

**MEGA Brands Inc.**  
(formerly MEGA Bloks Inc.)

Consolidated Financial Statements  
**December 31, 2006 and 2005**  
(expressed in U.S. dollars)

April 1, 2007

## Auditors' Report

**To the Shareholders of MEGA Brands Inc.**  
(formerly Mega Bloks Inc.)

We have audited the consolidated balance sheet of **MEGA Brands Inc.** as at December 31, 2006 and the consolidated statements of earnings, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of MEGA Brands Inc. as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 23, 2006.

*PricewaterhouseCoopers LLP*

Chartered Accountants

Montréal, Quebec

# MEGA Brands Inc.

## Consolidated Statements of Earnings

For the years ended December 31, 2006 and 2005

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

	2006 \$	2005 \$
<b>Net sales</b> (note 3)	547,347	384,863
<b>Cost of sales</b>	328,822	214,668
<b>Gross profit</b> (note 4)	218,525	170,195
Marketing and advertising expenses	26,808	24,573
Research and development expenses	18,334	9,402
Other selling, distribution and administrative expenses	109,815	71,074
Loss (gain) on foreign currency translation	(4,846)	2,796
Voluntary product recall and replacement (note 4)	5,612	-
Product liability settlement and related expenses (note 5)	15,490	-
Integration expenses (note 6)	3,573	-
Litigation expenses (note 7)	4,769	-
<b>Earnings from operations</b>	38,970	62,350
<b>Interest and other expenses</b>		
Interest on long-term debt	22,526	9,310
Other interest (note 8)	177	954
	22,703	10,264
<b>Earnings before income taxes</b>	16,267	52,086
<b>Income taxes</b> (note 9)		
Current	(1,217)	5,473
Future	(7,864)	7,005
	(9,081)	12,478
<b>Net earnings for the year</b>	25,348	39,608
<b>Earnings per share</b> (note 10)		
Basic	0.79	1.35
Diluted	0.74	1.26

The accompanying notes are an integral part of these consolidated financial statements.

# MEGA Brands Inc.

## Consolidated Statements of Retained Earnings (Deficit) For the years ended December 31, 2006 and 2005

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(in thousands of U.S. dollars)

	<b>2006</b>	<b>2005</b>
	<b>\$</b>	<b>\$</b>
<b>Deficit – Beginning of year</b>	(12,712)	(52,320)
Net earnings for the year	25,348	39,608
<b>Retained earnings (deficit) – End of year</b>	<u>12,636</u>	<u>(12,712)</u>

The accompanying notes are an integral part of these consolidated financial statements.

**MEGA Brands Inc.**  
**Consolidated Balance Sheets**  
**As at December 31, 2006 and 2005**

(in thousands of U.S. dollars)

	<b>2006</b>	<b>2005</b>
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	13,658	19,567
Accounts receivable (note 12)	161,612	173,666
Inventories (note 13)	140,630	82,280
Income taxes	9,317	-
Future income taxes (note 9)	8,354	13,396
Prepaid expenses	12,025	8,324
	<hr/>	<hr/>
	345,596	297,233
<b>Property, plant and equipment</b> (note 14)	43,213	39,351
<b>Intangible assets</b> (note 15)	79,517	72,230
<b>Goodwill</b> (note 16)	300,829	306,973
<b>Deferred charges</b>	3,281	4,708
<b>Future income taxes</b> (note 9)	28,006	-
	<hr/>	<hr/>
	800,442	720,495
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	153,437	108,025
Additional consideration accrued on business combination (note 11)	57,825	74,075
Income taxes	-	4,744
Current portion of long-term debt	9,609	8,784
	<hr/>	<hr/>
	220,871	195,628
<b>Long-term debt</b> (note 17)	302,345	292,169
<b>Future income taxes</b> (note 9)	27,782	12,682
	<hr/>	<hr/>
	550,998	500,479
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 18)	236,088	231,592
<b>Contributed surplus</b> (note 19)	720	1,136
<b>Retained earnings (deficit)</b>	12,636	(12,712)
	<hr/>	<hr/>
	249,444	220,016
	<hr/>	<hr/>
	800,442	720,495
<b>Commitments and contingencies</b> (note 22)		

**Approved by the Board of Directors**

\_\_\_\_\_ Director

\_\_\_\_\_ Director

# MEGA Brands Inc.

## Consolidated Statements of Cash Flows

For the years ended December 31, 2006 and 2005

(in thousands of U.S. dollars)

