



Q3

Quarterly Report

Third quarter ended September 30, 2004

Stock Exchange

Toronto Stock Exchange: MB

Shares Outstanding

(as at September 30, 2004)

27,234,265 Common Shares

Third Quarter Fiscal 2004 Trading History

TSX	(CA\$)
High:	\$ 22.00
Low:	\$ 17.91
Close:	\$ 18.75
Average volume:	71,147

Transfer Agent

CIBC Mellon Trust Company
1.800.387.0825

Financial Highlights

(all figures in millions of U.S. dollars, except per share amounts)

	<u>Q3 2004</u>	<u>Q3 2003</u>
Net sales	\$ 85.9	\$ 78.4
Earnings from operations	\$ 18.7	\$ 19.9
Net Earnings	\$ 14.1	\$ 12.5
Earnings per share		
Basic	\$ 0.52	\$ 0.46
Diluted	\$ 0.48	\$ 0.43

Investor Relations

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Q3

Quarterly Report

Third quarter ended September 30, 2004

Management's discussion and analysis of financial position and results of operations

This management's discussion and analysis of financial position and results of operations ("MD&A") should be read in conjunction with the accompanying unaudited Consolidated Financial Statements and Notes for the three-month periods ended September 30, 2004 and 2003, as well as the annual MD&A and audited Consolidated Financial Statements and Notes for the year ended December 31, 2003 including the section on risks and uncertainties. The Company's accounting policies are in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") of the Canadian Institute of Chartered Accountants ("CICA"). This discussion and analysis compares performance for 2004 with 2003 and discusses issues and risks that may impact future operations.

In this MD&A, the terms "we", "us" and "our" refer to Mega Bloks Inc. ("Mega Bloks") and our subsidiaries.

(All figures are expressed in U.S. dollars, unless otherwise specified.)

Corporate overview

Mega Bloks is the world's second largest manufacturer and marketer of construction toys and the largest Canadian toy company. We design, manufacture and market a broad line of construction toys under the MEGA BLOKS brand, targeting the preschool and boys 5+ markets. Over 90% of our products retail for \$29.99 or less. Based on the enduring play value of our system of interlocking plastic building blocks, our products have broad appeal and enjoy relatively steady demand.

We employ more than 1,000 people serving over 100 countries from 14 offices around the world. We expanded our market reach outside North America by establishing Mega Bloks Latinoamerica S.A de C.V. in 1997, Mega Bloks Europe N.V. in 1998 and Mega Bloks International SARL in 2004. These subsidiaries directly support major international retailers while providing a logistical and administrative platform for our global operations. We market and distribute our products primarily through our own network in nearly all major toy markets. In 2003, 63% of our consolidated net sales were recorded in North America, which is comprised of the United States and Canada, and the balance in the International market, which includes sales in all other countries.

Our overall business strategy is to increase net sales on a worldwide basis through the introduction of new product lines, extension and enhancement of existing product lines, as well as expanded sales to existing retail customers, penetration of additional retail channels and penetration of new geographic markets. We operate a state-of-the-art manufacturing facility in Montreal, featuring multiple capacity plastic injection-molding machines, specialized automated counting systems and multi-product integrated assembly lines. Toys manufactured in this facility accounted for approximately 65% of 2003 sales and the remaining sales were derived from products manufactured under contract in Asia. We successfully closed an Initial Public Offering ("IPO") in 2002 and listed our shares on the Toronto Stock Exchange.

Recent developments

On July 30, 2004, the Cancellation Division of the European Union Office for Harmonization in the Internal Market, Trademarks and Designs ("OHIM") upheld Mega Bloks' request and declared invalid a three-dimensional trademark registration of the Lego-related company Kirkbi A/S for a block design in relation to "construction toys". Although Kirkbi has appealed the decision, Mega Bloks notes that OHIM's holding is consistent with jurisprudence around the world to the effect that useful product configurations may be protected by patents, as the block design was, but not trademarks.

On October 14, 2004, Mega Bloks announced that it has entered into a licensing deal with global character-based entertainment licensing leader Marvel Enterprises to create a comprehensive line of toy products featuring Marvel's ever-popular super hero franchises. Pursuant to the multi-year agreement, Mega Bloks has obtained the rights to develop an assortment of playsets, vehicles and other building-themed products featuring several premiere Marvel classic and movie based properties including Spider-Man, X-Men, Fantastic Four, Hulk, Captain America, Daredevil, Silver-Surfer, Punisher, Blade and Namor. The initial licensed product offerings are expected to be available at retail in time for the 2004 holiday season.



