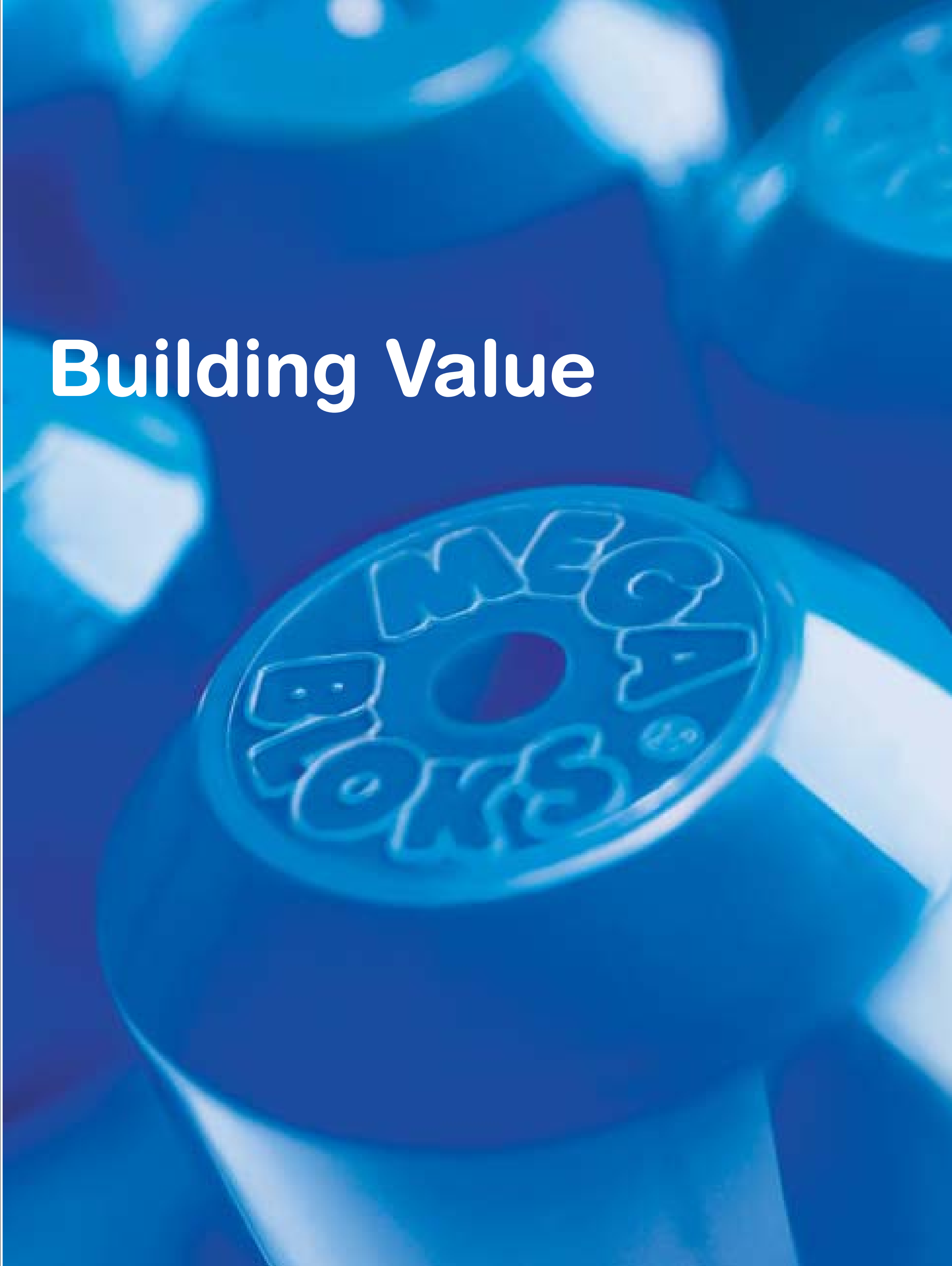
MEGA BLOKS®

Building Value

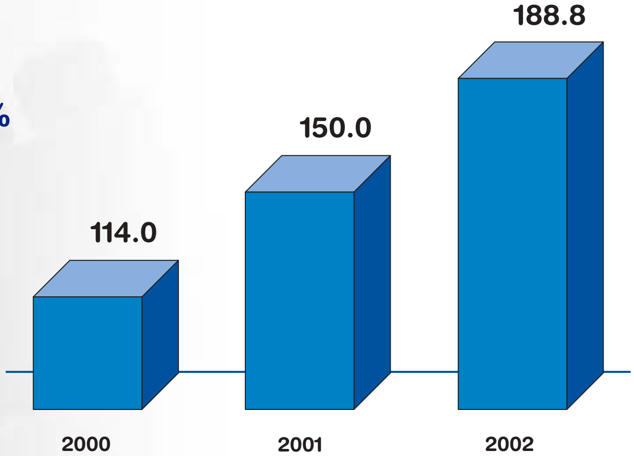


Annual
Report
2002

Delivering Results

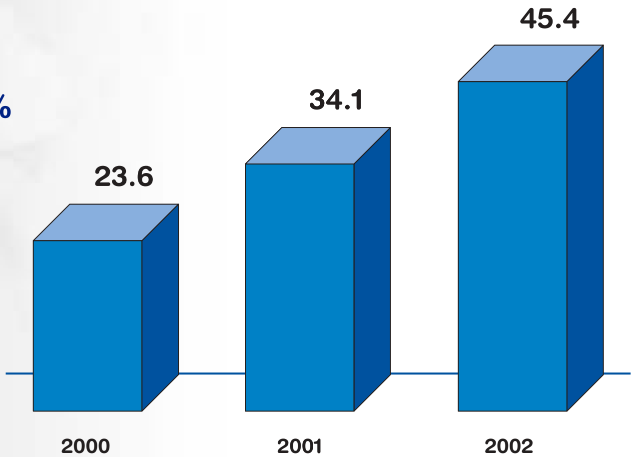
Net Sales
(US $ Millions)

CAGR*: 28.7%



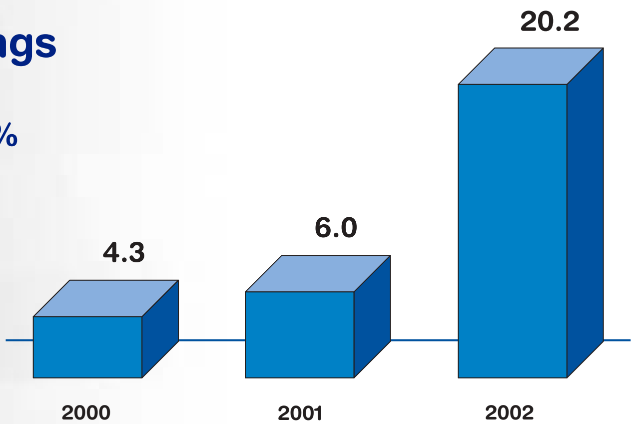
EBITDA**
(US $ Millions)

CAGR*: 38.6%



Net Earnings
(US $ Millions)

