MEGA Brands Inc.

Management's Discussion and Analysis of Financial Position and Results of Operations

For the fourth quarter and year ended December 31, 2006

Financial Highlights

(U.S. $ millions, except per share data)	Years ended December 31, 2006 (Audited) $	2005 (Audited) $	Three-month periods ended December 31, 2006 (Unaudited) $	2005 (Unaudited) $
Net sales	**547.3**	384.9	**164.8**	166.2
Earnings (loss) from operations	**39.0**	62.4	**(1.3)**	31.7
Net earnings	**25.3**	39.6	**2.8**	20.9
Earnings per share				
Basic	**0.79**	1.35	**0.09**	0.66
Diluted	**0.74**	1.26	**0.08**	0.61
Specified Items[1] per share				
Basic	**(0.86)**	–	**(0.53)**	–
Diluted	**(0.82)**	–	**(0.50)**	–
Earnings per share before Specified Items[1]				
Basic	**1.65**	1.35	**0.61**	0.66
Diluted	**1.56**	1.26	**0.58**	0.61

[1] Earnings per share before Specified Items is not calculated in accordance with Canadian Generally Accepted Accounting Principles and are unaudited items. The Corporation believes this to be a relevant measure because it excludes items that are not typical of ongoing operations and allows shareholders and other investors to compare the Corporation's performance for the three-month and twelve-month periods ended December 31, 2006 with the similar 2005 periods. Please refer to the section titled "Specified Items Affecting Operations" on page 7 of this Management's Discussion and Analysis.

Stock Exchange

Toronto Stock Exchange: MB

Trading History

TSX	(CA$) Q4 2006	(CA$) 2006
High:	$27.60	$29.75
Low:	$22.10	$20.25
Close:	$26.15	$26.15
Average volume:	171,217	117,165

Shares Outstanding

(as at March 30, 2007)

32,711,213 Common Shares

Transfer Agent

CIBC Mellon Trust Company

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Management's Discussion and Analysis of Financial Position and Results of Operations

For the fourth quarter and year ended December 31, 2006

This Management's Discussion and Analysis of Financial Position and Results of Operations ("MD&A"), which is current as of April 1, 2007, should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto for the years ended December 31, 2006 and 2005. The financial information in this MD&A and in our financial statements has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") of the Canadian Institute of Chartered Accountants ("CICA"). We also present certain non-GAAP financial measures, which we believe are useful to investors for comparing our performance from period to period. Please refer to the non-GAAP financial measures section of this MD&A.

All figures in this MD&A are expressed in U.S. dollars, (reporting and functional currency) unless otherwise indicated. Throughout this MD&A, MEGA Brands Inc. (formerly Mega Bloks Inc.) and its subsidiaries are referred to as "MEGA Brands", the "Corporation", "we", "our" and "us". The name ''MEGA Brands America'' refers to Rose Art Industries, Inc., Warren Industries, Inc. and their respective subsidiaries, as they were at the time of the acquisition.

Forward-Looking Statements

All statements in this MD&A that do not directly and exclusively relate to historical facts constitute "forward-looking statements". These statements represent the Corporation's intentions, plans, expectations and beliefs. In certain instances, these statements require us to make assumptions and there is significant risk that these assumptions may not be correct. Furthermore, these statements are subject to risks, uncertainties and other factors, many of which are beyond the Corporation's control. These factors include and are not restricted to: realization of synergies, litigation and its inherent uncertainty, including the recovery of the full product liability settlement amount and risks associated with product recalls, international operations, insurance coverage, difficulty in predicting consumer preferences and development and acceptance of new products, rate of growth or profitability, dependence on a few large customers, fluctuations in the price of plastic resins and other raw materials as well as currency rates, seasonality of toy and stationery industries, risks related to licensed products, retail environment, construction toy litigation and financing and interest rate matters. The words "believe", "estimate", "expect", "intend", "anticipate", "foresee", "plan", and similar expressions and variations thereof, identify certain of such forward-looking statements, which speak only as of the date on which they are made. The Corporation disclaims any intention or obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by applicable legislation. Readers are cautioned not to place undue reliance on these forward-looking statements. More information about the risks that could cause our actual results to significantly differ from our current expectations can be found in the "Risks and Uncertainties" section of this MD&A. When we state that we believe that the Corporation is well positioned for continued growth, that we anticipate sales growth in the upcoming year and that there is strong growth potential for ROSE ART® and MAGNETIX® brands in international markets, that we expect to realize operational efficiencies in 2007, that we expect to recover from insurers and through other recourses substantially the full amount paid to settle the lawsuits relating to injuries to children resulting from the ingestion of magnets and that we expect to recover the full amounts of the escrow fund provided for under the Stock Purchase Agreement ("SPA"), we have assumed that we will succeed in realizing the cost and revenue synergies from the integration of MEGA Brands America including without limitation the synergies resulting from the downsizing and closing of manufacturing plants in North America and the concentration of distribution in one facility, that we will maintain or increase the quality of products manufactured in new locations, that we will be successful in reducing inventory levels, that we will maintain service levels in our new distribution facility, that we will be able to attract and retain key personnel in key positions, that international markets that we service through our sales and marketing organization will have a strong interest both in ROSE ART brands and in other products that we will offer, that the retail markets into which we sell will continue to demonstrate strong demand for the Corporation's product lines, that our insurers will not successfully deny any material portion of the claims, and that any such portion which may be denied will be recoverable against former shareholders of MEGA Brands America, and that the number and quantum of self-insured product liability claims will not be material. As described in the "Risks and Uncertainties" section of this MD&A, there are risks and uncertainties that could mean that one or more of these assumptions ultimately turn out to be incorrect and that we do not therefore experience the growth that we anticipate.

Corporate Overview

MEGA Brands designs, manufactures and markets high quality toys and stationery products. Headquartered in Montreal, the Corporation has approximately 6,000 employees with offices, manufacturing facilities or distribution centers in 14 countries. The Corporation's products are sold in over 100 countries.

The Corporation operates under two geographical segments, North America and International, with sales and marketing conducted through two product lines.

- Toys product lines are comprised of MEGA BLOKS® construction toys in the preschool and boys 5-plus categories, MAGNETIX® building sets for children 6-plus and MEGA™ games and puzzles for families.

- Stationery and Activities product lines are comprised of art materials (crayons, colored pencils, highlighters and markers) sold mainly under the ROSE ART® brand; writing instruments (pens, mechanical pencils and woodcase pencils) sold mainly under the ROSE ART, SRX® and USA GOLD® brands; dry-erase and cork presentation boards, organizers and accessories sold mainly under the BOARD DUDES® brand, and ROSE ART and MEGA craft and activity sets.

Industry Overview

The traditional toy industry, which excludes video games and computer hardware and software, represents annual sales at wholesale of approximately $16 billion in North America and $40 billion worldwide. The Corporation competes in categories with total estimated manufacturers' shipments of approximately $4 billion in North America and $6 billion in the rest of the world.

Worldwide sales of traditional toys have been growing in recent years despite lower sales in North America. In North America, sales declined between 2003 and 2005 mainly as a result of lower purchases for children 12 years of age and older due to the growing popularity of electronic games and a decline in the number of children in the 5-9 age group. An additional factor in the sales decrease was the intense competition among retailers which resulted in a reduction of shelf space for traditional toys and lower prices. North American toy sales stabilized in 2006 and demographic trends are shifting favorably, with growth forecasted in the number of children aged 5-9 during the next several years. Outside North America, demand for traditional toys is increasing with strong potential in many parts of the world mainly due to higher disposable incomes.

The Corporation is a significant player in selected categories of the growing $94.1 billion stationery market in North America. The Corporation currently participates in product categories which amounts to approximately $16 billion in estimated manufacturer shipments. Most of the Corporation's products are currently sold in the School Supply segment of the stationery market, which represents approximately 14% of total manufacturers' shipments, and is served mainly by mass retailers and food and drug stores. The much larger Office Supply segment of the stationery market, which is served mainly by specialty retailers, offers the Corporation an attractive growth opportunity.

Strategy, Objectives and 2006 Developments

MEGA Brands has achieved 22 consecutive years of profitability and sales growth since the launch of its first construction blocks in 1985. This success is driven by product innovation and strong execution against our strategic objectives.

Product Innovation

Product innovation is the key success factor in the toy industry and the main driver of sales growth. In 2006, we renewed approximately 40% of the previous year's toy sales with new product lines and extensions, enhancements and replacements of existing lines. We meet this competitive necessity by investing 3-4% of sales on new product design, engineering, prototyping and development.

With over 60 awards and mentions for exceptional design, innovation, learning attributes and play experience, 2006 was a banner year for innovation. Toy testers and critics were particularly excited by our MAGTASTIK® product line which was selected for more than a dozen awards including Dr. Toy's Smart Play/Smart Toy Program, the Gold Seal for Oppenheim Toy Portfolio's Best Toy Award, and Toy Wishes Top 12 Toys of the Year. The MAGNETIX MagnaCase was singled out as one of Dr. Toy's 100 Best Children's Products and 10 Best Toys of 2006.

Our CAT® Super Tower Crane garnered the 2006 Toy of the Year Award from Family Fun Magazine and the Parents' Choice Approved Award. The Pirates of the Caribbean line won Today's Parent Seal of Approval and The Black Pearl, a fully buildable ship playset was selected as one of The Toy Insider's Hot 20 Toys for the Holiday Season. Many other products received awards and mentions in 2006, including Tiny 'N Tuff® Off-Road Set, Buildable Noah's Ark™ and MEGA Wagon™.

Strategic Licensing

Licensed products, which accounted for approximately 19.0% of sales in 2006 compared to approximately 20.0% in 2005, complement our internal product development initiatives. In recent years, we have entered into licensing agreements with affiliates of The Walt Disney Corporation, Marvel Enterprises Inc., NASCAR and others. Our focus is on evergreen brands with enduring popularity that have the potential to expand our product lines and drive incremental sales growth. The percentage of our annual sales based on licenses is lower than the 30-35% average for the North American toy industry.