Results of operations

The following table presents a summary of certain selected consolidated financial information on a comparable basis to the same period of the previous year:

	Three-month periods ended September 30,				Nine-month periods ended September 30,			
	2004		2003		2004		2003	
(U.S. \$ thousands, except per share data)	\$	% of Net sales	\$	% of Net sales	\$	% of Net sales	\$	% of Net sales
Earnings Data								
Net sales	85,888	100.0%	78,366	100.0%	142,258	100.0%	127,597	100.0%
Cost of sales	44,748	52.1%	39,868	50.9%	77,657	54.6%	67,702	53.1%
Gross profit	41,140	47.9%	38,498	49.1%	64,601	45.4%	59,895	46.9%
Marketing, research and development and advertising expenses	12,809	14.9%	10,362	13.2%	20,665	14.5%	17,502	13.7%
Other selling, distribution and administrative expenses	10,696	12.5%	9,792	12.5%	26,839	18.9%	24,250	19.0%
Gain on foreign currency translation	(1,039)	(1.2%)	(1,534)	(2.0%)	(1,763)	(1.2%)	(2,727)	(0.4%)
Earnings from operations	18,674	21.7%	19,878	25.4%	18,860	13.2%	20,870	16.4%
Interest expense	261	0.3%	554	0.7%	1,044	0.7%	1,537	1.2%
Earnings before income taxes	18,413	21.4%	19,324	24.7%	17,816	12.5%	19,333	15.2%
Income taxes	4,305	5.0%	6,791	8.7%	4,126	2.9%	6,825	5.3%
Net earnings	14,108	16.4%	12,533	16.0%	13,690	9.6%	12,508	9.8%
Earnings per share								
Basic	0.52		0.46		0.50		0.46	
Diluted	0.48		0.43		0.47		0.43	
Weighted average number of outstanding shares								
Basic	27,208,571		27,025,820		27,162,290		26,965,036	
Diluted	29,342,887		29,437,076		29,371,445		29,416,638	



The following tables present a summary of selected consolidated balance sheet data as at September 30 and Canadian dollar data for the three-month and nine-month periods ended September 30:

As at September 30,		
(U.S. \$ thousands)	2004	2003
Balance Sheet Data		
Working capital ⁽¹⁾	\$ 86,169	\$ 70,907
Capital assets	33,757	32,822
Total assets	172,086	153,169
Total debt	20,961	37,443

	Three-month periods ended September 30,		Nine month periods ended September 30,	
	2004	2003	2004	2003
(Canadian \$ thousands, except per share data)				
Canadian Dollar Data ⁽²⁾				
Net sales	\$ 108,554	\$ 99,047	\$ 179,800	\$ 161,270
Earnings from operations	23,602	25,124	23,837	26,378
Net earnings	17,831	15,840	17,303	15,809
Earnings per share				
Basic	\$ 0.66	\$ 0.58	\$ 0.64	\$ 0.58
Diluted	\$ 0.61	\$ 0.54	\$ 0.59	\$ 0.54

(1) Working capital is defined as current assets minus current liabilities.

(2) U.S. dollar financial data is converted into Canadian dollars at the September 30, 2004 period end exchange rate of CA\$1.2639 per US\$1.00, using the translation of convenience method.



Net sales

Net sales in the third quarter of 2004 increased 9.6% to \$85.9 million compared to \$78.4 million in the third quarter of 2003. In North America, net sales were \$45.6 million in the third quarter of 2004, compared to \$44.7 million in the same period last year, an increase of 2.0%. International net sales increased 19.7% to \$40.3 million compared to \$33.6 million in the third quarter of 2003. In the third quarter of 2004, International net sales accounted for 46.9% of consolidated net sales compared to 42.9% in the same period last year. During the third quarter, we achieved our overall growth through the success of our 2004 product initiatives and successful international expansion.

By the end of the third quarter, the majority of the new products planned for introduction in 2004 were in retail. Early sales results, consumers and retailers feedback for most of these new products were favorable and position Mega Bloks well for the Christmas season even with a challenging retail environment in North America.

For the nine-month period ended September 30, 2004, net sales increased 11.5% or \$14.7 million, to \$142.3 million compared to \$127.6 million in the corresponding period of 2003. The international market accounted for 46.2 % of net sales for the nine-month period ended September 30, 2004 compared to 42.5 % for the same period in 2003.

Gross profit

Gross profit in the third quarter of 2004 was \$41.1 million, an increase of 6.9% compared to \$38.5 million in the same quarter last year. Gross margin was 47.9% compared to 49.1% in the third quarter of 2003. The decrease in gross margin is explained mainly by higher commodity prices and the year-over-year weakening of the U.S. dollar against the Canadian dollar.

For the nine-month period ended September 30, 2004, gross profit totaled \$64.6 million compared to \$59.9 million for the corresponding period of 2003, an increase of \$4.7 million or 7.9%. As a percentage of net sales, gross margin was 45.4% for the nine-month period ended September 30, 2004 compared to 46.9% for the same period in 2003.

Operating expenses

Marketing, research and development, and advertising expenses in the third quarter of 2004 were \$12.8 million, an increase of 23.6% compared to \$10.4 million in the same period last year. This increase is explained by higher brand investment during the third quarter of 2004 compared to the same period last year. As a percentage of net sales, marketing, research and development, and advertising expenses increased to 14.9% compared to 13.2% in the third quarter of 2003.