	2006 \$	2005 \$
<b>Cash flow from</b>		
<b>Operating activities</b>		
Net earnings for the year	25,348	39,608
Items not affecting cash and cash equivalents		
Amortization of property, plant and equipment	12,462	10,343
Amortization of deferred charges	1,044	1,538
Amortization of intangible assets	667	161
Stock-based compensation plans	2,126	732
Future income taxes	(7,864)	7,005
Loss (gain) on foreign currency	(2,610)	1,680
	<u>31,173</u>	<u>61,067</u>
Changes in non-cash operating working capital items (note 20)	(15,300)	(36,026)
	<u>15,873</u>	<u>25,041</u>
<b>Financing activities</b>		
Proceeds from long-term debt	-	300,000
Repayment of long-term debt	(28,998)	(13,409)
Repayment of subsidiary indebtedness upon acquisition	(624)	(36,382)
Change in revolving credit facility	40,000	(11,000)
Issuance of capital stock	3,882	57,158
Addition of deferred charges	-	(4,457)
	<u>14,260</u>	<u>291,910</u>
<b>Investing activities</b>		
Acquisition of property, plant and equipment	(17,456)	(9,977)
Acquisition of intangible assets	-	(1,391)
Proceeds from disposal of property, plant and equipment	304	-
Business combinations (note 11)	(18,890)	(291,623)
	<u>(36,042)</u>	<u>(302,991)</u>
<b>Increase (decrease) in cash and cash equivalents</b>	(5,909)	13,960
<b>Cash and cash equivalents – Beginning of year</b>	<u>19,567</u>	<u>5,607</u>
<b>Cash and cash equivalents – End of year</b>	<u>13,658</u>	<u>19,567</u>
<b>Supplementary disclosure of cash flow information (note 20)</b>		

The accompanying notes are an integral part of these consolidated financial statements.

# **MEGA Brands Inc.**

## **Notes to Consolidated Financial Statements**

**December 31, 2006 and 2005**

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### **1 Nature of business**

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

The Corporation designs, manufactures and markets a broad line of toys and stationery and activities products. The Corporation sells and distributes its products in over 100 countries under the MEGA BLOKS, ROSE ART, MAGNETIX and BOARD DUDES brands.

### **2 Significant accounting policies**

#### **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.

# **MEGA Brands Inc.**

## Notes to Consolidated Financial Statements

**December 31, 2006 and 2005**

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### **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).

### **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.

# **MEGA Brands Inc.**

## **Notes to Consolidated Financial Statements**

**December 31, 2006 and 2005**

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(column figures are expressed in thousands of U.S. dollars, except per share data)

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.

### **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.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 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.

### 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 non-competition 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.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 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.

### 3 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.
- 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.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

- 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.

#### 4 Voluntary product recall and replacement

Under a voluntary recall and replacement program of MAGNETIX products jointly announced with the Consumer Products Safety Commission ("CPSC") on March 31, 2006, the Corporation recorded product replacement expenses of \$5.6 million, consisting of freight costs to meet customer shipment dates due to manufacturing delays resulting from design changes to MAGNETIX products, related packaging and development costs, and product replacements for consumers.

In addition, the Corporation recorded reimbursements of MAGNETIX products returned by customers of \$6.6 million as a reduction of sales. The Corporation also recorded write-offs of MAGNETIX components of \$4.3 million as a result of design changes to such components and recorded inventory write-offs of \$4.2 million following plant closures as part of the integration of MEGA Brands America. These write-offs have been included in cost of sales.

#### 5 Product liability settlement and related expenses

	2006	2005
	\$	\$
Settlement payments (note 22(b))	13,500	-
Legal expenses	1,990	-
	<hr/>	
	15,490	-
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The Corporation expects to recover substantially the full settlement amount of \$13.5 million from its insurers and through other recourses. Since there is no assurance that a favourable outcome will be achieved, no recovery has been recognized as at December 31, 2006.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 6 Integration expenses

The Corporation recorded integration expenses of \$3.6 million mainly related to branding, plant asset write-offs, travel and professional fees and plant closure costs resulting from the integration of MEGA Brands America.

### 7 Litigation expenses

The Corporation recorded litigation expenses of \$4.8 million, mainly for the litigation with the former shareholders of Rose Art (note 22(a)).

