Toys International Limited s Registration Statement on Form 20-F filed on June 30, 2005

Exhibit 8

The following is a list of the Company s subsidiaries and variable interest entities:

Name of subsidiary	Place of incorporation and Operations
Playwell International Limited:	
Great Wall Alliance limited	British Virgin islands
Asian World Enterprises Company Limited	Belize
Hong Kong Toy Centre Limited	Hong Kong
Gatelink Mould Engineering Limited	Hong Kong
Grand Toys International Inc:	United States
Grand Toys (US) Ltd	United States
Grand Toys Ltd	Canada
Ark Creations, Inc	United States
Grand Toys (HK) Limited	Hong Kong
International Playthings inc.	United States
Hua Yang Holdings Co., Limited:	Cayman Islands
Hua Yang Printing Holdings Company Limited	Hong Kong
Dong Guan Hua Yang Printing Products Company Ltd	People s Republic of China
Shenzhen Hua Yang Printing Products Company Ltd	People s Republic of China
Hua Yang (UK) Limited	United Kingdom
Hua Yang USA, Inc	United States
Kord Holdings, Inc.:	British Virgin islands
Subsidiaries:	

Kord Printing Company Limited	Hong Kong
Kord Gifts Manufactory Limited	Hong Kong
Kord Plastic Manufactory Company Limited	Hong Kong
Kord Party Favour Manufactory Limited	Hong Kong
Variable Interest entities:	
Kord (Qing Xin) Packing products Limited	People s Republic of China
Dongguan Kord Packing products Limited	People s Republic of China
QingXin Kord Gifts Manufactory Company Limited	People s Republic of China
Sun Tat Toys Manufactory	Hong Kong
Sun Tat Toys Factory	People s Republic of China
Sun Tat Plastic Manufactory	Hong Kong
Sun Tat Plastic Factory	People s Republic of China

.

50

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

EXHIBIT 12.1

CERTIFICATION PURSUANT TO

Section 302 of the Sarbanes-Oxley Act of 2002

I, Jeff Hsieh Cheng, Chief Executive Officer, of Grand Toys International Limited (the Company), certify that:

1.

I have reviewed this annual report on Form 20-F of Grand Toys International Limited;

2.

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

3.

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

4.

The company s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

(a)

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

(b)

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c)

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

(d)

Disclosed in this report any change in the company s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company s internal control over financial reporting; and

5.

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

(a)

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

(b)

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

Date: November 15, 2006

/s/ Jeff Hsieh Cheng

Name: Jeff Hsieh Cheng

Title: Chief Executive Officer

51

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

EXHIBIT 12.2

CERTIFICATION PURSUANT TO

Section 302 of the Sarbanes-Oxley Act of 2002

I, David J. Fremed, Chief Financial Officer, of Grand Toys International Limited (the Company), certify that:

1.

I have reviewed this annual report on Form 20-F of Grand Toys International Limited;

2.

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

3.

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

4.

The company s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

(a)

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

(b)

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c)

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

(d)

Disclosed in this report any change in the company s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company s internal control over financial reporting; and

5.

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

(a)

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

(b)

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

Date: November 15, 2006

/s/ David J. Fremed

Name: David J. Fremed

Title: Chief Financial Officer

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

EXHIBIT 13

CERTIFICATION PURSUANT TO

18 U.S.C. § 1350

Pursuant to 18 U.S.C. § 1350, we, Jeff Hsieh Cheng, Chief Executive Officer, and David J. Fremed, Chief Financial Officer, of Grand Toys International Limited (the Company), hereby certify that the Company s Annual Report on Form 20-F for the year ended December 31, 2004 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 15, 2006

/s/ Jeff Hsieh Cheng

Name: Jeff Hsieh Cheng

Title: Chief Executive Officer

/s/ David J. Fremed

Name: David J. Fremed

Title: Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Schedule 15

VALUATION AND QUALIFYING ACCOUNTS AND ALLOWANCES

	Balance at beginning of year	Additions charged to operations	Net Deductions (a)	Balance at end of year
Allowance for Doubtful Accounts:				
Year Ended December 31, 2005	$ 4,394,673	$ 322,877	$ (73,952)	$ 4,643,598
Year Ended December 31, 2004	658,163	3,887,712	(151,202)	4,394,673
Year Ended December 31, 2003	655,294	-	2,869	658,163

(a) Includes write-offs, recoveries of previous write-offs and currency translation adjustments

Exhibit 4.5a

EMPLOYMENT AGREEMENT

This AGREEMENT is made and entered into as of the 18th day of July, 2005, by and between GRAND TOYS INTERNATIONAL, INC., a Nevada corporation with offices at 1710 Route Transcanadienne, Dorval, Quebec, Canada (Grand), and ROGER BILDSTEN, a citizen of the United States of America residing at 5100 Juanita Avenue, Edina, MN 55424 (Bildsten).

WHEREAS, Grand, through its wholly-owned subsidiaries, and its parent company, Grand Toys International Limited (Grand HK) and its subsidiaries, is engaged in the business of designing, developing, producing, marketing, distributing, importing and selling toys and toy-related products (the Business).