For the nine-month period ended September 30, 2004, marketing, research and development and advertising expenses amounted to \$20.7 million compared to \$17.5 million for the corresponding period of 2003, an increase of \$3.2 million or 18.1%. As a percentage of net sales, marketing, research and development, and advertising expenses represented 14.5% for the nine-month period ended September 30, 2004 compared to 13.7% for the same period in 2003.

Other selling, distribution and administrative expenses in the third quarter of 2004 totaled \$10.7 million, an increase of 9.2% compared to \$9.8 million in the same period last year. As a percentage of sales, such expenses were, in line with last year at 12.5% due to the leveraging of general and administrative costs which was offset by the increase in distribution and selling expenses.

For the nine-month period ended September 30, 2004, other selling, distribution and administrative expenses amounted to \$26.8 million compared to \$24.3 million for the corresponding period of 2003, an increase of \$2.6 million or 10.7%. As a percentage of net sales, other selling, distribution and administrative expenses represented 18.9% for the nine-month period ended September 30, 2004 compared to 19.0% for the same period in 2003.

We recorded a gain on foreign currency translation of \$1.0 million in the third quarter of 2004 compared to \$1.5 million in the same period last year reflecting notional amount of foreign exchange contracts maturing at lower favorable rates.

For the nine-month period ended September 30, 2004, gain on foreign currency translation decreased by \$1.0 million to \$1.8 million compared to \$2.7 million for the corresponding period of 2003.



Earnings from operations

As a result of the above, earnings from operations in the third quarter of 2004 amounted at \$18.7 million compared to \$19.9 million for the same period last year.

For the nine-month period ended September 30, 2004, earnings from operations amounted \$18.9 million compared to \$20.9 million for the corresponding period of 2003, a decrease of \$2.0 million.

Non-operating expenses

Interest expense in the third quarter of 2004 was \$0.3 million compared to \$0.6 million in the same period last year. This decrease results mainly from a lower borrowing base than the same period last year.

For the nine-month period ended September 30, 2004, interest expense amounted to \$1.0 million compared to \$1.5 million for the corresponding period of 2003, a decrease of \$0.5 million or 32.1%.

Income taxes totaled \$4.3 million compared to \$6.8 million for the third quarter of 2003. Our effective income tax rate was 23.4% in the third quarter of 2004 compared to 35.1% in the same period last year reflecting the Company's overall corporate structure at the international level.

Net earnings

Consequently, net earnings in the third quarter of 2004 were \$14.1 million or \$0.48 diluted per share compared to \$12.5 million or \$0.43 diluted per share in the third quarter of 2003.

For the nine-month period ended September 30, 2004, the Company's net earnings were \$13.7 million or \$0.47 diluted per share compared to \$12.5 million or \$0.43 diluted per share.

Shares outstanding

The weighted average number of shares outstanding for the third quarter of 2004 was 27,208,571 compared to 27,025,820 for the third quarter of 2003.

For the nine-month period ended September 30, 2004, the weighted average number of shares was 27,162,290 compared to 26,965,036 in the same period last year.

Seasonality and quarterly fluctuations

The toy business is seasonal and we have historically experienced significant quarterly fluctuations in operating results. As a result of this, operating results for any quarter are not necessarily indicative of results for any future period and are comparable only with corresponding periods of prior years. Our profitability is typically lower for the first and second quarters as a result of fairly constant fixed operating expenses while net sales are at their lowest levels of the year. This seasonality is consistent with the results of other companies in the toy industry and we anticipate this will continue in the future.

Liquidity and capital resources

We have historically funded our operations and capital requirements with cash generated from operations and borrowings under a revolving credit facility. Our primary capital needs are related to inventory financing, accounts receivable funding, debt servicing and capital expenditures for new product line initiatives. As a result of the seasonal nature of the toy business, our working capital requirements are variable throughout the year. Our need for working capital typically grows through the first three quarters as inventories are built up for the peak sales period in the fourth quarter. For the same reason, our interim statements of cash flows are generally not indicative of cash flows for a full year. Therefore, year over-year comparisons between statements of cash flows are generally more meaningful than with the previous year-end.



Liquidity and capital resources (continued)

Operating activities, after changes in non-cash operating working capital items, used \$12.5 million in the third quarter of 2004 compared to \$16.2 million in the third quarter last year. This improvement was due mostly to higher net earnings and depreciation compared to the same period last year.

Financing activities in the third quarter of 2004 generated \$7.4 million compared to \$11.8 million in the same period last year. These amounts represent mainly Mega Bloks' draws on its revolving credit facility.

Investing activities used \$1.3 million in the third quarter of 2004 compared to \$1.6 million in the same period of 2003. For both periods, these amounts reflect the acquisition of capital assets. We expect acquisitions of capital assets in 2004 to be consistent with 2003.

Cash and cash equivalents decreased by \$6.4 million in the third quarter of 2004 compared to a decrease of \$6.0 million in the same period of 2003. As at September 30, cash and cash equivalents amounted \$2.8 million in 2004 compared to \$4.3 million in 2003.