In 2006, we announced a multi-year licensing partnership with MTV Networks to develop construction toys based on Dora the Explorer, Go Diego Go! and The Backyardigans. New products based on these popular Nickelodeon character brands will launch in 2007 beginning in the United States and Canada with an expansion to the United Kingdom, France, Australia and Latin America later in the year and other countries in 2008. Dora the Explorer is among the top-rated preschool television shows in the world, the number one preschool license in North America, the number one overall toy license in France and Canada, and the number one girls' license in the United Kingdom.

Building on our successful relationship with Disney, one of the world's most successful children's brands, we announced a multi-year agreement in 2006 to launch a global line of arts and crafts products based on popular Disney properties. The new line will feature Disney Princess and Pirates of the Caribbean, with products available in North America, Europe, Scandinavia, Africa and the Middle East in 2007. We are also offering preschool vehicles based on the Disney Pixar movie ''Cars''.

Our 2007 product lines will include playsets based on two major theatrical releases scheduled for Spring 2007: Disney's ''Pirates of the Caribbean: At World's End'' and Marvel's ''Spider-Man 3''.

Strategy, Objectives and 2006 Developments (Continued)

International Growth

Penetration of international markets is an important driver of our long-term growth. We have established a strong sales, marketing and logistics organization in Europe and Mexico, a marketing partnership with Bandai in Japan, as well as distributorships covering another 60 global markets. Our international sales increased 14.6% in 2006 to $149.6 million compared to $130.5 million in 2005.

We expect continued international growth for the MEGA BLOKS brand through market share gains in Western Europe and Australia, penetration of new markets in Central and Eastern Europe, and sales growth in Latin America, Asia, the Middle East and Africa. In 2006, MEGA Brands was the leader in the construction category in both the United Kingdom and in Spain, the first time we surpassed the former leader in these important European markets. We increased our share in virtually all of our international markets in 2006. In the Australia and Pacific regions, we positioned ourselves for continued market penetration by establishing a subsidiary in Australia, following several years of sales growth through distributors.

We believe there is strong growth potential for the ROSE ART and MAGNETIX brands in international markets through our existing sales and marketing organization. In 2006, we expanded the distribution of MAGNETIX products into several new markets in Europe, Asia and Latin America, and we prepared the ground for the introduction of arts and crafts and stationery products in our international markets in 2007. We selected a portfolio of ROSE ART craft and activity sets and adapted these products for introduction into our key European markets for 2007, complemented by a broad assortment of Disney licensed products. In stationery, we have a dedicated sales force in five markets - United Kingdom, France, Italy, Mexico and Australia - and our products will be available at retail for the 2007 back-to-school season.

Growth by Acquisition

We plan to supplement our internal growth with selected strategic acquisitions that will reinforce our product range and consumer reach. In identifying attractive acquisition candidates, we are looking to: expand into basic and growing categories, strengthen our position in current core competencies, expand shelf space into multiple aisles, strengthen relationships with key retailers, expand global distribution and enter into new retail channels. Furthermore, we are looking for acquisitions that will offer significant synergies. Our priority in 2007 is to fully realize the benefits of the integration of MEGA Brands America.

The acquisition of The Board Dudes, Inc. (''Board Dudes''), which closed in February, 2006, positioned the Corporation as the second largest supplier of dry erase and cork presentation boards and accessories, a $400 million category in the North American stationery market, based on manufacturers' shipments.

The integration of MEGA Brands America, which we acquired in July 2005, progressed significantly to plan during 2006. The following actions were implemented during the year.

- We opened a 450,000 sq. ft. distribution center in Fife, Washington State, in April 2006 to receive and process all products manufactured in China for sale in North America.

- After completing our 2006 manufacturing requirements, we closed plants in Eugene, Oregon (Fuzzy® flocked posters) and Lafayette, Indiana (games and puzzles) and relocated production to China.

- Following the 2006 back-to-school season, we relocated the production of crayons, paints and dough to our facility in Shenzhen, China, resulting in a corresponding downsizing of the Woodridge, New Jersey, plant.

- Distribution centers for products relocated to China were closed down or downsized at all three plants. We also downsized our Montreal distribution center and consolidated some of its activities into our Montreal manufacturing facility.

- At the end of 2006, we closed a plant in China and consolidated manufacturing in a single, expanded facility.

Strategy, Objectives and 2006 Developments (Continued)

Growth by Acquisition (Continued)

Manufacturing costs for the product lines relocated to China were incurred in our North American plants in 2006. The Corporation also incurred costs for setting up the Fife, Washington distribution center which offset savings on freight incurred for transporting products manufactured in China from the West Coast to the Montreal distribution center.

With the integration of MEGA Brands America essentially completed by the end of 2006, we expect to realize between $7-10 million of operational efficiencies in 2007.

We estimate that our North American plants will supply approximately 25% of consolidated net sales, our plant in China for 25%, focusing on high-volume production, and our Asian supplier base, mainly in China, for the remaining 50%.

Other Developments

Shareholders adopted a special resolution on June 15, 2006, authorizing the Corporation to change its legal name to MEGA Brands Inc. The Corporation filed the amendment to its articles of incorporation under the Canada Business Corporations Act to change its name on June 22, 2006. The legal names of the Corporation's principal subsidiaries were changed to MEGA Brands America, Inc. (formerly Rose Art Industries, Inc.), MEGA Brands International (formerly Mega Bloks International Sàrl) and MEGA Brands Europe NV (formerly Mega Bloks Europe NV).

On May 8, 2006, the former shareholders of Rose Art Industries, Inc. initiated litigation against the Corporation in the U.S. District Court for the Southern District of New York ("Rosen Litigation"). The plaintiffs are seeking payment of the Contingent Purchase Price under the terms of the Stock Purchase Agreement ("SPA") entered into between them and the Corporation effective July 26, 2005. The Corporation has filed an answer and counter claim denying each and every material allegation relating to the lawsuit. The Corporation's counter claim alleges that the former shareholders failed to uphold certain terms of the SPA. The Corporation accrued as a reserve $51.0 million in its 2005 audited consolidated financial statements with respect to the Contingent Purchase Price pending final determination of the amount owed, if any. As at December 31, 2006, no disbursements had been made and the Corporation will continue to maintain the reserve until the lawsuit is resolved. No trial date had been set as at April 1, 2007. The Corporation is currently awaiting the Court's ruling on a number of procedural issues after which it expects to enter into a protracted discovery period.

On November 17, 2006, Jeffrey and Lawrence Rosen, the former shareholders of Rose Art Industries, Inc., filed proceedings before the American Arbitration Association against the Corporation seeking unspecified damages for the Corporation's alleged breach of their respective employment agreements. The Corporation is contesting the proceedings.

On March 31, 2006, the Corporation jointly announced with the US Consumer Products Safety Commission (''CPSC'') a voluntary recall and replacement program of MAGNETIX building sets in the hands of families with children under the age of six. This action was taken in response to the death of a toddler and injuries to several children resulting from magnet ingestion.

On October 24, 2006, the Corporation announced that it had settled four lawsuits and ten claims related to injuries to children resulting from the ingestion of magnets. Terms of the settlement include no admission of liability. The aggregate amount paid to settle the lawsuits and claims is $13.5 million and is recorded as a product liability settlement expense in the 2006 consolidated statement of earnings. The Corporation expects to recover substantially the full amount from its insurers and through other recourses, although there can be no assurance that a favorable outcome will be achieved. Discussions with our insurers in this regard are underway. On September 14, 2006 and on December 5, 2006, two lawsuits related to magnet ingestion requiring surgical removal were served on the Corporation and remain outstanding. They are being handled by the Corporation's insurers. On March 29, 2007 the Corporation learned that a third lawsuit had been filed in U.S. District Court in Denver by the family of a child who is alleged to have sustained similar injuries. The lawsuit has been reported to our insurers. The Corporation is also aware of at least seven other incidents in which children are alleged to have required surgery following the ingestion of multiple magnets. Lawsuits have not been filed in these matters as of April 1, 2007. The Corporation is not able to assess with any certainty the outcome of these lawsuits and claims or impact, if any. As such, no amounts have been reserved in our year-end financial statements.

Other Developments (Continued)

The Corporation's portfolio of product liability insurance was renewed on December 1, 2006. As a result of the voluntary recall and replacement program and the ensuing publicity and product liability lawsuits and claims against the Corporation, the cost of insurance coverage for MAGNETIX products manufactured before May 1, 2006 was prohibitive. After careful consideration of the risks and an analysis of the costs of insurance, the Corporation determined that it was more economically advantageous, all factors considered, to self-insure these risks. As such, the Corporation is self-insured for incidents occurring after December 1, 2006, for MAGNETIX products manufactured prior to May 1, 2006.

On March 28, 2007, the Corporation learned that a competitor who sells magnetic building sets primarily in Europe, Plastwood S.R.L. and Plastwood Corporation, filed a complaint against MEGA Brands America and MEGA Brands in the Western District of Washington. The complaint is based in significant part on representations alleged to have been made prior to the Corporation's acquisition of MEGA Brands America. The complaint does not provide support for Plastwood's allegations of its own lost sales and other consequences. The Corporation believes it has valid defenses to the complaint and intends to defend the action vigorously. As such, no amounts have been reserved in our year-end financial statements.

The Corporation incurred significant litigation expenses in 2006, particularly in the fourth quarter, related mainly to the Rosen Litigation. Management believes that these expenses were warranted under the circumstances and will be offset by the benefit of asserting the Corporation's rights under the SPA and its insurance policies. The Rosen Litigation has delayed recovery against the $15 million escrow fund provided for under the SPA. Management expects that the resolution of the Rosen Litigation will also resolve the issue of the claims against the escrow fund, although there can be no assurance that a favorable outcome will be achieved.