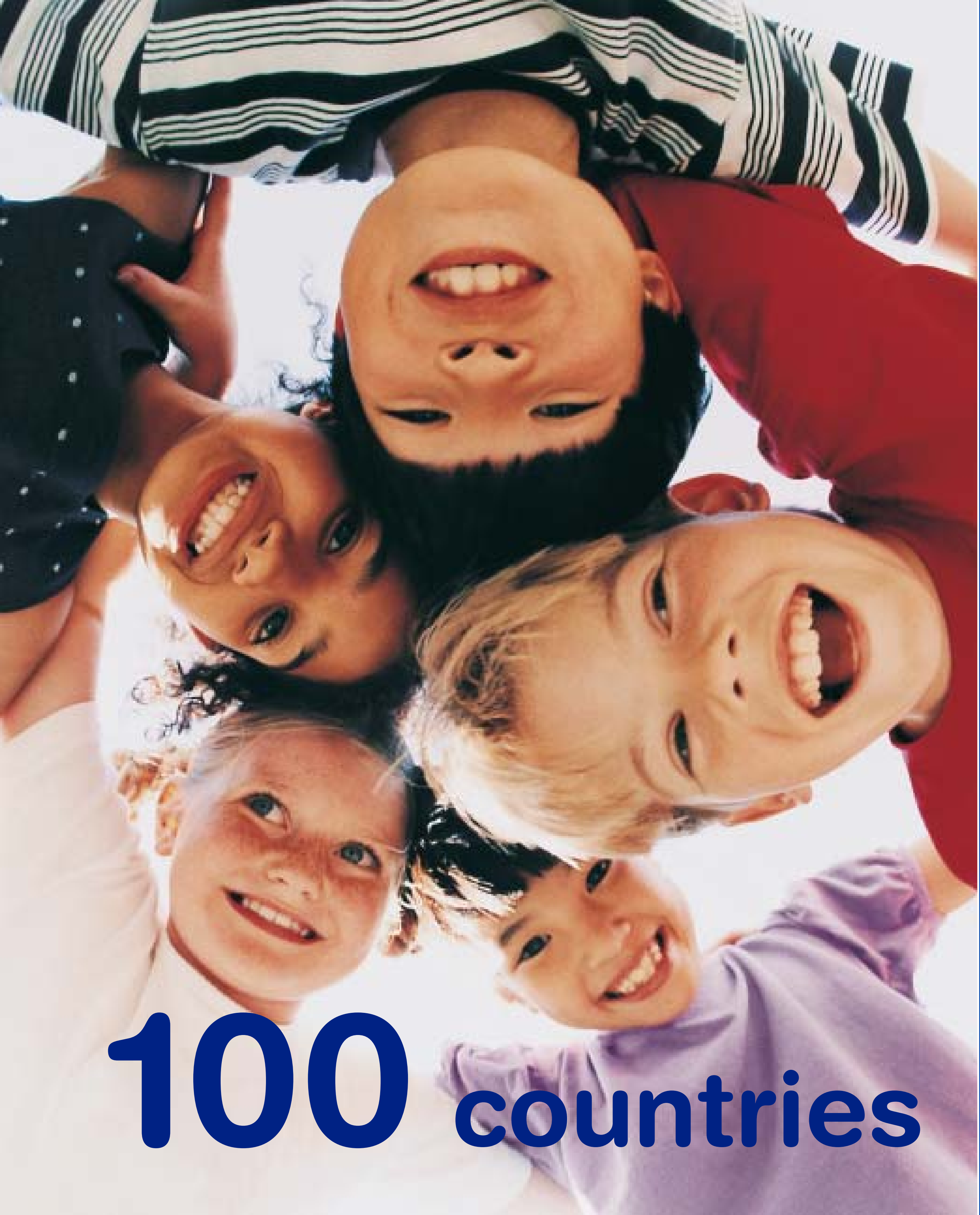
CAGR*: 116.5%



* Compounded annual growth rate

** EBITDA is income before interest, income taxes, depreciation, amortization, gain or loss on foreign currency translation and unusual items.

1 vision


100 countries

1000

ideas

Profile

Mega Bloks is a worldwide leader in the design, manufacture and marketing of construction toys. The MEGA BLOKS® system creates fun, educational and high quality toys that inspire kids and parents to play and learn together. We are a global organization employing nearly 1000 people with sales in over 100 countries.

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Chairman's letter

Dear Shareholders,

Our company started with an idea. When my wife Rita and I began in 1967, our vision was to offer quality toys with universal appeal to help develop young minds. Our early experience as successful toy distributors led us to design and manufacture proprietary products as a way of sustaining the company's long-term growth.

Our first product, which we launched in 1985, was a big construction block for the preschool age group. It was an evergreen product – one with broad appeal, stable demand and unaffected by fads. This was the genesis of the MEGA BLOKS brand.

The immediate success of this product gave us the confidence to create an entire system of simple interlocking plastic building blocks. By 1989, the company focused exclusively on its own proprietary products and MEGA BLOKS grew very rapidly to become the second largest construction toy brand in the world.

The future promises to be even more exciting.

Today, the MEGA BLOKS brand enjoys global recognition. We are solidly entrenched in North America with significant room for further growth. Internationally, we have achieved critical mass in key markets and are poised for strong gains. In fact, our growth is just beginning.

In 2002, we reached a new milestone with our initial public offering and listing on the Toronto Stock Exchange. This event strengthened our financial position while providing new means to reach our objectives. We welcome our new shareholders and thank them for their confidence in our company.

During the year, we also reinforced our Board of Directors with the addition of three independent directors – Michel Coutu, Jean-Guy Desjardins and Peter T. Main. All three have impressive business credentials and the company will benefit from their knowledge, counsel and support.

Mega Bloks is fortunate to count on exceptionally creative and dedicated people, led by an inspired group of senior managers with many years of experience in the design and manufacture of innovative toy products. Together, they form a world-class team capable of taking the brand and the company to greater heights.