Anticipated sales growth in 2004 will result in increased working capital requirements mainly to finance trade accounts receivable and inventories. We expect to fund our operations and working capital requirements with cash from operations and borrowings from our revolving credit facility. As demonstrated in the first quarter of last year and in the second quarter of this year, our objective is to use free cash flow generated in 2004 to further reduce our long-term debt.

Balance sheet

Our financial position remained strong in the third quarter of 2004 culminating with total borrowings of \$21.0 million at the end of the third quarter compared to \$37.4 million at the end of the same period last year. The total debt to capitalization ratio was 0.19 as at September 30, 2004 compared to 0.39 in 2003.

Working capital at the end of the third quarter of 2004 totaled \$86.2 million compared to \$70.9 million in 2003, reflecting higher trade accounts receivable and inventories.

Trade accounts receivable were \$83.2 million, an increase of \$12.7 million compared to \$70.5 million at the end of the third quarter of 2003. Higher trade accounts receivable are explained from increases sales and geographical mix of customers.

Inventories were \$41.9 million compared to \$33.9 million in the third quarter of 2003. This increase is explained mainly by tight inventory management policies implemented by North American retailers.

Financial instruments

We are exposed to market risks attributable to fluctuations in foreign currency exchange rates, primarily changes in the value of the U.S. dollar versus other currencies such as the Canadian dollar, the Euro, the British pound and the Mexican peso. Our sales are primarily denominated in U.S. dollars while the majority of our expenses are incurred in Canadian dollars.

Our policy is to mitigate, when appropriate, our exposure to market risk by partially hedging such exposure using foreign currency contracts primarily to hedge expenses denominated in Canadian dollars and inter-company transactions denominated in other foreign currencies.



Financial instruments (continued)

The following table summarizes our foreign currency commitments as at September 30, 2004:

Foreign currency contracts	Notional amount	Average exchange rate	Maturing up to	Notional equivalent	Fair market value including notional equivalent
	\$			US \$	US \$
Sell - \$US to \$CAN	16,000	1.4658	Feb. 2006	16,000	18,258
- Euro to \$US	35,150	1.1451	Dec. 2005	40,251	36,841
- Euro to \$CAN	1,200	1.6521	Dec. 2004	1,569	1,647
- GBP to \$US	13,750	1.6884	Dec. 2005	23,216	21,903

Contractual obligations

Our future liabilities under firm contractual obligations, including debt repayments, capital leases and operating leases, are summarized in our annual MD&A for the year 2003. Since December 31, 2003, there has been no significant change to our contractual obligations other than the repayment of our term loan.

Significant accounting policies and use of estimates

Our consolidated financial statements are prepared in accordance with GAAP using the U.S. dollar (functional currency) as the reporting currency. In preparing the financial statements in conformity with GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Our significant accounting policies are presented in our 2003 annual report in Note 2 to the financial statements. We believe that the following accounting policies and estimates are most significant to assist in understanding and evaluating our financial results.

Revenue recognition

We recognize revenues when our products are shipped to customers. Accruals for customer discounts, rebates and defective allowances are recorded as the related revenues are recognized. Accruals for returns are based on market data, historical trends and information from customers and are therefore subject to estimation.

Financial instruments

We use a combination of financial instruments to manage risks related to fluctuations in exchange rates. The derivative instruments we use mainly are foreign exchange contracts. We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Gains and losses on foreign exchange contracts are recognized through income and generally offset transaction losses or gains on the foreign currency cash flows, which they are intended to hedge. We do not use derivative financial instruments for trading purposes.

Gains and losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other assets or liabilities and recognized in the statement of earnings in the period in which the underlying hedged transaction is recognized. In the event a designated item is sold, extinguished or matures prior to the termination of the related derivative instrument, a gain or loss on such a derivative instrument is recognized in the statement of earnings.



Stock-based compensation plans

We have adopted the fair value method of accounting recommended by the CICA in Section 3870, "Stock-based Compensation and Other Stock-based Payments", prospectively for new stock-based compensation awards granted after January 1, 2003. The fair value of option awards is recognized as an expense and any consideration paid by employees on exercise of stock options is credited to share capital. The fair value of options is estimated on the date of grant using the Black-Scholes option-pricing model, including certain assumptions such as risk-free interest rate, expected life of options and expected volatility of the our share price.

Inventories

Inventories are stated at the lower of cost and market value. Cost is established based on the first-in, first-out method. Market value is defined as replacement cost for raw materials and net realizable value for work in process and finished goods.

Recent accounting pronouncements

The CICA issued Accounting Guideline 13, "Hedging Relationships", which deals with the identification, documentation, designation and effectiveness of hedges and also the discontinuance of hedge accounting, but does not specify hedge accounting methods. This guidance is applicable to hedge relationships in effect in fiscal years beginning on or after July 1, 2003.

The Company adopted this Accounting Guideline effective January 1, 2004. The monetary or derivative financial instruments used in risk management and qualifying for hedge accounting are recorded using hedge accounting.