### 8 Other interest

	2006	2005
	\$	\$
Facility fees net of interest revenue	177	39
Write-off of deferred expenses related to previous credit facility	-	727
Bridge loan fees	-	188
	<hr/>	<hr/>
	177	954
	<hr/>	<hr/>

### 9 Income taxes

a) The following table is a reconciliation of the differences between the statutory income tax rate and the effective income tax rate:

	2006	2005
	\$	\$
Income tax expense at Canadian statutory rate	5,209	16,303
Benefits arising from financing structures	(8,466)	(2,085)
Effects of foreign tax rate differences	(11,666)	(2,300)
Others	5,842	560
	<hr/>	<hr/>
Income tax expense (recovery)	(9,081)	12,478
	<hr/>	<hr/>

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(column figures are expressed in thousands of U.S. dollars, except per share data)

b) As at December 31, future income taxes are as follows:

	<b>2006</b>	<b>2005</b>
	\$	\$
<b>Future income tax assets</b>		
Property, plant and equipment	3,075	-
Accrued integration charges and accrued liabilities	2,856	11,631
Share issue costs	411	1,202
Loss carryforward	17,882	-
Interest deduction carryforward	7,049	-
Asset revaluation	2,571	-
Others	2,516	1,557
	<u>36,360</u>	<u>14,390</u>

Loss carryforward relates to MEGA Brands America and will expire no later than 2026.

	<b>2006</b>	<b>2005</b>
	\$	\$
<b>Future income tax liabilities</b>		
Property, plant and equipment	7,075	7,048
Intangible assets and goodwill	11,914	4,230
Unrealized portion of foreign exchange gain	310	314
Others	8,483	2,084
	<u>27,782</u>	<u>13,676</u>
<b>Future income taxes – net</b>	<u>8,578</u>	<u>714</u>
Classified in the consolidated financial statements as		
Future income tax assets		
Current	8,354	13,396
Long-term	28,006	-
	<u>36,360</u>	<u>13,396</u>
Future income tax liabilities		
Long-term	27,782	12,682
	<u>27,782</u>	<u>12,682</u>
<b>Future income taxes – net</b>	<u>8,578</u>	<u>714</u>

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 10 Earnings per share

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

	2006	2005
<b>Numerator for basic and diluted net earnings per common share</b>		
Net income attributable to common shareholders	\$25,348	\$39,608
<b>Denominator for basic net earnings per common share</b>		
Weighted average number of common shares outstanding	32,220,495	29,281,145
<b>Basic earnings per share</b>	\$0.79	\$1.35
<b>Denominator for diluted net earnings per common share</b>		
Weighted average number of common shares outstanding	32,220,495	29,281,145
Plus impact of stock options	1,968,539	2,109,311
<b>Diluted average number of common shares</b>	34,189,034	31,390,456
<b>Diluted earnings per share</b>	\$0.74	\$1.26

### 11 Business combinations

- a) On January 24, 2006, the Corporation, through its subsidiary MEGA Brands America, entered into an agreement to acquire all voting shares of The Board Dudes, Inc. ("Board Dudes"), a privately held corporation based in Corona, California. Board Dudes designs and distributes dry-erase boards, cork boards, foam boards, and school and locker products. The purchase price paid is \$17 million subject to certain adjustments and was financed through existing credit facilities. During the third quarter of 2006, as part of these adjustments, an amount of \$1.9 million was paid to the Board Dudes principals. Contingent consideration to the selling principals of up to \$7 million is payable between 2006 and 2009 depending on the attainment of certain performance targets. Any additional consideration will be recorded to goodwill. The transaction closed on February 1, 2006 and the results of operations are included in the consolidated statement of earnings as of this date.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

The acquisition was accounted for using the purchase method. The purchase price allocation was finalized in the fourth quarter of 2006. The fair value of net assets acquired was as follows:

	\$
Assets acquired	
Non-cash working capital	3,050
Property, plant and equipment	98
Intangible assets	7,990
Goodwill <sup>(1)</sup>	8,376
Long-term debt	<u>(624)</u>
Non-cash assets acquired	18,890
Cash and cash equivalents	<u>43</u>
Net assets acquired	<u>18,933</u>
Consideration	
Cash	18,296
Acquisition costs	<u>637</u>
	<u>18,933</u>

(1) Goodwill is deductible for tax purposes.