Yours very truly,

Victor J. Bertrand
Chairman of the Board

Message to shareholders

The MEGA BLOKS brand continued to gather momentum and grow market share in 2002; our financial performance hit records across the board.

Net sales increased 26% to $188.8 million from $150 million in 2001, marking the 17th consecutive year of sales growth. We did extremely well in a challenging North American retail environment with a 17% sales increase to $132.2 million while international sales rose 52% to $56.6 million. Gross profit was up 29% to $90 million from $70 million in 2001 and net earnings more than tripled to $20.2 million from $6 million.

This performance gives us new targets to aim for and strong momentum to achieve our higher goals. Our vision is to be the world's most dynamic and innovative toy company, building quality products that are expandable and universal.

We are confident our business will continue to grow, build value and deliver results in the years to come.

Evergreen brand

We have built the foundation of our business on toys and play patterns that enjoy constant demand and broad appeal in gender and age. Construction toys are not fad-driven. These and other attributes make MEGA BLOKS an evergreen brand with enduring popularity.

MEGA BLOKS is one of the top 10 toy brands in North America, enjoying 87% brand awareness. We are continuously re-investing in brand development – from product innovation and packaging to promotion, advertising and marketing. Close attention to in-store merchandising will help improve our presence on retail shelves. All of these efforts contribute to the excitement around the MEGA BLOKS brand.

Innovation in action

New products are the lifeblood of our business and we have a proven track record. In 2002, our toys won more than 25 awards. Among them were the prestigious Dr. Toy and Oppenheim Toy Portfolio awards for best educational toy products.

Pivotal to winning product design are talented creative people. We are extremely proud to have one of the best development teams in the industry, over 100 strong at the end of 2002. Year after year, great ideas and a disciplined process enable us to design award-winning toys and bring them to market on time. We have become the world's fastest growing designer and manufacturer of construction toys.

As part of our strategy, we continue to pursue incremental licensing opportunities on a selective basis. Our first Disney and Power Rangers products will be released in 2003, complementing and expanding our existing offerings.

Operational excellence

Our dedication to operational excellence is a key component to the success of the MEGA BLOKS brand. By delivering the best quality, value and speed-to-market, we meet the needs of the leading global retailers. Wal-Mart Canada, Target, Toys "R" Us USA and Toys "R" Us Canada have recognized our performance and service with vendor awards in the past two years.

Our operations are fully integrated and we focus on quality in every step – from product design to stocking shelves. Over the years, we have established a reputation for reliability and a high level of service.

Global growth

We have a sound growth strategy. We aim to increase our market share by growing faster than other players in the construction category, which recorded worldwide sales of approximately $1.4 billion in 2002. We also tap into additional segments of the $40 billion traditional toy industry by incorporating the play patterns of other toy categories into our brand.

Our customer focus is core to the execution of our strategy. In North America, where MEGA BLOKS is a household name with over 20% market share, we are well positioned with the leading retailers. Our products meet their margin objectives, volumes and delivery times.

Going forward, we will increase sales to existing customers as they build new stores in new markets. We are also actively expanding our presence in new distribution channels such as food, drug, specialty stores and warehouse clubs. The popularity of our brand and the value we offer both retailers and consumers are strong selling points.

In international markets, our investments in our own sales force, distribution system and retailer relationships have led to a significant breakthrough in the United Kingdom and France. This success is helping us exploit the universal appeal of our products in other markets on the European continent. In Latin America and Asia, we continue to reinforce our third party distribution structure and expect to reap the benefits in the years ahead. Our international market share is now over 7% and, over time, we are confident of achieving similar penetration rates as in North America.

Confident outlook

No matter where kids live, they love to build, create and learn. Adults like that too and are always willing to buy toys that stimulate, educate and entertain children. Mega Bloks offers compelling value – appealing toys at attractive price points. Our value proposition is a key competitive strength over the long-term.

We are optimistic that the strength of our brand in North America, our growing presence in international markets and new products will drive sales growth in the years to come. For 2003, we are offering the broadest and most comprehensive product line in our history, featuring over 40 new products and many updates to existing items. Our product line was extremely well received at the European and North American toy fairs in early 2003 and we are looking forward to another strong year.

People and teamwork

People and teamwork are fundamental to our success. This was certainly true in 2002, a year of exceptional innovation and intense activity. We wish to thank our employees for their dedication, as well as their continued passion and commitment toward our vision. We are both very proud to lead this company as part of a superb team.