When the hedging relationship no longer qualifies as an effective hedge, hedge accounting is discontinued prospectively and the financial instrument is carried at fair value on the consolidated balance sheet as of the date hedge accounting is discontinued. Any subsequent changes in fair value will be recognized in "Gain/loss on foreign currency translation" in conformity with EIC-128, "Accounting for trading, speculative or non-hedging derivative financial instruments". At September 30, 2004, an amount of \$1,477,000 representing the fair value of certain derivative instruments that no longer qualify for hedge accounting has been recognized. An offsetting amount has been recorded as a deferred charge that will be recognized in income over the next two years as the original hedged items occur. If the financial instrument once again qualifies as a hedging relationship, hedge accounting will be applied again as of the new date of designation.

The CICA issued Handbook Section 3110, "Asset Retirement Obligations". The new standard focuses on the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. The standard is effective for fiscal years beginning on or after January 1, 2004. The adoption of this new standard did not have a material impact on our consolidated financial statements.

The CICA issued Handbook Section 3063, "Impairment of Long-lived Assets", which is effective for fiscal years beginning on or after April 1, 2003. This section provides guidance on recognizing, measuring and disclosing impairment of long-lived assets. It replaces the write-down provisions in Section 3061, "Property, plant and equipment". The adoption of this new standard did not have a material impact on our consolidated financial statements.

Risks and uncertainties

For a discussion of the risks that could affect our business, please refer to our annual MD&A for 2003. Since December 31, 2003, there has been no significant changes to our risks and uncertainties.



Forward-looking statements

Certain statements made in this MD&A may constitute forward-looking statements and are subject to significant risks and uncertainties which are difficult to predict and assumptions which may prove to be inaccurate. The results or events predicted in these statements may differ materially from actual results or events. Certain of the risk factors which could cause results or events to differ materially from current expectations include the following: difficulty in predicting customer preferences and importance of new products, dependence on a few large customers, litigation, seasonality of the toy industry, fluctuations in the price of plastic resins and currency fluctuations. The forward-looking statements contained in this document represent the Company's expectations as of October 28, 2004 and, accordingly, are subject to change after such date. However, the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Additional information relating to Mega Bloks is available on SEDAR at www.sedar.com.





Consolidated statements of earnings

(in thousands of U.S. dollars, except per share amounts)
(Unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2004	2003	2004	2003
Net sales	\$ 85,888	\$ 78,366	\$ 142,258	\$ 127,597
Cost of sales	44,748	39,868	77,657	67,702
Gross profit	41,140	38,498	64,601	59,895
Marketing, research and development, and advertising expenses	12,809	10,362	20,665	17,502
Other selling, distribution and administrative expenses	10,696	9,792	26,839	24,250
Gain on foreign currency translation	(1,039)	(1,534)	(1,763)	(2,727)
Earnings from operations	18,674	19,878	18,860	20,870
Interest expense				
Long-term debt	159	494	855	1,398
Other	102	60	189	139
	261	554	1,044	1,537
Earnings before income taxes	18,413	19,324	17,816	19,333
Income taxes				
Current	3,754	6,189	3,583	4,592
Future	551	602	543	2,233
	4,305	6,791	4,126	6,825
Net earnings	\$ 14,108	\$ 12,533	\$ 13,690	\$ 12,508
Earnings per share (Note 7)				
Basic	\$ 0.52	\$ 0.46	\$ 0.50	\$ 0.46
Diluted	\$ 0.48	\$ 0.43	\$ 0.47	\$ 0.43



Consolidated statements of deficit

(in thousands of U.S. dollars)
(Unaudited)

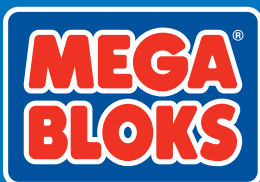
	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2004	2003	2004	2003
Balance, beginning of period	\$ (77,915)	\$ (106,327)	\$ (77,497)	\$ (106,014)
Net Earnings	14,108	12,533	13,690	12,508
Related party transaction adjustment (Note 10)	-	-	-	(288)
Balance, end of period	\$ (63,807)	\$ (93,794)	\$ (63,807)	\$ (93,794)



Consolidated balance sheet

(in thousands of U.S. dollars)

	September 30, 2004 (Unaudited)	December 31, 2003 (Audited)	September 30, 2003 (Unaudited)
Assets			
Current assets			
Cash and cash equivalents	\$ 2,752	\$ 3,595	\$ 4,306
Accounts receivable - trade	83,204	93,417	70,531
Accounts receivable - other	4,597	4,617	3,043
Inventories	41,889	24,440	33,849
Income taxes	–	24	5,151
Prepaid expenses	3,393	3,823	2,097
	135,835	129,916	118,977
Capital assets	33,757	33,510	32,822
Deferred charges	2,494	1,292	1,370
	\$ 172,086	\$ 164,718	\$ 153,169
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	\$ 44,300	\$ 42,782	\$ 47,250
Income taxes	4,823	–	–
Current portion of long-term debt (Note 3)	543	955	820
	49,666	43,737	48,070
Derivative financial instruments	1,477	–	–
Long-term debt (Note 3)	20,418	35,489	36,623
Future income taxes	9,541	8,998	8,396
	81,102	88,224	93,089
Shareholders' equity			
Capital stock (Note 4)	154,234	153,729	153,711
Contributed Surplus	557	262	163
Deficit	(63,807)	(77,497)	(93,794)
	90,984	76,494	60,080
	\$ 172,086	\$ 164,718	\$ 153,169