Specified Items Affecting Operations

The Corporation recorded Specified Items Affecting Operations in 2006. Depending on their nature, the 2006 Specified Items were recorded against net sales, in cost of sales or as operating expenses. This classification was determined in accordance with GAAP.

The following table summarizes all Specified Items Affecting Operations during the year.

(U.S. $ thousands, except per share data)	Year ended December 31, 2006	Three-month period ended December 31, 2006
(Unaudited)		
MAGNETIX product replacement expenses	**16,029**	**13,758**
Product liability settlement and related expenses	**15,490**	**1,463**
Integration expenses	**8,303**	**8,303**
Litigation expenses	**4,769**	**3,678**
	44,591	**27,202**

MAGNETIX product replacement expenses

- The Corporation recorded credits and charges of $6.6 million ($5.9 million in the fourth quarter) as a reduction of net sales. The net impact of these charges on gross profit amounted to $6.1 million for the year ($5.5 million in the fourth quarter).
- The Corporation recorded write-offs of MAGNETIX components of $4.3 million ($4.3 million in the fourth quarter) as a result of the redesign of such components. These amounts are recorded in cost of sales.
- The Corporation recorded product replacement expenses of $5.6 million ($4.0 million in the fourth quarter), consisting of freight costs to meet customer shipment dates due to manufacturing delays for redesigned MAGNETIX products, development costs for the redesign of MAGNETIX components, and product replacements for consumers under the voluntary recall and replacement program for MAGNETIX products jointly announced with the CPSC. The total amount is recorded as a separate line item in operating expenses.

Specified Items Affecting Operations (Continued)

Product liability settlement and related expenses

- The Corporation settled four lawsuits and ten claims related to magnet ingestion and recorded product liability settlement and related expenses of $15.5 million, consisting of $13.5 million for the product liability settlement recorded in the third quarter and $2.0 million of related legal expenses ($1.5 million in the fourth quarter). The total amount is recorded as a separate line item in operating expenses.

Integration expenses

- The Corporation recorded a charge of $4.7 million mostly related to inventory write-offs ($4.7 million in the fourth quarter) following plant closures as part of the integration of MEGA Brands America. This amount is recorded in cost of sales.
- The Corporation recorded integration expenses of $3.6 million ($3.6 million in the fourth quarter), mainly related to branding, plant asset write-offs, plant closure costs and other miscellaneous integration charges. This amount is recorded as a separate line item in operating expenses.

Litigation expenses

- The Corporation recorded litigation expenses of $4.8 million ($3.7 million in the fourth quarter), mainly for the Rosen Litigation. This amount is recorded as a separate line item in operating expenses.

Management believes that under the terms of the acquisition of MEGA Brands America, all claims and expenses related to MAGNETIX, as well as certain other expenses, are recoverable against the sellers, including but not limited to the $15.0 million escrow fund provided for in the SPA. However, the Corporation also expects to recover substantially the full amount of the $13.5 million product liability settlement from its insurers and through other recourses, there can be no assurance that a favorable outcome will be achieved.

Selected Financial Information

The following table presents a summary of selected consolidated income statement data for the years ended December 31, 2006, 2005 and 2004, as well as the three-month periods ended December 31, 2006 and 2005:

	Years ended December 31, (Audited)			Three-month periods ended December 31, (Unaudited)	
(U.S. $ thousands, except per share data)	**2006**	2005	2004	**2006**	2005
Net sales	**547,347**	384,863	215,456	**164,805**	166,234
Cost of sales	**328,822**	214,668	123,821	**113,272**	88,559
Gross profit	**218,525**	170,195	91,635	**51,533**	77,675
Marketing and advertising expenses	**26,808**	24,573	13,382	**10,562**	13,067
Research and developement expenses	**18,334**	9,402	5,691	**5,858**	3,658
Other selling, distribution and administrative expenses	**109,815**	71,074	37,244	**24,540**	28,658
Loss (gain) on foreign currency translation	**(4,846)**	2,796	(3,117)	**(858)**	589
Product liability settlement and related expenses	**15,490**	–	–	**1,463**	–
Voluntary product recall and replacement	**5,612**	–	–	**3,995**	–
Litigation expenses	**4,769**	–	–	**3,678**	–
Integration expenses	**3,573**	–	–	**3,573**	–
Unusual items	**–**	–	5,158	**–**	–
Earnings (loss) from operations	**38,970**	62,350	33,277	**(1,278)**	31,703
Interest and other expenses					
Interest on long-term debt	**22,526**	9,310	1,207	**6,419**	5,127
Other interest	**177**	954	170	**371**	(26)
	22,703	10,264	1,377	**6,790**	5,101
Earnings (loss) before income taxes	**16,267**	52,086	31,900	**(8,068)**	26,602
Income taxes					
Current	**(1,217)**	5,473	7,427	**(5,126)**	360
Future	**(7,864)**	7,005	(704)	**(5,703)**	5,331
	(9,081)	12,478	6,723	**(10,829)**	5,691
Net earnings	**25,348**	39,608	25,177	**2,761**	20,911
Earnings per share					
Basic	**0.79**	1.35	0.93	**0.09**	0.66
Diluted	**0.74**	1.26	0.86	**0.08**	0.61

Weighted average number of outstanding shares	**2006**	2005	2004	**2006**	2005
Basic	**32,220,495**	29,281,145	27,185,175	**32,352,319**	31,854,644
Diluted	**34,189,034**	31,390,456	29,331,615	**34,289,179**	34,080,643

The following tables present a summary of selected consolidated balance sheet data as at December 31, 2006, 2005 and 2004 and Canadian dollar data for the years ended December 31, 2006, 2005 and 2004 as supplementary information for Canadian investors:

(Canadian $ thousands, except per share data)	As at December 31, 2006	2005	2004
	$	$	$
Balance Sheet Data			
Working capital [(1)]	**124,725**	101,605	101,092
Property, plant and equipment	**43,213**	39,351	32,221
Total assets	**800,442**	720,495	183,155
Total debt	**311,954**	300,953	24,572

(Canadian $ thousands, except per share data) (Unaudited)	Year ended December 31, 2006	2005	2004
	$	$	$
Canadian Dollar Data [(2)]			
Net sales	**637,823**	448,481	251,071
Net earnings	**29,538**	46,155	29,339
Earnings per share			
Basic	**0.92**	1.58	1.08
Diluted	**0.86**	1.47	1.00

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

(2) U.S. dollar financial data is converted into Canadian dollars at the December 31, 2006 period end exchange rate of CA$1.1653 per US$1.00, using the translation of convenience method.

Contractual Obligations

The following table presents a summary of contractual obligations for the following years:

	Years						
	2007	2008	2009	2010	2011	After 5 years	**Total**
Long-term debt	9,000	9,000	4,200	42,600	2,600	243,750	**311,150**
Capital leases	609	195	–	–	–	–	**804**
Operating leases	13,465	10,189	9,209	8,192	3,637	1,268	**45,960**
Total contractual obligations	**23,074**	**19,384**	**13,409**	**50,792**	**6,237**	**245,018**	**357,914**

Results of Operations

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Adoption of EIC-156

In 2006, the Corporation adopted a new guideline issued by the Emerging Issues Committee of the CICA called EIC-156, ''Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Product)''. As a result, certain allowances given to customers in the normal course of business, for which the fair market value cannot be precisely determined, are recorded as a reduction of sales. Under the former accounting standard used by the Corporation, such allowances were included in sales, cost of sales goods sold and marketing and advertising expenses. For comparative purposes, the Corporation has reclassified such allowances for 2005. The adoption of EIC-156 reduced net sales by $25.8 million in 2006 and $22.2 million in 2005 and by $9.8 million and $9.7 million in the fourth quarters of 2006 and 2005, respectively.

Net Sales

Net sales increased 42.2% in 2006 to $547.3 million compared to $384.9 million in 2005. Higher net sales reflect mainly the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005, as well as organic growth in construction toys. Recorded against net sales in 2006 are $6.6 million of Specified Items.

Net sales of Toys product lines reached $333.7 million in 2006 compared to $291.6 million in 2005, an increase of 14.4%. The majority of this increase reflects the inclusion of magnetic construction toys and games and puzzles for the full year compared to approximately five months in 2005. Organic growth in construction toys also contributed to the higher net sales.

Net sales of Stationery and Activities product lines increased 129.0% to $213.7 million compared to $93.3 million in 2005. This growth reflects the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005, as well as the contribution from Board Dudes.

Net sales in North America increased 56.4% to $397.8 million compared to $254.3 million in 2005, mainly as a result of the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005. Net sales of construction toys were stable, with higher sales in the preschool category and MAGNETIX offset by a slight decline in boys 5-plus products.

International net sales were up 14.6% to $149.6 million compared to $130.5 million in 2005. The Corporation increased its market share in the construction toy category in virtually all international markets in 2006 and gained the leadership position in this category in the United Kingdom and Spain for the first time. International net sales accounted for 27.3% of consolidated net sales in 2006 compared to 33.9% in 2005.

Cost of Sales

Cost of sales increased 53.1% to $328.8 million in 2006 compared to $214.7 million in 2005. The majority of this increase is due to the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005. Recorded in cost of sales 2006 are $8.5 million of Specified Items.

Gross Profit

Reflecting the growth in net sales, gross profit increased 28.4% to $218.5 million in 2006 compared to $170.2 million in 2005. Gross margin declined to 39.9% compared to 44.2% in 2005. The decline in gross margin in 2006 is explained mainly by additional freight costs incurred in order to meet customer deadlines for the delivery of redesigned MAGNETIX products and higher magnet costs due to the escalation in commodity prices, for a combined impact of approximately $10.0 million. In addition, Specified Items impacting gross profit amounted to $15.1 million. Plastic resin prices in 2006 were in line with 2005 and did not negatively impact gross margin.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005 (Continued)

Operating Expenses

Marketing and advertising expenses increased to $26.8 million in 2006 compared to $24.6 million in 2005. This increase reflects the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005. As a percentage of net sales, such expenses declined to 4.9% compared to 6.4% in 2005. This decrease reflects the proportionately lower marketing and advertising expenses for Stationery and Activities product lines.