WHEREAS, Grand is desirous of employing Bildsten as its President, and Bildsten is willing to serve Grand in such capacity, all upon the terms and subject to the conditions hereinafter set forth.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained, the parties hereto, intending to be legally bound, agree as follows:

1.

Employment

Grand agrees to employ Bildsten, and Bildsten agrees to be employed by Grand, upon the terms and subject to the conditions of this Agreement.

2.

Term

The term of this Agreement (the Term) shall be for a period of three (3) years (the Initial Term) commencing on the date hereof and ending on July 17, 2008 unless sooner terminated; provided however, that the Term of this Agreement shall automatically be extended for additional one year periods after the expiration of the Initial Term unless either Bildsten or Grand notifies the other within 90 days prior to the end of the Term that he or it elects not to further extend the Term.

3.

Duties; Efforts; Indemnification

During the term of this Agreement, Bildsten shall serve as President of Grand, reporting directly to the Chief Executive Officer or such other person or persons as the Board of Directors of Grand (the Board) shall designate. Bildsten shall be responsible for the North American mass market operations of Grand and, subject to any contractual limitations to which Bildsten may be subject, coordinating with Grand s North American specialty market operations. He shall also perform such duties as are commensurate with the position of President and such other executive duties as may be assigned to him from time to time by the Board or the Chief Executive Officer so long as such duties are not inconsistent with his position as President of a company of comparable size.

55

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

(a)

Bildsten shall devote all of his business time, attention and energies, on a full time and exclusive basis, to the business and affairs of Grand, shall use his best efforts to advance the best interests of Grand, and shall not during the Term be engaged in any other business activities, whether or not such business activities are pursued for gain, profit or other pecuniary advantage, without Board consent; provided, however, that, it shall not be a violation of this Agreement for Bildsten to (i) serve on corporate, civic or charitable boards or committees, or (ii) manage passive personal investments, in either case so long as any such activities do not interfere with the performance of his responsibilities as an employee of Grand in accordance with this Agreement.

(b)

Subject to and in accordance with the provisions of the amended Articles of Incorporation of Grand, Grand shall indemnify Bildsten to the fullest extent permitted by applicable law for all amounts (including, without limitation, judgments, fines, settlement payments, expenses and attorney s fees) incurred or paid by Bildsten in connection with any third party action, suit, investigation or proceeding arising out of or relating to the performance by Bildsten of services for, or the acting by Bildsten as a director, officer or employee of, Grand or of any other person or entity at Grand s request, and Grand shall advance to Bildsten or pay on his behalf such amounts as the directors of Grand determine to be due by reason of such indemnification.

4.

Compensation and Benefits

(a)

Base Salary. Grand shall pay to Bildsten a base salary (the Base Salary) at a rate of US$225,000 per annum, payable in accordance with Grand s payroll practices for its executive employees. The Board will review the Base Salary for possible increase not less than annually during the Term with a view to ensuring that it remains commensurate with the time and effort required for the discharge of his responsibilities pursuant to this Agreement

(b)

Bonus. For the year ending December 31, 2005, Bildsten will receive a bonus of $100,000 payable on March 31, 2006 provided Bildsten s employment is not terminated by Grand for Cause (as defined below) or by Bildsten voluntarily before March 31, 2006. For each year during the Term beginning on January 1, 2006, Bildsten will be eligible to receive a bonus under any incentive bonus plan adopted by the board of directors of Grand HK for the benefit of senior executives of Grand HK and its subsidiaries.

(c)

Options. Grand HK shall grant to Bildsten options to purchase American Depositary Shares (ADSs) representing beneficial ownership of 200,000 ordinary shares in the capital of Grand HK at a price per ADS which shall be equivalent to the closing market price thereof on the last day prior to the date of the grant on which securities markets in the United States are open and are otherwise subject to Grand HK s 2004 Stock Option Plan. The options shall vest as to 66,667 ADS on each of the first and second anniversaries of such date and the balance of the ADSs on the third anniversary of such date and shall expire on the tenth anniversary of such date; provided, however, that any unvested options shall terminate in the event that your employment is terminated prior to the applicable vesting date. In addition, Bildsten may, at the discretion of the

56

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

Board, be granted additional stock options, share appreciation rights or bonuses under plans adopted by the Board for the benefit of employees of Grand HK and its subsidiaries.

(d)

Out-of-Pocket Expenses. Grand shall promptly pay to Bildsten the reasonable expenses incurred by him in the performance of his duties hereunder in accordance with Grand s policies in effect from time to time, including, without limitation, those incurred in connection with business related travel or entertainment, or, if such expenses are paid directly by Bildsten, shall promptly reimburse him for such payment, provided that Bildsten provides proper documentation thereof in accordance with Grand s policy.

(e)

Participation in Benefit Plans. Bildsten shall be entitled to participate in or receive benefits under any pension plan, health and accident plan or any other employee benefit plan or arrangement made available now or in the future by Grand to its North American executives and key management personnel.

5.