Consolidated statements of cash flows

(in thousands of U.S. dollars)
(Unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2004	2003	2004	2003
Cash flows from operating activities				
Net earnings	\$ 14,108	\$ 12,533	\$ 13,690	\$ 12,508
Items not affecting cash and cash equivalents				
Amortization	3,610	2,375	7,200	5,975
Gain on foreign currency translation	(1,039)	(1,534)	(1,763)	(2,727)
Others	675	602	838	2,233
	17,354	13,976	19,965	17,989
Changes in non-cash operating working capital items	(29,831)	(30,146)	1,347	(2,064)
	(12,477)	(16,170)	21,312	15,925
Cash flows from financing activities				
Repayment of long-term debt	(69)	(111)	(12,733)	(14,066)
Change in revolving term bank loan	7,250	11,500	(2,750)	7,500
Issue of capital stock	167	381	505	648
Related party transaction adjustment	–	–	–	(419)
	7,348	11,770	(14,978)	(6,337)
Cash flows from investing activities				
Acquisition of capital assets	(1,310)	(1,585)	(7,177)	(8,158)
	(1,310)	(1,585)	(7,177)	(8,158)
Increase (decrease) in cash and cash equivalents	(6,439)	(5,985)	(843)	1,430
Cash and cash equivalents, beginning of period	9,191	10,291	3,595	2,876
Cash and cash equivalents, end of period	\$ 2,752	\$ 4,306	\$ 2,752	\$ 4,306
Supplementary disclosure of cash flow information				
Interest paid	\$ 382	\$ 568	\$ 1,070	\$ 1,465
Income taxes paid	\$ 752	\$ 1,244	\$ 2,140	\$ 11,045



Notes to interim consolidated financial statements

For the three-month and nine-month periods ended September 30, 2004 and 2003
(Column figures are expressed in thousands of U.S. dollars, except per share data)
(Unaudited)

1. Basis of presentation

The consolidated financial statements are expressed in U.S. dollars as it is the Company's functional currency and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), which requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates.

The unaudited interim consolidated financial statements have been prepared in accordance with GAAP on a basis consistent with those followed in the consolidated financial statements dated December 31, 2003 except as noted below. However, they do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest Annual Report.

The 2003 consolidated financial statements have been restated to reflect the application of Canadian Institute of Chartered Accounts ("CICA") Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments" prospectively for new awards grants after January 1, 2003. During fiscal 2003, the Company adopted this application during the fourth quarter.

2. Changes in accounting policies

The Company has adopted the following new Accounting Guideline and Handbook Sections issued by the CICA:

Hedging Relationships

The CICA issued Accounting Guideline 13, "Hedging Relationships", which deals with the identification, documentation, designation and effectiveness of hedges and also the discontinuance of hedge accounting, but does not specify hedge accounting methods. This guidance is applicable to hedge relationships in effect in fiscal years beginning on or after July 1, 2003.

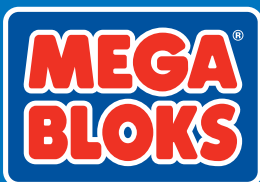
The Company adopted this Accounting Guideline effective January 1, 2004. The monetary or derivative financial instruments used in risk management and qualifying for hedge accounting are recorded using hedge accounting.

When the hedging relationship no longer qualifies as an effective hedge, hedge accounting is discontinued prospectively and the financial instrument is carried at fair value on the consolidated balance sheet as of the date hedge accounting is discontinued. Any subsequent changes in fair value will be recognized in "Gain/loss on foreign currency translation" in conformity with EIC-128, "Accounting for trading, speculative or non-hedging derivative financial instruments". At September 30, 2004, an amount of \$1,477,000 representing the fair value of certain derivative instruments that no longer qualify for hedge accounting has been recognized. An offsetting amount has been recorded as a deferred charge that will be recognized in income over the next two years as the original hedged items occur. If the financial instrument once again qualifies as a hedging relationship, hedge accounting will be applied again as of the new date of designation.

Asset Retirement Obligations

The CICA issued Handbook Section 3110, "Asset Retirement Obligations". The new standard focuses on the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. The standard is effective for fiscal years beginning on or after January 1, 2004.

The adoption of this new Handbook Section did not have a material impact on our consolidated financial statements.