Research and development expenses were $18.3 million in 2006 compared to $9.4 million in 2005. This increase reflects mainly the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005. As a percentage of sales, such expenses increased to 3.3% compared to 2.4% in 2005.

Other selling, distribution and administrative expenses were $109.8 million in 2006 compared to $71.1 million in 2005. This increase reflects mainly the inclusion of MEGA Brands America for the full year in 2006 compared to approximately five months in 2005. These expenses were 20.1% of net sales in 2006 compared to 18.5% in 2005.

Earnings from Operations

As a result of the above, earnings from operations were $39.0 million in 2006 compared to $62.4 million in 2005. Earnings from operations resulted in a loss of $11.7 million in North America compared to earnings of $40.3 million in 2005. International earnings from operations rose to $50.7 million compared to $22.1 million in 2005.

Non-Operating Expenses

Interest expense was $22.7 million in 2006 compared to $10.3 million in 2005, reflecting mainly borrowings used to finance the acquisition of the MEGA Brands America. The acquisition closed on July 26, 2005, which accounts for most of the difference in interest expense between the two years, with the balance explained by higher interest rates in 2006.

The Corporation recorded an income tax recovery of $9.1 million in 2006 compared to an income tax charge of $12.5 million in 2005. Before Specified Items, the effective tax rate in 2006 was 12.6% compared to 24.0% in 2005, reflecting mainly the proportionately higher earnings from operations in lower tax jurisdictions in 2006 compared to 2005. The tax rate used to establish income tax expense is the applicable estimated effective rate of each entity of the Corporation. The effective tax rate also takes into consideration the financing structure put in place following the acquisition of MEGA Brands America. As a result of this acquisition, the Corporation also expects to benefit from cash flow savings of approximately $100.0 million over a period of 15 years from the deductibility of goodwill for tax purposes in the United States.

Net Earnings

Net earnings were $25.3 million or $0.74 diluted earnings per share in 2006 compared to $39.6 million or $1.26 diluted earnings per share in 2005. Basic earnings per share were $0.79 in 2006 compared to $1.35 in 2005.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005 (Continued)

Impact of Specified Items

The following table presents the impact of Specified Items on the 2006 statement of earnings. Management believes that an analysis of 2006 and fourth quarter 2006 operating performance before Specified Items is appropriate because such items are not typical of ongoing operations.

Twelve-month periods ended December 31,				(US $ thousands)	Three-month periods ended December 31,			
Audited 2006	Unaudited Specified Items 2006	Unaudited Before Specified Items[1]	Audited 2005		Unaudited 2006	Unaudited Specified Items 2006	Unaudited Before Specified Items[1]	Unaudited 2005
547,347	**6,606**	**553,953**	**384,863**	**Net Sales**	**164,805**	**5,865**	**170,670**	**166,234**
328,822	(8,541)	320,281	214,668	Cost of sales	113,272	(8,628)	104,644	88,559
218,525	15,147	233,672	170,195	Gross profit	51,533	14,493	66,026	77,675
26,808	–	26,808	24,573	Marketing and advertising expenses	10,562	–	10,562	13,067
18,334	–	18,334	9,402	Research and development expenses	5,858	–	5,858	3,658
109,815	–	109,815	71,074	Other selling distribution and administrative expenses	24,540	–	24,540	28,658
(4,846)	–	(4,846)	2,796	Loss (gain) on foreign currency translation	(858)	–	(858)	589
15,490	(15,490)	–	–	Product liability settlement and related expenses	1,463	(1,463)	–	–
5,612	(5,612)	–	–	Voluntary product recall and replacement	3,995	(3,995)	–	–
4,769	(4,769)	–	–	Litigation expenses	3,678	(3,678)	–	–
3,573	(3,573)	–	–	Integration expenses	3,573	(3,573)	–	–
38,970	**44,591**	**83,561**	**62,350**	**Earnings from operations**	**(1,278)**	**27,202**	**25,924**	**31,703**
22,703	–	22,703	10,264	Interest and other expenses	6,790	–	6,790	5,101
16,267	**44,591**	**60,858**	**52,086**	**Earnings (loss) before income taxes**	**(8,068)**	**27,202**	**19,134**	**26,602**
(9,081)	16,722	7,641	12,478	Income taxes	(10,829)	10,200	(629)	5,691
25,348	**27,869**	**53,217**	**39,608**	**Net earnings**	**2,761**	**17,002**	**19,763**	**20,911**
0.79	**0.86**	**1.65**	**1.35**	**Earnings per share - Basic**	**0.09**	**0.53**	**0.61**	**0.66**
0.74	**0.82**	**1.56**	**1.26**	**Earnings per share - Diluted**	**0.08**	**0.50**	**0.58**	**0.61**

(1) The terms ''net sales before Specified Items'', ''cost of sales before Specified Items'', ''gross profit before Specified Items'', ''gross margin before Specified Items'', ''earnings (loss) from operations before Specified Items'',''earnings (loss) before income taxes before Specified Items'', ''net earnings before Specified Items'' and ''diluted earnings per share before Specified Items'' do not have any standardized meaning under GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. We present them as a measure of operating performance of our ongoing business without the effects of unusual items. We exclude such items because they affect the comparability of our financial results between periods and could potentially distort the analysis of trends in business performance.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net Sales

Net sales increased 78.6% to $384.9 million in 2005, compared to $215.5 million in 2004. The main factors contributing to this overall growth were the inclusion of MEGA Brands America as of July 26, 2005 and the continued success of our construction toy business as a result of strong penetration in international markets.

Net sales of Toys product lines increased by 35.2% to $291.6 million in 2005 compared to $215.5 million in 2004. This strong increase was driven primarily by higher sales of preschool and boys 5-plus products in all key European markets, Latin America and Canada, and the addition of magnetic construction toys and games and puzzles following the acquisition of MEGA Brands America. This increase was partly offset by a slight decline in construction toy sales in the U.S. reflecting an overall challenging retail environment for the toy industry and the cautious inventory approach of major retailers.

Net sales of Stationery and Activities product lines were $93.3 million in 2005 compared to nil in 2004. The Corporation was not active in these categories prior to the acquisition of MEGA Brands America.

Net sales in North America increased 100.1% to $254.3 million in 2005 compared to $127.1 million in 2004. International net sales were $130.5 million in 2005, an increase of 47.6% compared to $88.4 million in 2004. Reflecting the net sales of MEGA Brands America in 2005, which are concentrated mainly in North America, international net sales accounted for 33.9% of consolidated net sales compared to 41.0% in 2004.

Gross Profit

Gross profit reached $170.2 million in 2005 compared to $91.6 million in 2004, an increase of 85.8%. The increase in gross profit was driven primarily by sales growth. Gross margin was 44.2% in 2005 compared to 42.5% in 2004. The increase in gross margin was mainly due to changes in product and customer mix compared to 2004. This was partially offset by lower gross margin generated by stationery products and higher resin costs incurred during the first six months of 2005.

Operating Expenses

Marketing and advertising expenses were $24.6 million in 2005, compared to $13.4 million in 2004, an increase of 83.6%. As a percentage of net sales, such expenses were 6.4% in 2005 compared to 6.2% in 2004.

Research and development expenses increased to $9.4 million in 2005 compared to $5.7 million in 2004. This increase reflects mainly the inclusion of MEGA Brands America in 2005.

Other selling, distribution and administrative expenses were up 108.4% to $71.1 million in 2005 compared to $34.1 million in 2004. These expenses represented 18.5% of net sales in 2005 compared to 15.8% in 2004. This increase is mainly explained by the expenses of MEGA Brands America from the date of acquisition and higher distribution costs, reflecting the significant growth in international sales in 2005.

In 2004, the Corporation recorded Specified Items of $5.2 million which were presented in earnings from operations as unusual items. These Specified Items consisted of a loss of $3.6 million due to the fact that certain derivative financial instruments ceased to qualify for hedge accounting as well as a $1.6 million charge in connection with professional and consulting services related to the expansion of the Corporation's presence in the German market.

Earnings from Operations

Earnings from operations increased 87.4% to $62.4 million in 2005 compared to $33.3 million in 2004.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004 (Continued)

Non-Operating Expenses

Interest expense was $10.3 million in 2005 compared to $1.4 million in 2004, reflecting mainly higher borrowings used to finance the acquisition of MEGA Brands America and, to a lesser extent, higher average interest rates compared to the previous year.

Income taxes were $12.5 million in 2005 compared to $6.7 million in 2004. The effective tax rate was 24.0% in 2005 compared to 21.1% in 2004. This increase reflects mainly the impact of the acquisition of MEGA Brands America, which resulted in higher earnings in higher tax jurisdictions.

Net Earnings

Net earnings increased 57.3% to $39.6 million or $1.26 diluted earnings per share compared to $25.2 million or $0.86 per share in 2004. Basic earnings per share increased to $1.35 in 2005 compared to $0.93 in 2004.

Liquidity and Capital Resources

Historically, our primary sources of liquidity have been cash flows from operations and short-term borrowings under a revolving credit facility. Cash flows from operations could be negatively impacted by decreased demand for our products, which could result from factors such as adverse economic conditions and changes in public and consumer preferences, or by increased costs associated with manufacturing and distribution of products. 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 and stationery industries, working capital requirements are variable throughout the year. Working capital needs typically grow through the first three quarters as inventories are built-up for the peak sales period.

Operating Activities

Cash flows from operating activities in 2006 amounted to $15.9 million compared to $25.0 million in 2005. This decrease is explained mainly by lower earnings from operations resulting from the Specified Items affecting operations incurred during the year.