- b) On July 26, 2005, the Corporation completed the acquisition of all voting shares of Rose Art Industries, Inc., Warren Industries, Inc. and their subsidiaries (“MEGA Brands America”), headquartered in Livingston, New Jersey. MEGA Brands America manufactures and markets arts and crafts, magnetic building sets and features school supplies. MEGA Brands America was a private corporation with a strong brand recognition in the United States.

The total purchase price consideration includes the assumption of \$37 million of outstanding MEGA Brands America debt, for a net purchase price of \$319 million. This purchase price consists of \$292 million in cash at closing, \$20 million of MEGA Brands America common shares at a price of CA\$19.00 per share issued to MEGA Brands America principals upon closing, and \$7 million of acquisition costs.

The transaction provides for a contingent payment of up to \$50 million payable if MEGA Brands America’s adjusted earnings before interest, taxes, depreciation and amortization (“EBITDA”) for 2005 exceeds \$50 million, based on five times such incremental amount. The transaction also provides for additional earn-out payments of 50% of the amounts exceeding adjusted EBITDA thresholds of \$60 million, \$65 million and \$70 million in 2005, 2006 and 2007 respectively.

The transaction was fully financed by credit facilities totaling \$400 million, including a \$100 million revolving credit facility for working capital purposes.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

The acquisition was accounted for using the purchase method. As at December 31, 2005, the Corporation allocated the purchase price on a preliminary basis to the assets acquired and the liabilities assumed based on management's best estimates of their fair value and taking into account all relevant information unavailable at that time. During the second quarter of 2006, the purchase price allocation was finalized and modified with adjustments primarily relating to non-cash working capital, future income taxes, and a corresponding entry to goodwill. As at year-end, goodwill was reduced on an after-tax basis by \$7.2 million for the decrease in the integration and restructuring reserve, and \$7.3 million for additional consideration accrued and other adjustment to fair value of net assets acquired.

	Preliminary \$	Final \$
Assets acquired		
Non-cash working capital	21,388	24,947
Property, plant and equipment	6,979	6,979
Future income tax assets	16,013	14,678
Intangible assets	71,000	71,000
Goodwill <sup>(1)</sup>	306,973	292,453
Long-term debt	(36,655)	(36,655)
	<hr/>	<hr/>
Non-cash assets acquired	385,698	373,402
Cash and cash equivalents	7,933	7,933
	<hr/>	<hr/>
Net assets acquired	393,631	381,335
	<hr/>	<hr/>
Consideration		
Cash	292,503	292,503
Acquisition costs	7,053	7,329
Additional consideration accrued on business combination	74,075	61,503
Issuance of shares to former Rose Art shareholders	20,000	20,000
	<hr/>	<hr/>
	393,631	381,335
	<hr/>	<hr/>

<sup>(1)</sup> Goodwill is deductible for tax purposes.

As at December 31, additional consideration accrued on business combination is as follows:

	2006 \$	2005 \$
Contingent purchase price	51,000	51,000
Other incentives	6,825	23,100
	<hr/>	<hr/>
	57,825	74,100
	<hr/>	<hr/>

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(column figures are expressed in thousands of U.S. dollars, except per share data)

### 12 Accounts receivable

	2006 \$	2005 \$
Trade	153,076	167,428
Other	8,536	6,238
	<hr/> 161,612	<hr/> 173,666

### 13 Inventories

	2006 \$	2005 \$
Raw materials	16,806	18,333
Work in progress	17,850	12,648
Finished goods	105,974	51,299
	<hr/> 140,630	<hr/> 82,280

### 14 Property, plant and equipment

	<hr/> 2006		
	Cost \$	Accumulated amortization \$	Net book value \$
Land	44	-	44
Buildings	882	17	865
Machinery and equipment	83,594	53,277	30,317
Computer equipment	8,489	5,246	3,243
Leasehold improvements	10,401	2,745	7,656
Computer equipment held under capital leases	1,997	1,602	395
Machinery and equipment held under capital leases	1,265	572	693
	<hr/> 106,672	<hr/> 63,459	<hr/> 43,213

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net book</b>
	\$	amortization	value
		\$	\$
Land	44	-	44
Buildings	889	7	882
Machinery and equipment	73,908	44,287	29,621
Computer equipment	7,298	4,227	3,071
Leasehold improvements	6,127	1,896	4,231
Computer equipment held under capital leases	1,996	1,412	584
Machinery and equipment held under capital leases	1,472	554	918
	<b>91,734</b>	<b>52,383</b>	<b>39,351</b>