2. Changes in accounting policies (continued)

Impairment of Long-lived Assets

The CICA issued Handbook Section 3063, "Impairment of Long-lived Assets", which is effective for fiscal years beginning on or after April 1, 2003. This section provides guidance on recognizing, measuring and disclosing impairment of long-lived assets. It replaces the write-down provisions in Section 3061, "Property, plant and equipment".

The adoption of this new Handbook Section did not have a material impact on our consolidated financial statements.

3. Long-term debt

On June 30, 2004, the Company amended its Credit Agreement bearing formal date of May 1, 2002. Through this Amendment Agreement, the Company and its lenders amended certain provisions of the Credit Agreement. First, the Company repaid \$12.0 million of the Term B Credit Facility. The Term B Credit Facility was for an original amount of \$25.0 million, of which 95% was payable at maturity in 2008. In addition, the Company increased its revolving credit facility to \$57.5 million from \$45.0 million. Strong free cash flow generated in 2003 and during the first six months of fiscal 2004 enabled the Company to repay approximately 50% of its Term B Credit Facility.

	September 30, 2004	December 31, 2003	September 30, 2003
Term loan of \$25.0 million, secured, maturing in May 2008 ⁽¹⁾	\$ 12,500	\$ 24,625	\$ 24,750
Obligations under capital leases maturing at various dates up to May 2008 ⁽²⁾	1,211	1,767	1,116
Loans, secured, maturing at various dates up to June 2004 ⁽³⁾	—	52	77
Revolving term bank loan of \$57.5 million, secured ⁽⁴⁾	7,250	10,000	11,500
	20,961	36,444	37,443
Current portion	543	955	820
	\$ 20,418	\$ 35,489	\$ 36,623

⁽¹⁾ Bearing interest at floating rates based on U.S. Base Rate plus 0.50% to 2.00% or LIBOR rate plus 1.50% to 3.00%, at the option of the Company, of which \$11,750 is repaid at maturity, secured by a movable hypothec on all assets of the Company. (As at September 30, 2003 and December 31, 2003, bearing interest at floating rates based on U.S. Base Rate plus 2.00% to 3.50% or LIBOR rate plus 3.00% to 4.50%, at the option of the Company, of which 95% is repaid at maturity, secured by a movable hypothec on all assets of the Company.)

⁽²⁾ Bearing interest at rates ranging between 5.82% and 10.57%.

⁽³⁾ Bearing interest at rates ranging between 8.88% and 9.07%, secured by computer equipment having a net book value of \$0.2 million.

⁽⁴⁾ Bearing interest at floating rates based on U.S. Base Rate plus 0.25% to 1.75% or LIBOR rate plus 1.25% to 2.75%, at the option of the Company, secured by a movable hypothec on all assets of the Company. (As at September 30, 2003 and December 31, 2003, revolving term bank loan of \$45.0 million, secured, bearing interest at floating rates based on U.S. Base Rate plus 1.50% to 3.00% or LIBOR rate plus 2.50% to 4.00%, at the option of the Company, secured by a movable hypothec on all assets of the Company.)

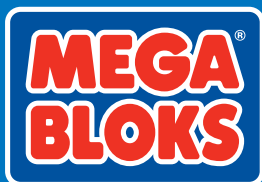
4. Capital stock

Outstanding share data

As at September 30, 2004, there were 27,234,265 Common Shares issued and outstanding.

5. Income taxes

The tax rate used to establish the income tax expense for the quarterly results is the applicable statutory rate of each subsidiary of the group which approximates the effective income tax rate of 23% for the nine-month period ended September 30, 2004.



6. Stock-based compensation plans

The Company has two stock-based compensation plans whereby, options may be granted to officers and other key employees of the Company and its subsidiaries to purchase common shares of the Company.

Under the Initial Stock Option Plan, the subscription price of each option equalled the estimated fair value of a share of the Company at the date of grant.

Immediately prior to the closing of the Initial Public Offering, the Company introduced a New Stock Option Plan. Under this plan, options to purchase common shares of the Company are granted at a subscription price of 100% of market value. Market value is determined as the closing price of the common shares on the Toronto Stock Exchange on the last date of trading prior to the effective date of the grant.

At September 30, 2004, a total of 6,037,631 common shares remained authorized for issuance under the Company's stock-based compensation plans. Options are exercisable during a period not to exceed ten years after the date of the grant. The right to exercise the options accrues over a period of three years of continuous employment. However, if there is a change of control of the Company, the options become immediately exercisable. Options are adjusted proportionately for any stock dividends or stock splits attributed to the common shares of the Company.

On March 24, 2004, the Board of Directors adopted a recommendation of the Compensation Committee that the Company voluntarily cap stock option grants at 15% of the number of common shares outstanding even though the Option Plan, as approved by the relevant regulatory authorities, allows for a significantly higher dilution rate when the available option grants under such plan are combined with option grants under the Initial Plan. The Compensation Committee is currently engaged in a review of various long-term compensation plans with a mandate to propose to the Board of Directors a plan that will replace in whole or in part the Option Plan with no or minimal dilutive effect on the number of common shares outstanding.