Financing Activities

Cash flows from financing activities in 2006 were $14.3 million, reflecting mainly a draw-down of $40.0 million of the Corporation's revolving credit facility and the repayment of $29.0 million of long-term debt. In 2006, the Corporation repaid $20.0 million of the principal amount of its $40-million Term A debt and concurrently increased the maximum amount of its revolving credit facility to $120.0 million from $100.0 million. For 2005, cash flows from financing activities were $291.9 million, resulting mainly from borrowings and an issue of capital stock to finance the acquisition of MEGA Brands America.

Investing Activities

Cash flows used for investing activities in 2006 were $36.0 million, including $17.5 million for acquisitions of property, plant and equipment and the balance coming mainly from the acquisition of Board Dudes. For 2005, cash flows used for investing activities amounted to $303.0 million, reflecting mainly the acquisition of MEGA Brands America.

We expect the level of capital expenditure to be higher in 2007 but to remain proportionally in line with sales growth.

Balance Sheets

As at December 31, 2006, current assets stood at $345.6 million compared to $297.2 million at the end of 2005. This increase is due mainly to higher inventories which rose to $140.6 million in 2006 compared to $82.3 million in 2005. In 2006, the Corporation built up inventories of basic products in anticipation of plant closures which occurred mainly in the fourth quarter. In addition, production levels in the last few months of 2006 were higher than usual due to demand for products tied to two movies scheduled for North American release in May 2007. The Corporation's objective is to reduce inventory levels to approximately $110.0 million by the end of 2007. Trade accounts receivable declined to $153.1 million in 2006 compared to $167.4 million in 2005 due to timing of shipments and customer payments.

Current liabilities increased to $220.9 million in 2006 compared to $195.6 million in 2005. This increase is due to higher accounts payable and accrued liabilities which rose to $153.4 million in 2006 compared to $108.0 million in 2005. The Corporation accrued US$51.0 million in its 2005 audited consolidated financial statements as additional consideration for the former shareholders of Rose Art Industries, Inc. pending final determination of the amount owed, if any. No disbursements were made in regard to this additional consideration as at December 31, 2006. The Corporation did not make an accrual for additional consideration based on the financial performance of MEGA Brands America in 2006.

Working capital stood at $124.7 million as at December 31, 2006 compared to $101.6 million at the end of 2005. This increase is due mainly to higher inventories at the end of 2006.

Long-term debt at the end of 2006 was $312.0 million compared to $301.0 million in 2005. As at December 31, 2006, the Corporation's debt was comprised of $14.4 million under its Term A facility maturing in 2009, $256.8 million under its Term B facility maturing in 2012 and $40.0 million drawn against its $120.0 million revolving credit facility. The Corporation entered into interest-rate swap agreements in 2005 to convert $150.0 million of its Term B facility from variable to fixed interest rates. The Corporation was in compliance with all covenants of its credit facility as at December 31, 2006.

As at December 31, 2006, the Corporation held cash and cash equivalents of $13.7 million and had $80.0 million of availability under its revolving credit facility. Based on its forecasts, the Corporation believes that cash flows from operating activities combined with liquidity available under its revolving credit facility will be sufficient to meet its requirements for working capital, acquisition of property, plant and equipment, debt repayments and other financial obligations. The Corporation also believes that its ability to access capital markets, if necessary, provides for any additional liquidity that may be required.

Please refer to the ''Balance Sheet Data'' and ''Contractual Obligations'' tables on page 10 of this MD&A for additional information about the Corporation's financial position.

Seasonality and Quarterly Fluctuations

We have historically experienced significant quarterly fluctuations in operating results and anticipate these fluctuations in the future. 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 two 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 our business. As a result of the seasonal nature of our business, our statements of cash flows for any quarter 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.

Selected Quarterly Financial Information

The following table presents selected quarterly financial information for the years 2006 and 2005:

(US $ thousands, except per share data)	**2006**				2005			
(Unaudited)	**Q1**	**Q2**	**Q3**	**Q4**	Q1	Q2	Q3	Q4
Net Sales	**78,564**	**102,200**	**201,778**	**164,805**	28,323	36,103	154,203	166,234
As a % of full year	***14.3%***	***18.7%***	***36.9%***	***30.1%***	*7.3%*	*9.4%*	*40.1%*	*43.2%*
Gross profit	**34,199**	**42,246**	**90,547**	**51,533**	11,387	13,849	67,284	77,675
Earnings (loss) from operations	**3,886**	**10,162**	**26,200**	**(1,278)**	(1,434)	(485)	32,567	31,703
Net earnings	**578**	**4,050**	**17,959**	**2,761**	(1,178)	(540)	20,415	20,911
EPS Basic	**0.02**	**0.13**	**0.56**	**0.09**	(0.04)	(0.02)	0.67	0.66
EPS Diluted	**0.02**	**0.12**	**0.53**	**0.08**	(0.04)	(0.02)	0.62	0.61

Three-Month Period Ended December 31, 2006 Compared to Three-Month Period Ended December 31, 2005

Consolidated net sales in the fourth quarter of 2006 were $164.8 million compared to $166.2 million in the fourth quarter of 2005.

Net sales of Toys product lines increased 4.2% to $123.1 million in the fourth quarter of 2006 compared to $118.1 million in the 2005 period. Net sales increased in all product categories except games and puzzles.

Net sales of Stationery and Activities product lines declined to $41.7 million compared to $48.1 million in the fourth quarter of 2005. This is explained mainly by lower sales of licensed craft and activity sets in the fourth quarter of 2006 compared to the corresponding 2005 period.

Net sales in North America were $116.9 million in the fourth quarter of 2006, compared to $127.0 million in the corresponding 2005 period. Net sales of preschool and boys 5-plus construction toys matched the levels achieved in the fourth quarter of 2005, while sales declined in craft and activity sets and games and puzzles. Stationery sales were higher than in the fourth quarter of 2005.

International net sales increased 22.0% to $47.9 million compared to $39.3 million in the fourth quarter of 2005. Sales growth was achieved in preschool, boys 5-plus and magnetic construction toys compared to the fourth quarter of 2005. International sales accounted for 29.1% of consolidated net sales in the fourth quarter of 2006 compared to 23.6% in the same 2005 period.

Cost of sales increased 28.0% to $113.3 million in the fourth quarter of 2006 compared to $88.6 million in the corresponding 2005 period. This increase is explained by additional freight costs incurred in order to meet customer deadlines for the delivery of redesigned MAGNETIX products and higher magnet costs due to the escalation in commodity prices, for a combined impact of approximately $10.0 million. Cost of sales in the fourth quarter of 2006 also includes Specified Items of $8.5 million.

Gross profit declined to $51.5 million compared to $77.7 million in the fourth quarter of 2005 and gross margin decreased to 31.3% of sales compared to 46.7% in the same 2005 period. Plastic resin prices were in line with the levels during the fourth quarter of 2005 and did not negatively impact gross margin.

Marketing and advertising expenses were $10.6 million compared to $13.1 million in the fourth quarter of 2005. As a percentage of net sales, such expenses were 6.4% compared to 7.9% in the fourth quarter of 2005. This decrease is due mainly to timing differences in such expenditures in 2006 compared to 2005. Marketing and advertising expenses for the first nine months of 2006 were 41.2% higher than in the corresponding 2005 period.

Research and development expenses increased to $5.9 million or 3.6% of sales, compared to $3.7 million or 2.2% of sales in the fourth quarter of 2005.

Three-Month Period Ended December 31, 2006 Compared to Three-Month Period Ended December 31, 2005 (Continued)

Other selling, distribution and administrative expenses were $23.7 million compared to $29.2 million in the fourth quarter of 2005. These expenses represented 14.4% of net sales in the fourth quarter of 2006 compared to 17.6% in 2005. This decrease is explained by an overall leveraging of administrative expenses and lower bonus payouts compared to 2005.

As a result of the above, loss from operations in the fourth quarter of 2006 was $1.3 million compared to earnings from operations of $31.7 million in the fourth quarter of 2005. Earnings from operations resulted in a loss of $34.4 million in North America compared to earnings of $25.4 million in the fourth quarter of 2005. International earnings from operations increased to $33.1 million compared to $6.3 million in the fourth quarter of 2005.

Interest expense was $6.8 million compared to $5.1 million in the fourth quarter of 2005, reflecting mainly higher average interest rates in the 2006 period.

The Corporation recorded an income tax recovery of $10.8 million in the fourth quarter of 2006 compared to $5.7 million of income taxes in the fourth quarter of 2005. Before Specified Items, the effective tax rate in the fourth quarter of 2006 was a recovery of 3.3% compared to a charge of 21.4% for the corresponding 2005 period.

Net earnings in the fourth quarter of 2006 were $2.8 million or $0.08 diluted earnings per share compared to $20.9 million or $0.61 diluted earnings per share in the fourth quarter of 2005. Basic earnings per share in the fourth quarter of 2006 were $0.09 compared to $0.66 in the same 2005 period.

Cash flows from operating activities before changes in non-cash working capital items were $3.0 million in the fourth quarter of 2006 compared to $30.5 million for the same period in 2005, mainly due to Specified Items recorded during the fourth quarter of 2006. After changes in non-cash working capital items, operating cash flow was $28.7 million compared to $11.0 million in the fourth quarter of 2005.

Shares Outstanding

The basic weighted average number of common shares outstanding in 2006 was 32,220,495 compared to 29,281,145 in 2005. The diluted weighted average number of shares outstanding in 2006 was 34,189,034 compared to 31,390,456 in 2005. The total number of shares outstanding as at December 31, 2006 was 32,664,913 compared to 32,105,575 at the end of 2005. As at April 1, 2007, there was a total of 2,617,306 stock options outstanding.

Outlook for 2007

We believe we have a strong product line-up in all of our categories for 2007, with the introduction of many new products, an exceptional licensed products offering and the launch of arts and crafts and stationery products in new geographic markets. We expect net sales to increase in North America and in our International markets. Earnings will be supported by operating synergies resulting from the integration of MEGA Brands America in 2006.