Our company has achieved 17 consecutive years of sales growth, creating tremendous opportunities for the future. Our brand is well positioned to become a global leader. By executing our long-term strategy and focusing on our core values, we will build an even better company for our shareholders, customers and employees in the years ahead.

Marc Bertrand
President and Chief Executive Officer

Vic Bertrand
Executive Vice President and Chief Operating Officer

Vic Bertrand Marc Bertrand

People and teamwork

At Mega Bloks, our number one resource is **people.**
We value quality, **creativity,** hard work and **family.**
We work together and **respect** each other.
We have **fun** and deliver results.

Evergreen brand

Blocks are **classic** toys.
Building is a **basic** play pattern.
Demand is **recurring.**
Our toys create **excitement.**
MEGA BLOKS is an **evergreen brand.**

Quality.

Universal.

Growth.

More Fun.

Educational.

Innovation in action

Our **ideas** drive innovation.
We **invent** new products **every day**.
Our product development process **optimizes** resources.
With each innovation, we **expand** the construction toy category.

Operational excellence

We are **vertically integrated.**

We **listen** and **respond** to our customers.

We invest in **leading technology** to deliver the best value.

We stand behind our product quality with a **lifetime guarantee.**

Global growth

We are one of the **fastest growing** companies in a **$40 billion** industry.

We are partnering with global retailers, opening **new markets** and expanding into new channels.

We are investing in our brand to fuel **more demand** for our products.

Our products have **universal appeal.** The world is our market.

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

This management's discussion and analysis of financial position and results of operations ("MD&A") should be read in conjunction with the Consolidated Financial Statements of the Company's fiscal years ended December 31, 2002 and 2001 and the notes thereto. The Company's accounting policies are in accordance with Canadian generally accepted accounting principles ("GAAP") of the Canadian Institute of Chartered Accountants ("CICA"). This discussion and analysis compares performance for 2002 with 2001 and discusses issues and risks that may impact future operations.

(All figures are expressed in thousands of U.S. dollars, unless otherwise indicated.)

Corporate overview

Headquartered in Montreal, Mega Bloks Inc. ("Mega Bloks" or the "Company") is the world's second largest manufacturer and marketer of construction toys and the largest Canadian toy company. Mega Bloks designs, manufactures and markets a broad line of construction toys under the MEGA BLOKS brand name that incorporates its system of interlocking plastic building blocks. Over 90% of the Company's products retail for $29.99 or less. Due to the simplicity and flexibility of building blocks, the Company's products have broad appeal and enjoy relatively steady demand. As a result, the Company's products generally do not require significant promotional spending and have low exposure to the fad-driven trends that typically characterize certain other sectors of the toy industry.

Mega Bloks and its wholly-owned subsidiaries employ approximately 1000 people serving over 100 countries from 11 offices located around the world. During the late 1990's, the Company expanded its international sales efforts by establishing Mega Bloks Latinoamerica S.A. de C.V. in 1997 and Mega Bloks Europe N.V. in 1998. The role of these foreign subsidiaries is to provide improved local support to major international retailers while establishing a logistical and administrative platform for the Company's international operations. In almost all major markets, the Company's products are sold primarily through its own distribution network.

The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. For reporting purposes, the Company prepares its financial statements in U.S. dollars in conformity with Canadian GAAP. The subsidiaries record their economic activities in their respective domestic currencies and, from an accounting standpoint, are considered fully integrated foreign operations. The temporal method is used for the currency translation of the financial statements of each subsidiary.

Operations are organized along two geographical segments: North America, which includes Canada and the United States; and International, which includes all other territories. In 2002 and 2001, net sales in North America represented approximately 70.0% and 75.2%, respectively, of the Company's total net sales.

Approximately 75% of the Company's products are manufactured at its manufacturing facility in Montreal. The Company's manufacturing operations include multiple capacity plastic injection-molding machines, specialized automated counting systems and multi product integrated assembly lines. The total production capacity of the Company's existing facility is approximately $240.0 million per year.

Corporate highlights

The Company completed its first year as a publicly traded company with great success. Fiscal 2002 marked the 17th consecutive year of sales growth. Net sales increased to $188.8 million, up from $150.0 million in 2001, representing growth of 25.8%. EBITDA increased to $45.4 million compared to $34.1 million in 2001, representing growth of 33.0%. Net earnings reached $20.2 million or $0.83 per share in 2002 versus $6.0 million or $0.31 per share for the same period in 2001. Fully diluted earnings per share before unusual items and non-recurring tax provisions amounted to $0.84 for the fiscal year ended December 31, 2002.