### 15 Intangible assets

	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net book</b>
	\$	amortization	value
		\$	\$
Trade name <sup>(1)</sup>	67,750	-	67,750
Intellectual property <sup>(1)</sup>	1,500	-	1,500
Intellectual property	1,391	145	1,246
Customer relationships	8,530	477	8,053
Non-competition covenants	1,210	242	968
	<b>80,381</b>	<b>864</b>	<b>79,517</b>

	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net book</b>
	\$	amortization	value
		\$	\$
Trade name <sup>(1)</sup>	64,500	-	64,500
Intellectual property <sup>(1)</sup>	1,500	-	1,500
Intellectual property	1,391	36	1,355
Customer relationships	5,000	125	4,875
	<b>72,391</b>	<b>161</b>	<b>72,230</b>

<sup>(1)</sup> Non-amortized indefinite service life intangible asset

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements December 31, 2006 and 2005

(column figures are expressed in thousands of U.S. dollars, except per share data)

### 16 Goodwill

The changes in the carrying value of goodwill are comprised of the following:

	2006 \$	2005 \$
<b>Balance – Beginning of year</b>	306,973	-
Acquisition of Rose Art (note 11)	(14,520)	306,973
Acquisition of Board Dudes (note 11)	8,376	-
<b>Balance – End of year</b>	<u>300,829</u>	<u>306,973</u>

Upon finalization in 2006 of the purchase price allocation of the net assets acquired of MEGA Brands America, goodwill was reduced by \$14.5 million.

### 17 Long-term debt

	2006 \$	2005 \$
<b>Credit facility</b>		
Term A loan, maturing March 2009 (note 17(a))	14,400	40,000
Term B loan, maturing July 2012 (note 17(b))	256,750	259,350
Revolving term facility, maturing July 2010 (note 17(c))	40,000	-
<b>Other debt</b>		
Obligations under capital leases, maturing up to May 2008 (note 17(d))	804	1,341
Mortgage, repaid in 2006 (note 17(e))	-	262
	<u>311,954</u>	<u>300,953</u>
Less: Current portion of long-term debt	9,609	8,784
	<u>302,345</u>	<u>292,169</u>

On July 26, 2005, the Corporation entered into a \$400 million Credit Facility with a syndicate of banks. This Credit Facility was used to finance the acquisition of Rose Art Industries, Inc. The facility is secured by a movable hypothec on all assets of the Corporation. During the third quarter of 2006, the Corporation amended the Credit Facility by prepaying \$20 million of the Term A loan, and increasing the revolving term facility by \$20 million. Under the terms of the Credit Facility, the Corporation must satisfy certain restrictive covenants as to financial ratios.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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The Credit Facility is available under U.S. base rate loans or LIBOR loans at the option of the Corporation. The Term A loan and the revolving term facility bear interest at the published rates based on U.S. base rate plus 0.25% to 1.25% or LIBOR plus 1.25% to 2.25%. The Term B loan bears interest at the published rates based on U.S. base rate plus 0.75% or LIBOR plus 1.75%.

- a) The Term A loan is a \$40 million credit facility. Payments are due in quarterly installments of 2% and 4%.
- b) The Term B loan is a \$260 million credit facility. Payments are due in quarterly installments of 0.25% and 93.25% at maturity.
- c) The revolving term facility is a \$120 million (2005 – \$100 million) revolving credit facility.
- d) Obligations under capital leases are denominated and payable in Canadian dollars (CA\$937), and bear interest from 3.74% to 7.65%.
- e) The mortgage obligation was fully repaid in 2006, and bore interest at a fixed rate of 6%.

The repayment requirements on the long-term debt during the next five years and thereafter are as follows:

Years	<u>Obligations under capital leases</u>			<u>Credit facility</u>	<u>Total</u>
	<u>Mimum payments</u> \$	<u>Interest</u> \$	<u>Principal</u> \$	<u>Principal</u> \$	<u>Principal repayments</u> \$
2007	642	33	609	9,000	9,609
2008	199	4	195	9,000	9,195
2009	-	-	-	4,200	4,200
2010	-	-	-	42,600	42,600
2011	-	-	-	2,600	2,600
Thereafter	-	-	-	243,750	243,750
	841	37	804	311,150	311,954