Significant Accounting Policies and Use of Estimates

Principles of consolidation and reporting currency

Consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") using the U.S. dollar (functional currency) as the reporting currency.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries since the date of acquisition. All intercompany balances and transactions have been eliminated on consolidation.

Use of estimates

Preparation of financial statements in conformity with GAAP requires management 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. The most significant areas requiring the use of management estimates relates to: inventory valuation, valuation of year-end provision on accounts receivable, future income taxes, intangible assets, goodwill, reserves and allowances, specifically those related to the integration costs, general liability and income taxes.

Revenue recognition

Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) products are shipped to customers and customer takes ownership and assumes risk of loss, (iii) collection of the respective receivable is probable, and (iv) sales price is fixed or determinable. Accruals for customer discounts, rebates, incentives and defective allowances are recorded as the related revenues are recognized.

Vendor allowance

The cash considerations received from vendors are deemed a reduction of the prices of the vendors' products or services and are accounted for as a reduction of cost of sales and related inventory when recognized in the Corporation's consolidated statements of earnings and balance sheets. Certain exceptions apply when the cash considerations received are either a reimbursement of incremental selling costs incurred by the Corporation, or a payment for assets or services delivered to the vendors.

Self-insurance

The Corporation is primarily self-insured for MAGNETIX products manufactured before May 1, 2006. Required accruals for self-insurance liabilities are determined by management based on claims filed and an estimate of claims incurred but not yet reported, and are not discounted.

Research and development expenses

Research expenses are charged to earnings net of related tax credits. Unless these expenses meet Canadian GAAP for deferral, development expenses are charged to earnings, net of the related tax credits. Research and development expenses are presented net of tax credits of $0.3 million for the year ended December 31, 2006 (2005 - $0.9 million).

Significant Accounting Policies and Use of Estimates (Continued)

Foreign currency translation

Monetary assets and liabilities denominated in currencies other than U.S. dollars (foreign currencies) and monetary assets and liabilities from foreign integrated subsidiaries are translated at the rates of exchange at the balance sheet date. Non-monetary balance sheet items denominated in foreign currencies and non-monetary balance sheet items from foreign integrated subsidiaries are translated at the rates of exchange prevailing at the respective transaction dates. Revenue and expense items arising from transactions in foreign currencies and from foreign integrated subsidiaries are translated into U.S. dollars at average rates during each reporting period. Gains or losses on foreign exchange are recorded in the consolidated statements of earnings.

All unrealized translation gains and losses on assets and liabilities denominated in foreign currencies are included in earnings for the year.

Derivative Financial Instruments

The Corporation uses various derivative financial instruments to manage interest rate risk and foreign exchange rate risk and formally documents when required all relationships between derivatives and the items they hedge, and its risk management objective and strategy for using various hedges. Derivatives that are economic hedges but do not qualify for hedge accounting are recognized at fair value with the changes in fair value recorded in earnings. The Corporation does not use derivative financial instruments for speculative or trading purposes.

When hedge accounting is applied, the Corporation formally assesses, 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 currency forward contracts designated as effective for hedge accounting are recognized in the consolidated statements of earnings during the same period as the underlying revenues and expenses. For interest rate swaps, the difference between the swap rate and the actual rate is reflected against the related interest expense.

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 consolidated statement of earnings in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, a gain or loss on such derivative instrument is recognized in the consolidated statement of earnings.

The following table summarizes our foreign currency commitments as at December 31, 2006:

Foreign currency contracts	Notional amount	Average exchange rate	Maturing up to	Notional equivalent	Fair market value
	$			$	$
Sell - Euro to $US	**6,000**	**1.3021**	**Dec. 2007**	**7,813**	**(154)**
- GBP to $US	**3,000**	**1.8746**	**Dec. 2007**	**5,624**	**(243)**

The following table summarizes our interest rate swap agreements as at December 31, 2006:

Interest rate swaps	Notional amount	Fixed rate	Maturing	Fair market value
	$			$
	150,000	**4.66325%**	**July 2012**	**2,828**

Significant Accounting Policies and Use of Estimates (Continued)

Stock Options and Share Units

The Corporation uses the fair value method to account for all stock-based compensations. This method requires awards of stock options to be measured on their date of grant using the fair value method. They are expensed and credited to contributed surplus over their vesting period, and reclassified to capital stock when stock options are exercised.

The Corporation's share unit plan, which became effective February 24, 2005, allows the Board of Directors to grant bonuses in the form of share units that are time and performance based, which vest primarily over a three-year period. The plan is non-dilutive and will be settled in shares purchased from the secondary market, or in cash, at the option of the Corporation. The share units are accounted for as liabilities on a fair value basis by using the quoted market price of the common shares at the end of each period. The share units are treated as stock-based compensation and are expensed and credited to accrued liabilities over the vesting period.

Earnings per share

Basic earnings per share is based on the weighted-average number of units outstanding during the period. The dilutive effect of stock options is determined using the treasury stock method.

Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments in money market instruments with maturities of three months or less.

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.

Property, plant and equipment

Property, plant and equipment are recorded at cost and are amortized over the lesser of their estimated useful lives and the term of the lease using the straight-line method and the following amortization periods:

Buildings	25 years
Machinery and equipment	3 to 15 years
Computer equipment	3 to 5 years
Leasehold improvements	Over the terms of the leases

Government grants

Government grants for property, plant and equipment acquisitions are netted against property, plant and equipment and are amortized on the same basis as the related asset. Government grants to create employment are recorded in earnings as a reduction of the related expenses when conditions are met.

Significant Accounting Policies and Use of Estimates (Continued)

Intangible assets

Intangible assets with a finite service life are accounted for at cost less accumulated amortization. They consist of customer relationships and intellectual property which are amortized over twenty years and noncompetition covenants which are amortized over five years.

Intangible assets with indefinite service life, consisting of the trade name and intellectual property, are accounted for at cost and are not amortized. The trade name and intellectual property are tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. As at December 31, 2006, the Corporation has performed an impairment test and no write-down was necessary.

Goodwill

Goodwill represents the excess of the acquisition cost of companies over the fair value of the identifiable net assets acquired and is not amortized. Goodwill is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. As at December 31, 2006, the Corporation has performed an impairment test and no write-down was necessary.

Deferred charges

Deferred charges are comprised mainly of financing charges. The financing charges are recorded at cost and are amortized according to the straight-line method over the term of the credit facility.

Impairment of long-lived assets

Long-lived assets are reviewed for impairment by management whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value (net recoverable value). If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value.
Future income taxes

The Corporation uses the tax liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse. It is more likely than not that all of the future income tax assets will be realized.

New accounting policies

The CICA has issued the following new Handbook Sections and guidelines:

a) EIC-156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Product)", was issued and provides guidance to companies that give incentives to customers or resellers in the form of cash, equity, free gifts, coupons and other. The adoption of EIC-156 is effective for fiscal years beginning on or after January 1, 2006. The adoption of this guideline reduced net sales by $25.8 million in 2006 and $22.2 million in 2005.

b) Handbook Section 3831, "Non-Monetary Transactions", effective for transactions initiated in periods beginning on or after January 1, 2006. This section prescribes to record non-monetary transactions at fair value unless the transaction has no commercial substance, it is an exchange of product or property, it is a non-monetary non-reciprocal transfer to owners or it is not reliably measurable. The adoption of this new Handbook Section did not have a material impact on the December 31, 2006 consolidated financial statements.

New accounting policies (Continued)

c) Impact of accounting pronouncements not yet implemented

The CICA has issued the following new Handbook sections that must be adopted by the Corporation for the fiscal year beginning on January 1, 2007. The Corporation is currently evaluating the impact of the adoption of these new sections on the consolidated financial statements.

i) Handbook Section 1506, "Accounting Changes": This Section established criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies and estimates, and correction of errors.
ii) Handbook Section 3855, "Financial Instruments - Recognition and Measurement": This Section describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial assets, except for those classified as held-to-maturity, and derivative financial instruments must be measured at their fair value. All financial liabilities must be measured at their fair value if they are classified as held for trading purposes; if not, they are measured at their carrying value.
iii) Handbook Section 3865, "Hedges": This Section describes when hedge accounting is appropriate. Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period.
iv) Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity": Comprehensive income is the change in equity of an enterprise during a period arising from transactions and other events and circumstances from non-owner sources. It includes items that would normally not be included in net income such as changes in the foreign currency translation adjustment relating to self-sustaining foreign operations and unrealized gains or losses on available-for-sale financial instruments. This Section describes how to report and disclose comprehensive income and its components. Section 3251 replaces Section 3520, "Surplus", and describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530. Upon adoption of this Section, the consolidated financial statements will include a statement of comprehensive income.

Risks and Uncertainties

Realization of Synergies from the Integration of MEGA Brands America

We may not realize the expected synergies of the MEGA Brands America acquisition, including anticipated sales growth or the estimated revenue and cost synergies. The expected cost synergies resulting from the recent acquisition of MEGA Brands America assume that (i) we will continue to manufacture products that maintain or increase the level of product quality; (ii) our new distribution center is able to meet customer demand in a timely and efficient manner; (iii) that we are able to retain key personnel and attract qualified employees to consolidate the integration of MEGA Brands America at both the operations and administrative level. In addition and beyond the matters outlined in "Specified Items Affecting Operations", the overall integration of the companies may result in unanticipated operational issues, expenses and liabilities, and a diversion of management's attention, which could have a material adverse effect on our financial condition, business operations, business prospects and results of operations.

Litigation

We are involved in a number of litigious matters, including but not limited to environmental and product liability and there can be no assurance that additional litigation will not arise in the future. As previously disclosed, the former shareholders of Rose Art Industries, Inc. filed on May 8, 2006 a complaint against the Corporation seeking payment of certain amounts due under the SPA. Additionally, on November 17, 2006, two of the former shareholders who held executive positions with Rose Art Industries, Inc. filed arbitration proceedings seeking unspecified damages for the Corporation's alleged breach of their employment agreements. The unfavorable disposition of pending or future litigation and arbitration could have a material adverse effect on our financial condition and results of operations. Litigation may result in substantial costs and expenses and may significantly divert the attention of management regardless of the outcome. There can be no assurance that we will be able to achieve a favorable settlement of pending litigation or obtain a favorable disposition of litigation that is not settled. In addition, current and future litigation, governmental proceedings, labor disputes or environmental matters could lead to increased costs or interruption of our normal business.