Termination

Bildsten s employment hereunder shall be terminated upon Bildsten s death or Bildsten s voluntarily leaving the employ of Grand (other than as a result of Grand s material breach of this Agreement), and may be terminated as follows:

(a)

For Cause. Grand shall have the right to terminate Bildsten s employment for Cause. A termination for Cause is a termination evidenced by a resolution adopted by the Board finding that Bildsten has:

(i)

breached or failed to comply with any of the material terms of this Agreement, including, without limitation, Sections 3, 7, 8 or 10 of this Agreement;

(ii)

failed to perform his duties under this Agreement, including refusing to carry out the reasonable written instructions of the Board or deliberately and intentionally disregarding the lawful instructions from the Board, in either case which instructions are consistent with the responsibilities and duties of Bildsten contemplated by this Agreement;

(iii)

engaged in gross negligence or willful misconduct in connection with or arising out of the performance of his duties hereunder;

(iv)

been under the influence of drugs (other than prescription medicine or other medically-related drugs to the extent that they are taken in accordance with their directions) or alcohol during the performance of his duties under this Agreement, or while under the influence of drugs or alcohol, engages in grossly inappropriate conduct;

(v)

engaged in behavior that would constitute grounds for liability for sexual harassment (as proscribed by the U.S. Equal Employment Opportunity Commission Guidelines, the New York Division of Human Rights and or any other

57

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

applicable state regulatory body) or, in the reasonable opinion of the Board other egregious conduct violative of laws governing the workplace; or

(vi)

committed any act of fraud, larceny, misappropriation of funds or embezzlement or been convicted of a felony or a crime of moral depravity;

provided, however, that (A) in the case of clauses (i), (ii) and (iii) above, Bildsten shall receive thirty (30) days advance written notice that the Board intends to meet to consider Bildsten s termination and specifying the actions constituting Cause, Bildsten shall have the opportunity to cure the conduct constituting Cause during such thirty (30) day period and (B) any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon the advice of counsel for Grand shall be conclusively presumed to be done, or omitted to be done, by Bildsten in good faith and in the best interests of Grand.

(b)

For Disability. Grand shall have the right to terminate Bildsten s employment as a result of Bildsten s Disability. For purposes of this Agreement, a termination for Disability shall occur:

(i)

immediately after the Board has provided a written termination notice to Bildsten supported by a written statement from a reputable independent physician selected by Grand to the effect that Bildsten shall have become so incapacitated as to be unable to resume, within 90 days, his employment hereunder by reason of physical or mental illness or injury; or

(ii)

upon rendering of a written termination notice by Grand after Bildsten has been unable to substantially perform his duties hereunder for 90 consecutive days (exclusive of any vacation permitted under Section 4(e) hereof) or for 180 days in any 360 day period by reason of any physical or mental illness or injury.

Bildsten agrees to make himself available and to cooperate in any reasonable examination by a reputable independent physician selected by Grand for the purpose of a termination pursuant to Section 5(b)(i).

6.

Effect of Termination

(a)

Death or Disability. In the event of the termination of Bildsten s employment as a result of his death or Disability, Grand shall:

(i)

pay to Bildsten or his estate, as the case may be, the Base Salary plus accrued and unpaid bonus in accordance with Section 4(b) through the date of his death or Disability (pro rated for any partial month); and

(ii)

reimburse Bildsten, or his estate, as the case may be, for any expenses pursuant to Section 4(d) (the amounts payable pursuant to the foregoing clauses (i) and (ii) are hereafter referred to as the Accrued Obligations).

58

= "LAST PAGE ONLY" = 0, = 1) 0 = 1 10/31/2006 4:31 PM

(b)

For Cause by Grand, by Bildsten Voluntarily or upon expiration of the Term. In the event that Bildsten s employment is terminated by Grand for Cause or by Bildsten voluntarily (other than as a result of Grand s material breach of this Agreement) or upon expiration of the Term, Grand shall pay to Bildsten the Accrued Obligations and Bildsten shall have no further entitlement to any other compensation or benefits from Grand, except as set forth herein.

(c)

Other than as a result of Bildsten s death or Disability, or by Grand otherwise than for Cause. In the event that Bildsten s employment is terminated other than by reason of his death or Disability or is terminated by Grand otherwise than for Cause, then, subject to receipt of a release of Grand and its directors, officers and employees and their respective successors and assigns of claims of Bildsten against them arising out of or by reason of his termination of employment hereunder:

(i)

Grand shall pay to Bildsten the Accrued Obligations; and

(ii)

Grand shall continue to pay Bildsten the Base Salary plus benefits in accordance with Section 4(e), together with bonus accruing in accordance with Section 4(b) from and after the most recent anniversary of the date hereof, until the earlier of (A) the last day of the Term (as if such termination had not occurred) or (B) the date that shall be six (6) months after the date of such termination.

(d)

This Section 6 sets forth the only obligations of Grand with respect to the termination of Bildsten s employment with Grand, and Bildsten acknowledges that upon the termination of his employment, he shall not be entitled to any payments or benefits which are not explicitly provided herein hereof. Any and all Accrued Obligations shall be paid within fifteen (15) days of the termination of Bildsten s employment.

7.