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 18 Capital stock

Authorized

An unlimited number of common shares without par value

Issued and outstanding

	2006		2005	
	Number of shares	Book value \$	Number of shares	Book value \$
<b>Balance – Beginning of year</b>	32,105,575	231,592	27,292,469	154,434
Issued pursuant to private placement <sup>(1)</sup>	-	-	3,100,000	54,513
Issued to Rose Art principals	-	-	1,285,894	20,000
Issued pursuant to exercise of stock options	559,338	4,496	427,212	2,645
<b>Balance – End of year</b>	<b>32,664,913</b>	<b>236,088</b>	<b>32,105,575</b>	<b>231,592</b>

<sup>(1)</sup> Subscription receipts of 3.1 million were exchanged on a one-to-one basis for common shares. These subscription receipts were originally sold on July 11, 2005 by way of a private placement at CA\$22.25 for aggregate proceeds of CA\$68,975,000 before fees of \$2.3 million.

### 19 Stock options, share unit and contributed surplus

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

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

Immediately prior to the closing of the Initial Public Offering which occurred in 2002, the Corporation introduced a New Stock Option Plan. Under this plan, options to purchase common shares of the Corporation are granted at a subscription price of 100% of market value. Market value is determined as the closing price of the common shares on the Toronto Stock Exchange on the last date of trading prior to the effective date of the grant.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(column figures are expressed in thousands of U.S. dollars, except per share data)

As at December 31, 2006, a total of 4,992,877 common shares remained authorized for issuance under the Corporation's stock-based compensation plans. Options are exercisable during a period not to exceed ten years after the date of the grant. The right to exercise the options accrues over a period of three years of continuous employment. However, if there is a change of control of the Corporation, the options become immediately exercisable. Options are adjusted proportionately for any stock dividends or stock splits attributed to the common shares of the Corporation.

On March 24, 2004, the Board of Directors adopted a recommendation of the Compensation Committee that the Corporation voluntarily cap stock option grants at 15% of the number of common shares outstanding even though the Option Plan, as approved by the relevant regulatory authorities, allows for a significantly higher dilution rate when the available option grants under such plan are combined with option grants under the Initial Plan.

The following table summarizes all stock options outstanding as at December 31 under the Corporation's stock option plans:

	<b>2006</b>		<b>2005</b>	
	<b>Number of options</b>	<b>Weighted average exercise price \$</b>	<b>Number of options</b>	<b>Weighted average exercise price \$</b>
	(in Canadian dollars)		(in Canadian dollars)	
<b>Options outstanding – Beginning of year</b>	3,233,858	9.01	3,702,541	8.93
Granted	-	-	-	-
Exercised	(559,338)	7.96	(427,212)	7.31
Forfeited	(8,914)	22.13	(41,471)	19.38
<b>Options outstanding – End of year</b>	<b>2,665,606</b>	<b>9.18</b>	<b>3,233,858</b>	<b>9.01</b>
<b>Options exercisable – End of year</b>	<b>2,610,425</b>	<b>8.94</b>	<b>3,009,997</b>	<b>8.12</b>

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

The following table summarizes information about stock options outstanding as at December 31, 2006:

Range of exercise price CA\$	Number outstanding	Weighted average remaining contractual life in years	Weighted average exercise price CA\$	Number exercisable	Weighted average exercise price CA\$
3.85	1,419,274	2.8	3.85	1,419,274	3.85
14.50	1,088,846	5.4	14.50	1,088,846	14.50
18.25 to 25.65	157,486	6.6	20.43	102,305	20.30
	<u>2,665,606</u>	<u>4.1</u>	<u>9.18</u>	<u>2,610,425</u>	<u>8.94</u>

Stock-based compensation expense for stock option amounts to \$198 in 2006 (2005 – \$451).

- b) 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 vesting after three years. The plan is non-dilutive and will be settled in shares purchased on the secondary market, or in cash, at the option of the Corporation.

The following table summarizes the share units outstanding as at December 31, 2006 and 2005 under the Corporation's share unit plan:

	Number of units	
	2006	2005
<b>Units outstanding – Beginning of year</b>	65,768	-
Granted	295,028	65,768
Exercised	(637)	-
Forfeited	(5,175)	-
<b>Units outstanding – End of year</b>	<u>354,984</u>	<u>65,768</u>
<b>Share unit plan compensation expenses</b>	<u>\$1,928</u>	<u>\$281</u>

Total compensation expense for stock-based employee compensation awards amount to \$2,126 in 2006 (2005 – \$732).