Risks and Uncertainties (Continued)

Litigation (Continued)

We are subject to regulation by the CPSC and similar state, provincial and international regulatory authorities and our products could be subject to involuntary recalls and other actions by such authorities. We may also voluntarily recall selected products out of concern for product safety. On March 31, 2006, we jointly announced with the CPSC a voluntary recall and replacement program of MAGNETIX building sets in the hands of families with children under the age of six. This action was taken in response to the death of a toddler and injuries to several children resulting from magnet ingestion. Approximately 14,000 consumer contacts were received under this program in 2006. The Corporation, jointly with the CPSC, continues to monitor the performance of these toys in the market to ensure that all safety standards are met.

We may experience defects in products after their production and sale to consumers. Recalls or defects could result in the rejection of our products by consumers, damage to our reputation, lost sales, negative publicity, fines or penalties diverted development resources and increased customer service and support costs, any of which could have a material adverse effect on our financial condition, business operations and/or business prospects. Individuals may sustain injuries from our products and we may be subject to claims and lawsuits resulting from such injuries.

On October 24, 2006, the Corporation announced that it had settled four lawsuits and ten claims related to injuries to children resulting from the ingestion of magnets. The aggregate amount paid to settle the lawsuits and claims is $13.5 million and is recorded as a product liability settlement expense in the 2006 consolidated statement of earnings. The Corporation expects to recover substiantially the full amount from its insurers and through other recourses, although there can be no assurance that a favorable outcome will be achieved. Discussions with our insurers in this regard are underway.

On September 14, 2006 and on December 5, 2006, two lawsuits related to magnet ingestion requiring surgical removal were served on the Corporation and remain outstanding. On March 29, 2007 the Corporation learned that a third lawsuit had been filed in U.S. District Court in Denver by the family of a child who is alleged to have sustained similar injuries. The Corporation is also aware of at least seven other incidents in which children are alleged to have required surgery following the ingestion of multiple magnets. The Corporation is not able to assess with any certainty the outcome of theses lawsuits and claims or impact, if any. As such, no amounts have been reserved in our year-end financial statements. There can be no assurance that additional incidents, lawsuits or claims will not arise, or that additional enquiries by the CPSC or other regulatory authorities in respect of MAGNETIX or other products will not be brought in the future, or result in additional product recalls.

In addition to the foregoing, on March 28, 2007, the Corporation learned that a competitor who sells magnetic building sets primarily in Europe, Plastwood S.R.L. and Plastwood Corporation, filed a complaint against MEGA Brands America and MEGA Brands in the Western District of Washington. The complaint is based in significant part on representations alleged to have been made prior to the Corporation's acquisition of MEGA Brands America. The complaint does not provide support for Plastwood's allegations of its own lost sales and other consequences. The Corporation believes it has valid defenses to the complaint and intends to defend the action vigorously. However, there can be no assurance of a favorable outcome.

International Operations

Our own sales, manufacturing and distribution facilities, as well as the utilization of third-party distribution, independent sales representatives and contract manufacturers, are subject to the risks normally associated with international operations, including: (i) costs associated with the repatriation of earnings; (ii) civil unrest and political and economic instability; (iii) significantly concentrated outbreaks of communicable diseases; (iv) greater difficulty protecting intellectual property rights; (v) complications in complying with foreign laws, fiscal regulations and changes in governmental policies; (vi) increased delivery lead time and potential for transportation delays and interruptions; (vii) the imposition of tariffs or trade sanctions; (viii) the loss of "most favored" trading status by the People's Republic of China in the United States or the European Union and; (ix) the difficulty of attracting and retaining local financial managers with knowledge and experience of North American accounting and internal control standards, and possessing English-language skills. There can be no assurance that these risks will not result in a material adverse effect on our financial condition and results of operations.

Risks and Uncertainties (Continued)

Insurance Coverage

Although the Corporation believes it has adequate product liability insurance generally, there is a risk that claims or liabilities could exceed or fall outside the scope of our insurance coverage, or impede our ability to obtain adequate insurance coverage in the future. As a result of the voluntary recall and replacement campaign with the CPSC on March 31, 2006 aimed at MAGNETIX building sets and the ensuing publicity and product liability lawsuits and claims against the Corporation, the cost of insurance coverage for these products manufactured before May 1, 2006 was prohibitive and as such, the Corporation is self-insured for incidents occuring after December 1, 2006 for MAGNETIX products manufactured before May 1, 2006. Consequently, the unfavorable disposition of any self-insured MAGNETIX related litigation could have a material adverse effect on our financial condition and results of operations.

As at April 1, 2007, insurance coverage has been confirmed subject to a standard reservation of rights for two of the three outstanding product liability lawsuits. For the most recent lawsuit filed March 29, 2007, coverage has not been assessed.

Consumer Preferences

Our business and operating results depend largely upon the appeal of our toy and stationery products. Our continued success will depend on our ability to enhance and extend existing product lines and to develop, introduce and gain consumer acceptance of new products. However, consumer preferences in our industry are continuously changing and are difficult to predict. Individual products typically have short life cycles, and there have been recent trends towards children outgrowing toys at younger ages, particularly in favor of interactive and high technology products, and an increased use of high technology in toys. There can be no assurance that: (i) any of our current product lines will continue to be popular for any significant period of time; (ii) any new products we introduce will achieve an adequate degree of market acceptance; or (iii) any new products' life cycles will be sufficient to permit us to recover development, manufacturing, marketing and other costs. A decline in the popularity of our existing products or the failure of new products to achieve and sustain market acceptance and to produce acceptable margins could have a material adverse effect on our financial condition and results of operations. Additionally, ongoing negative publicity surrounding MAGNETIX toys in the U.S. and other key markets may result in a loss of consumer confidence in the brand.

Rate of Growth or Profitability

There can be no assurance that our rate of growth will continue or that we will be able to maintain our present level of net sales or profitability. Furthermore, future growth, if achieved, may place a strain on our management and financial controls systems, and there can be no assurance that management would be able to manage such growth effectively. Failure to manage any future growth experienced by us could have a material adverse effect on our financial condition and results of operations.

Customer Concentration

For the year ended December 31, 2006, our two largest customers accounted for approximately 39.1% of net sales. We do not have firm purchase commitments from any of our customers. If some of these customers were to cease doing business with us or to reduce the amount of their purchases, by virtue of experiencing financial difficulty or otherwise, it could have a material adverse effect on our sales, financial condition and results of operations. In addition, most large retail chains have begun to sell private-label toys, arts and crafts and office products designed and branded by the retailers themselves. Such private label items may be sold at prices lower than our comparable products, and may result in lower purchases of our products by such retailers. Additionally, in recent years, several large customers engaged in price cutting of toy products during the holiday season, and arts and crafts and stationery products during the back-to-school season, which, if these trends continue, could have a material adverse effect on our gross profit, profitability and consumer perception of the brand equity of our products.

Risks and Uncertainties (Continued)

Prices of Raw Materials

Our principal raw material is plastic resin, which is subject to the volatility in crude oil prices. We do not hedge against adverse price fluctuations. Furthermore, limited supplier production capacity and strong demand have placed upward pressure on the price of resin. There can be no assurance that this pressure will decline. While we have succeeded in passing on a portion of the increase in the price of plastic resin to our customers, there is no assurance we will be able to continue to do so, particularly if there are substantial price increases or that price increases occur over a sustained period. Prices of other raw materials are also subject to fluctuations. Unfavorable swings in commodity prices could have a material adverse effect on our financial condition and results of operations.

Currency Fluctuations

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, Euro, British pound, Mexican peso and Australian dollar. Our policy is to stabilize earnings by limiting foreign currency exposure mainly through forward exchange contracts. Our risk management approach is to have hedging mechanisms in place for a maximum period of 24 months. Our hedging policy strictly prohibits unauthorized speculative foreign exchange transactions. We only enter into forward contract agreements with solid financial counterparties. Furthermore, in order to limit the risk of incurring losses in the event the counterparty does not fulfill its obligation, we only enter into forward exchange contract agreements with members of our lending syndicate. We do this because we are not required to provide additional security and/or guarantees to the members of the lending syndicate other than the security package already in place under our credit agreement.

Seasonality

Our business is seasonal and therefore our annual operating results depend in large part on our sales during the third and fourth quarters. This seasonality is increasing as large retailers become more efficient in their control of inventory levels through just-in-time inventory management systems. Retailers require the Corporation to ship products closer to the time they expect to sell the products to consumers creating shorter lead times for production and increased pressure to fill orders promptly. The logistics of supplying more products within shorter time periods increases the risk that we will fail to achieve compressed shipping schedules, which may reduce our sales and affect our financial performance.

Risks Relating to Licensed Products

While we attempt to balance our licensed and non-licensed product offerings, and to make a judicious selection of brands and entertainment properties which we license from third-parties, there is a risk that guaranteed royalty payments and advances thereon which we are required to pay to licensors may not be recouped from the sale of licensed products. Additionally, the sale of licensed products relating to entertainment properties, particularly theatrical releases, often presents limited durations during which our customers will carry licensed product inventory, which consequently could reduce demand for such licensed products.

Retail Environment

The retail environment is highly competitive and there is no assurance that retailers who sell our products will not experience liquidity problems such as those that led to a rationalization of the mass-market retail channel in North America in recent years. If our key customers were to delay payments or cease doing business as a result of liquidity problems or bankruptcy, this could have a material adverse effect on our financial condition and results of operations.