The following table summarizes total stock options outstanding as at September 30 under the Company's Stock Option plans:

(in Canadian dollars)	2004		2003	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, January 1	3,866,825	\$ 8.66	3,925,483	\$ 7.76
Granted	98,586	20.72	192,600	20.55
Exercised	(114,733)	5.93	(231,992)	3.99
Forfeited	(63,234)	18.74	(27,521)	13.13
Options outstanding, September 30	3,787,444	\$ 8.89	3,858,570	\$ 8.59
Options exercisable, September 30	2,820,266	\$ 6.33	2,569,018	\$ 5.21



7. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share:

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2004	2003	2004	2003
Numerator for basic and diluted net earnings per common share:				
Net earnings attributable to common shareholders	\$ 14,108	\$ 12,533	\$ 13,690	\$ 12,508
Denominator for basic net earnings per common share:				
Weighted average number of common shares outstanding	27,208,571	27,025,820	27,162,290	26,965,036
Earnings per share - Basic	\$ 0.52	\$ 0.46	\$ 0.50	\$ 0.46
Denominator for diluted net income per common share:				
Weighted average number of common shares outstanding	27,208,571	27,025,820	27,162,290	26,965,036
Plus impact of stock options	2,134,316	2,411,256	2,209,155	2,451,602
Diluted common shares	29,342,887	29,437,076	29,371,445	29,416,638
Earnings per share - Diluted	\$ 0.48	\$ 0.43	\$ 0.47	\$ 0.43

Fair value method for the Company's stock based compensation plan

CICA Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments", recommends the recognition of an expense for option awards using the fair value method of accounting for options issued after January 1, 2002. It permits the use of other methods, including the intrinsic value based method, provided pro forma disclosures of net income and earning per share applying the fair value method are made. In 2003, the Company adopted the recommendations of CICA Handbook Section 3870, with respect to the use of the fair value method to recognize an expense for option awards, prospectively for new awards granted after January 1, 2003. The fair value compensation expense recorded for the nine-month period ended September 30, 2004, in respect of these awards was \$295,000 (\$163,000 in 2003).

The pro forma disclosures have been presented as if the recommended recognition provisions of Section 3870 for awards granted in 2002 had been adopted in 2004 and 2003.

	Three-month periods ended September 30,				Nine-month periods ended September 30,			
	As reported		Pro forma ⁽¹⁾		As reported		Pro forma ⁽¹⁾	
	2004	2003	2004	2003	2004	2003	2004	2003
Net earnings	14,108	12,533	13,480	11,914	13,690	12,508	11,837	10,724
Earnings per share:								
Basic	0.52	0.46	0.50	0.44	0.50	0.46	0.44	0.40
Diluted	0.48	0.43	0.46	0.40	0.47	0.43	0.40	0.36

(1) Compensation expense under the fair value based method is recognized over the vesting period of the related stock options. Accordingly, the pro forma results of applying this method may not be indicative of future amounts.



7. Earnings per share (continued)

The fair value of options granted during the nine-month periods ending September 30, 2004 and 2003 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumption:

	2004	2003
Risk-free interest rate	4.56 %	5.52 %
Expected option life	6 years	7.8 years
Expected volatility	27 %	33%
Expected dividends	0%	0%

The average fair value of each option granted was \$CA7.56 (\$CA8.43 in 2003)

8. Seasonal nature of business

Historically, the first two quarters have presented lower level of activity and produced weaker results than the last two quarters.

9. Contingency

On April 29, 2004, the Supreme Court of Canada granted Kirkbi AG and Lego Canada Inc. ("Lego") leave to present an appeal to the Court from a July 14, 2003 decision of the Federal Court of Appeal. No hearing date for the appeal has been set at this time. Lego's action, which was dismissed by the Federal Court Trial Division and the Federal Court of Appeal, claims that Lego has the exclusive right to the "look" of the knobs of stackable, interlocking toy blocks marketed by both Lego and Mega Bloks.

10. Related party transactions

Related party transaction adjustment

On May 29, 2003, the Company closed a secondary offering through a filing of a Base PREP Prospectus with Canadian securities regulatory authorities. The secondary offering qualified the distribution of 6,223,240 common shares (the "Offered Shares") of the Company owned by certain shareholders. The Company did not receive any proceeds from the sale of the Offered Shares. The expenses (other than the Underwriters' fees) of the offering paid by the Company in the amount of approximately \$419,000 (\$288,000 net of income taxes) were recorded as a related party transaction adjustment reflected as an increase in deficit.

11. Segmented information

The Company manages its business as a single operating segment - manufacturing and distribution of toys.

Geographic information

The table below presents information by geographic region. Revenues are attributed to countries based on location of customer:

	Three-month periods ended		Nine-month periods ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Net sales				
Canada	\$ 6,175	\$ 5,169	\$ 10,325	\$ 8,515
United States	39,440	39,548	66,169	64,830
International	40,273	33,649	65,764	54,252
	\$ 85,888	\$ 78,366	\$142,258	\$127,597