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

c) Contributed surplus

The following table summarizes charges to contributed surplus:

	<b>2006</b>	<b>2005</b>
	\$	\$
<b>Balance – Beginning of year</b>	1,136	685
Value of compensation cost associated with stock-based compensation expense	198	451
Stock options exercised	(614)	-
<b>Balance –End of year</b>	<u>720</u>	<u>1,136</u>

## 20 Statement of cash flows

a) Changes in non-cash operating working capital items

	<b>2006</b>	<b>2005</b>
	\$	\$
Accounts receivable	15,004	2,179
Inventories	(56,781)	(2,694)
Prepaid expenses	(3,619)	(400)
Accounts payable and accrued liabilities	43,237	(31,203)
Income taxes	(14,061)	1,626
Derivative financial instruments	-	(3,573)
Additional consideration accrued on business combination	(3,678)	-
Foreign currency translation relating to working capital items	4,598	(1,961)
	<u>(15,300)</u>	<u>(36,026)</u>

b) Supplementary information

	<b>2006</b>	<b>2005</b>
	\$	\$
Interest paid	22,217	6,534
Income taxes paid	14,805	1,840
Non-cash items		
Property, plant and equipment acquired by means of capital leases	-	517
Additional consideration accrued on business combination	(12,572)	74,075
Issuance of common shares	-	20,000

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

### 21 Derivative financial instruments

#### Foreign currency risk management

The Corporation enters into certain foreign currency forward contracts to manage the risks associated with foreign currency exchange rates, namely the Canadian dollar, the euro, the British pound, the Mexican peso and the Australian dollar. As at December 31, 2006, the Corporation had entered into foreign currency forward contracts to sell €6 million and GBP3 million at average exchange rates of 1.3021 and 1.8746 respectively, all maturing in 2007. The fair value of these forward contracts as at December 31, 2006 is \$0.4 million in favour of third parties. These derivative instruments have not been designated as hedges for accounting purposes as the Corporation has terminated its designation of all hedging relationships for foreign currency forward contracts. The associated liability is recorded in accrued liabilities and the unrealized loss has been recorded in the foreign currency translation account.

As at December 31, 2005, the Corporation had entered into foreign currency forward contracts to sell US\$7.25 million, €7.25 million and GBP3.5 million at average exchange rates of 1.2439, 1.3301, and 1.9004 respectively, all maturing in 2006. The fair value of these forward contracts as at December 31, 2005 was \$2.2 million in favour of the Corporation. These derivative instruments were all designated as hedges for accounting purposes.

#### Interest rate swaps

The Corporation enters into interest rate swap agreements to convert certain long-term debt from variable to fixed interest rates in order to achieve an appropriate mix of fixed and variable interest rate debt. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based, and are recorded as an adjustment of interest expense on the hedged debt instrument. The related amount payable to, or receivable from, counterparties is included as an adjustment to accrued interest.

As at December 31, 2006 and 2005, the interest rate swap agreements are with third parties for a notional value of \$150 million at a fixed rate of 4.66325%, maturing in July 2012. The Corporation is applying hedge accounting to these financial instruments and no amount is recorded in these consolidated financial statements. As at December 31, 2006, the fair value of these swaps was \$2.8 million (2005 – \$1 million) in favour of the Corporation.

#### Credit risk

The Corporation does not believe it is subject to significant concentration of credit risk. Cash and short-term investments are in place with major financial institutions. The Corporation is exposed to some credit risk on accounts receivable; however, the Corporation regularly monitors its credit risk exposure and takes steps to mitigate the risk of loss, including obtaining credit insurance. The Corporation's extension of credit is based on an evaluation of each customer's financial condition and the Corporation's ability to obtain credit insurance coverage for that customer.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

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(column figures are expressed in thousands of U.S. dollars, except per share data)

The Corporation is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. It minimizes this exposure by entering into contracts with counterparties that are of high-credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored.

### **Fair value**

The Corporation has determined that the carrying value of its short-term financial assets and liabilities other than the derivative financial instruments above approximates fair values as at the balance sheet dates because of the short-term maturity of those instruments. The fair value of the Corporation's long-term debt approximates its carrying value as the majority of long-term debt bears interest at rates that vary based on the U.S. base rate and LIBOR.