Risks and Uncertainties (Continued)

Construction Toy Litigation

We are currently involved in litigation proceedings, which, regardless of the outcome, may result in substantial expenses and divert the attention of management. The most significant proceedings against us involve our principal competitor, The Lego Group ("Lego"). Lego continues to challenge the Corporation's sale of functionally and aesthetically compatible construction toys in various markets. There can be no assurance that we will achieve a favorable outcome in any of these markets. The unfavorable disposition of pending litigation could have a material adverse effect on our financial condition, operations and business prospects.

On July 10, 2006, the Office for Harmonization of the Internal Market of the European Union (Trade Marks and Designs) Grand Board of Appeal ("OHIM") affirmed the cancellation of a three-dimensional Community Trademark registration for a brick design in the name of Lego Juris A/S (''Lego''), with respect to wares described as "construction toys". Lego subsequently appealed this decision to the European Court of First Instance, where the matter is now pending. The Corporation believes that the trend of jurisprudence in such matters favors public access to useful product configurations, like the basic Lego block, which are no longer protected by patents, and the Corporation does not expect Lego to succeed with its appeal.

Financing and Interest Rates

Increases in interest rates, both domestically and internationally, could negatively affect the cost of financing both our operations and investments. Any reduction in our credit ratings could increase the cost of obtaining financing. Additionally, our ability to issue long-term debt and obtain seasonal financing could be adversely affected by factors such as an inability to meet our debt covenant requirements. The ability to conduct our operations could be negatively impacted should these or other adverse conditions affect our primary sources of liquidity.

Disclosure Controls and Procedures

We comply with *Multilateral Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings* issued by the Canadian Securities Administrators. The President and Chief Executive Officer and the Executive Vice-President and Chief Financial Officer together with Management, have evaluated the effectiveness of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting ("ICFR") as at December 31, 2006. They have concluded that the Corporation's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Corporation and its subsidiaries is complete and reliable.

During the course of its evaluation, which focused intensively on the integration of MEGA Brands America and its subsidiaries, Management identified a limited number of significant weaknesses that were not considered material either individually or in the aggregate. In response to the significant weaknesses identified, additional manual controls were performed for the annual closing process.

Disclosure Controls and Procedures (Continued)

The following significant, non-material ICFR weaknesses have been identified and are described in conjunction with their corresponding remediation plans:

1. ***Lack of sufficient resources in our accounting and finance organization.*** Due to sustained organic growth combined with the acquisition of MEGA Brands America and its subsidiaries, the Corporation lacks a sufficient complement of personnel with a level of financial reporting expertise commensurate with our financial reporting requirements. In fiscal 2007, we began to implement a finance structure designed to meet the challenges presented by the overall growth of the Corporation. As such, additional accounting professionals will be hired to remediate this aspect of its ICFR.

2. ***Monitoring of non-routine and non-systematic transactions***. We did not have effective compliance with controls that are in place to monitor and accurately record non-routine and non-systematic transactions. This weakness is primarily related to the difficulty of ensuring that internal controls are well-understood and harmonized across the organization. A key aspect of the remediation plan in regard to this significant, non-material ICFR weakness took place in December 2006, when the Corporation converted the MEGA Brands America information technology platform to the one used by the Corporation to ensure consistent and timely communication of financial and accounting information. The Corporation has performed additional manual testing to ensure that the accounting for such non-routine and non-systematic transactions is appropriate and materially correct.

3 ***Controls over financial reporting of foreign subsidiaries.*** We did not have effective compliance with controls that are in place to ensure adherence to the ICFR of foreign subsidiaries, particularly as concerns the monitoring and tracking of inventory in our China manufacturing facility and at the Fife, Washington distribution center of MEGA Brands America. To address this ICFR weakness, the Corporation has instituted the process of analyzing inventory variances on a monthly basis and has seconded senior finance personnel to supervise the accounting procedures and inventory controls at the close of each quarter. The information technology platform of our Chinese facility will be converted in 2007 to ensure more consistent and timely communication of financial and accounting information. With respect to the Fife facility, MEGA Brands America has already converted to the information technology platform used by the Corporation to ensure consistent and timely communication of financial and accounting information.

Additional Information

Additional information about MEGA Brands, including our Annual Information Form, is available on SEDAR at www.sedar.com.

Consolidated statements of earnings

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

	Three-month periods ended December 31,		Twelve-month periods ended December 31,	
	2006	2005	**2006**	2005
	(Unaudited)	(Unaudited)	**(Audited)**	(Audited)
	$	$	**$**	$
Net sales	**164,805**	166,234	**547,347**	384,863
Cost of sales	**113,272**	88,559	**328,822**	214,668
Gross profit	**51,533**	77,675	**218,525**	170,195
Marketing and advertising expenses	**10,562**	13,067	**26,808**	24,573
Research and development expenses	**5,858**	3,658	**18,334**	9,402
Other selling, distribution and administrative expenses	**24,540**	28,658	**109,815**	71,074
Loss (gain) on foreign currency translation	**(858)**	589	**(4,846)**	2,796
Product liability settlement and related expenses	**1,463**	–	**15,490**	–
Voluntary product recall and replacement	**3,995**	–	**5,612**	–
Litigation expenses	**3,678**	–	**4,769**	–
Integration expenses	**3,573**	–	**3,573**	–
Earnings (loss) from operations	**(1,278)**	31,703	**38,970**	62,350
Interest and other expenses				
Interest on long-term debt	**6,419**	5,127	**22,526**	9,310
Other interest	**371**	(26)	**177**	954
	6,790	5,101	**22,703**	10,264
Earnings (loss) before income taxes	**(8,068)**	26,602	**16,267**	52,086
Income taxes				
Current	**(5,126)**	360	**(1,217)**	5,473
Future	**(5,703)**	5,331	**(7,864)**	7,005
	(10,829)	5,691	**(9,081)**	12,478
Net earnings	**2,761**	20,911	**25,348**	39,608
Earnings per share				
Basic	**0.09**	0.66	**0.79**	1.35
Diluted	**0.08**	0.61	**0.74**	1.26

Consolidated statements of retained earnings (deficit)

(in thousands of U.S. $)

	Three-month periods ended December 31,		Twelve-month periods ended December 31,	
	2006	2005	**2006**	2005
	(Unaudited)	(Unaudited)	**(Audited)**	(Audited)
	$	$	**$**	$
Balance, beginning of period	**9,875**	(33,623)	**(12,712)**	(52,320)
Net earnings	**2,761**	20,911	**25,348**	39,608
Balance, end of period	**12,636**	(12,712)	**12,636**	(12,712)

Consolidated balance sheets

(in thousands of U.S. $)

	December 31, 2006	December 31, 2005
	(Audited)	(Audited)
	$	$
Assets		
Current assets		
Cash and cash equivalents	**13,658**	19,567
Accounts receivable	**161,612**	173,666
Inventories	**140,630**	82,280
Income taxes	**9,317**	–
Future income taxes	**8,354**	13,396
Prepaid expenses	**12,025**	8,324
	345,596	297,233
Property, plant and equipment	**43,213**	39,351
Intangible assets	**79,517**	72,230
Goodwill	**300,829**	306,973
Deferred charges	**3,281**	4,708
Future income taxes	**28,006**	–
	800,442	720,495
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**153,437**	108,025
Additional consideration accrued on business combination	**57,825**	74,075
Income taxes	**–**	4,744
Current portion of long-term debt	**9,609**	8,784
	220,871	195,628
Long-term debt	**302,345**	292,169
Future income taxes	**27,782**	12,682
	550,998	500,479
Shareholders' equity		
Capital stock	**236,088**	231,592
Contributed surplus	**720**	1,136
Retained earnings (Deficit)	**12,636**	(12,712)
	249,444	220,016
	800,442	720,495

Consolidated statements of cash flows

(in thousands of U.S. $)

	Three-month periods ended December 31,		Twelve-month periods ended December 31,	
	2006	2005	**2006**	2005
	(Unaudited)	(Unaudited)	**(Audited)**	(Audited)
	$	$	**$**	$
Cash flows from operating activities				
Net earnings	**2,761**	20,911	**25,348**	39,608
Items not affecting cash and cash equivalents				
Amortization of property, plant and equipment	**3,238**	3,152	**12,462**	10,343
Amortization of deferred charges	**364**	263	**1,044**	1,538
Amortization of intangible assets	**313**	161	**667**	161
Stock-based compensation plans	**798**	128	**2,126**	732
Future income taxes	**(5,703)**	5,331	**(7,864)**	7,005
Loss (gain) on foreign currency	**21**	(238)	**(2,610)**	1,680
	1,732	29,708	**31,173**	61,067
Changes in non-cash operating working capital items	**26,306**	(18,672)	**(15,300)**	(36,026)
	28,038	11,036	**15,873**	25,041
Cash flows from financing activities				
Proceeds from long-term debt	**–**	–	**–**	300,000
Repayment of long-term debt	**(2,404)**	(646)	**(28,998)**	(13,409)
Repayment of subsidiary indebtedness upon acquisition	**–**	–	**(624)**	(36,382)
Change in revolving credit facility	**(20,000)**	(7,500)	**40,000**	(11,000)
Issuance of capital stock	**2,360**	2,056	**3,882**	57,158
Addition of deferred charges	**–**	(82)	**–**	(4,457)
	(20,044)	(6,172)	**14,260**	291,910
Cash flows from investing activities				
Acquisition of property, plant and equipment	**(4,812)**	(2,374)	**(17,456)**	(9,977)
Acquisition of intangible assets	**–**	–	**–**	(1,391)
Proceeds from disposal of property, plant and equipment	**250**	–	**304**	–
Business combinations	**530**	(1,434)	**(18,890)**	(291,623)
	(4,032)	(3,808)	**(36,042)**	(302,991)
Increase (decrease) in cash and cash equivalents	**3,962**	1,056	**(5,909)**	13,960
Cash and cash equivalents, beginning of year	**9,696**	18,511	**19,567**	5,607
Cash and cash equivalents, end of year	**13,658**	19,567	**13,658**	19,567