## **22 Commitments and contingencies**

- a) On May 8, 2006, the former shareholders of Rose Art initiated litigation against the Corporation in the U.S. District Court for the Southern District of New York. 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 on July 26, 2005. The Corporation has filed an answer and counterclaim denying each and every material allegation relating to the lawsuit. The Corporation's counterclaim alleges that the former shareholders failed to uphold certain terms of the SPA. The Corporation accrued US\$51.0 million in its 2005 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 accrual until the lawsuit is resolved. Based on management's assessment, no additional consideration is due for 2006.

On November 17, 2006, the former shareholders of Rose Art filed arbitration 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.

- b) On March 31, 2006, the Corporation jointly announced with the U.S. 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 favourable outcome will be achieved.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

On September 14, 2006 and 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 the Corporation's 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 has not been able to assess with any certainty the outcome of these lawsuits and claims or their impact, if any. Therefore, no amount has been reserved as at December 31, 2006.

- c) 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 the Corporation in the U.S. District Court for the Western District of Washington alleging damages for false advertising and unfair and deceptive acts and practices. The Corporation has not been able to assess the outcome of this lawsuit or its impact, if any. Therefore, no amount has been reserved.
- d) The Corporation is also defending other claims, which arise in the ordinary course of business. The Corporation believes that the outcome of any individual claim or the aggregate of all such claims will not have a material impact on its business, financial condition or results of operations.
- e) The Corporation has entered into operating leases for premises, which it occupies, for an amount of \$44.7 million. The minimum annual rent payable (excluding certain occupancy charges) for each of the next five years is as follows:

	\$
2007	13,465
2008	10,189
2009	9,209
2010	8,192
2011	3,637

- f) In connection with an agreement with Investissement Québec, an aggregate amount of CA\$3.9 million was granted to the Corporation over a period of three years. This grant was conditional upon acquiring a certain level of property, plant and equipment and the creation and maintenance of a certain level of employment for a period of five years terminated in 2006.

In 2001, 2002 and 2003, the Corporation received grants of \$1.9 million to acquire certain property, plant and equipment and to create employment. Approximately 61% of the grants received in 2001, 2002 and 2003 were accounted for as a reduction of property, plant and equipment. The remaining portion of the grants was recorded in earnings as a reduction of related expenses in 2006.

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

- g) As at December 31, 2006, the Corporation had outstanding letters of guarantee in the amount of \$1.6 million (2005 – \$2.4 million) relating to financial guarantees issued in the normal course of business. These guarantees are issued under standby facilities available to the Corporation within the New Credit Facility.

### 23 Segmented information

#### Description of segments

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

- a) The 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 the family.
- b) The Stationery and Activities product lines are comprised of art materials (crayons, coloured 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.
- c) Information by segment as to MEGA Brands' operations in geographic areas is presented below on the basis the Corporation uses to manage its business. Net sales are categorized based on location of the customer while long-lived assets are categorized based on their location:

<b>Segmented information</b>	<b>2006</b>	<b>2005</b>
	\$	\$
Net sales		
Toys	333,667	291,576
Stationery and Activities	213,680	93,287
	<hr/>	<hr/>
	547,347	384,863
	<hr/>	<hr/>
<b>Geographic information</b>	<b>2006</b>	<b>2005</b>
	\$	\$
Net sales		
North America <sup>(1)</sup>	397,778	254,318
International	149,569	130,545
	<hr/>	<hr/>
	547,347	384,863
	<hr/>	<hr/>

<sup>(1)</sup> Includes net sales for Canada in 2006 of \$27.4 million (2005 – \$21.1 million).

# MEGA Brands Inc.

## Notes to Consolidated Financial Statements

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(column figures are expressed in thousands of U.S. dollars, except per share data)

	2006 \$	2005 \$
Earnings from operations		
North America	(11,728)	40,252
International	50,698	22,098
	<hr/> 38,970	<hr/> 62,350
	<hr/>	<hr/>
	2006 \$	2005 \$
Property, plant and equipment, intangible assets, and goodwill		
North America <sup>(1)</sup>	343,312	412,752
International	80,247	5,802
	<hr/> 423,559	<hr/> 418,554
	<hr/>	<hr/>

<sup>(1)</sup> Includes property, plant and equipment for Canada in 2006 of \$31.1 million (2005 – \$31.4 million).

### Other information

- d) Net sales for the year ending December 31, 2006 to the Corporation's two largest customers amounted to \$148.8 million (2005 – \$91.1 million) and \$65.3 million (2005 – \$33.5 million).

## 24 Comparative figures

Certain of the prior year's figures have been reclassified to conform with the current year's presentation.