On May 9, 2002, the Company successfully closed its initial public offering (the "Offering"). Under the Offering, the Company issued 7,250,000 common shares from treasury at a price of CA$14.50 per share, resulting in gross proceeds of CA$105,125,000. Concurrent with the closing of the Offering, the Company entered into a new credit facility totaling $75.0 million with a syndicate of lenders. The Company used the net proceeds of its Offering together with the proceeds from its new credit facility to repay all outstanding indebtedness under its previous credit facility.

On November 12, 2002, the Company announced that it had agreed to enter into licensing agreements with Disney Enterprises, Inc. and its affiliates. Through these licensing agreements, the Company was granted the rights to make construction toys incorporating Disney classic characters as well as characters associated with the Power Rangers television series. For classic Disney characters, the Company can sell and distribute its products in all markets, while the Power Rangers products may be sold in markets where the Company distributes its "Micro" category product lines, except for Japan.

On November 22, 2002, the Company filed a Base PREP Prospectus with the Canadian securities regulatory authorities in connection with the secondary offering by affiliates of The Blackstone Group, one of the principal shareholders of the Company, of a portion of their common shares. Mega Bloks did not issue any new shares from treasury as part of this secondary offering.

Results of operations

The following tables set forth selected consolidated financial information and other data for the two years ended December 31, 2002 and 2001 and are derived from the Consolidated Financial Statements of the Company. The tables should be read in conjunction with the Consolidated Financial Statements of the Company, including the notes thereto.

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

	Years ended December 31					
	2002		2001		Change	
	$	%	$	%	$	%
Earnings Data						
Net sales	$ 188,807	100.0%	$ 150,043	100.0%	$ 38,764	25.8%
Cost of sales	98,816	52.3%	80,021	53.3%	18,795	23.5%
Gross profit	89,991	47.7%	70,022	46.7%	19,969	28.5%
Marketing, research and development and advertising expenses	21,701	11.5%	16,502	11.0%	5,199	31.5%
Other selling, distribution and administrative expenses	30,047	15.9%	23,623	15.7%	6,424	27.2%
(Gain) loss on foreign currency translation	(223)	(0.1%)	1,609	1.1%	(1,832)	(113.9%)
Unusual items	5,816	3.1%	3,716	2.5%	2,100	56.5%
Earnings from operations	32,650	17.3%	24,572	16.4%	8,078	32.9%
Interest expense	4,856	2.6%	10,348	6.9%	(5,492)	(53.1%)
Earnings before income taxes	27,794	14.7%	14,224	9.5%	13,570	95.4%
Income taxes	7,628	4.0%	8,176	5.4%	(548)	(6.7%)
Net earnings	$ 20,166	10.7%	$ 6,048	4.0%	$ 14,118	233.4%
EBITDA(1)	$ 45,355	24.0%	$ 34,111	22.7%	$ 11,244	33.0%
Per Share Data						
Earnings per share						
Basic	$ 0.83		$ 0.31		$ 0.52	167.7%
Diluted	$ 0.76		–		–	–
Weighted average number of outstanding shares						
Basic	24,261,617		19,273,020		4,988,597	25.9%
Diluted	26,467,410		–		–	–

	Years ended December 31			
	2002	2001	Change	
	$	$	$	%
Balance Sheet Data				
Working capital[2]	$ 61,221	$ 55,813	$ 5,408	9.7%
Capital assets	30,318	27,018	3,300	12.2%
Total assets	123,694	106,519	17,175	16.1%
Total debt	$ 43,757	$ 113,850	$ (70,093)	(61.6%)

	Years ended December 31			
	2002	2001	Change	
	$	$	$	%
Canadian Dollar Data[3]				
Net sales	$ 298,240	$ 237,008	$ 61,232	25.8%
EBITDA[1]	71,643	53,882	17,761	33.0%
Net earnings	31,854	9,553	22,301	233.4%
Earnings per share				
Basic	$ 1.31	$ 0.49	$ 0.82	167.7%
Diluted	$ 1.20	–	–	–

(1) *EBITDA is income before interest, income taxes, depreciation, amortization, gain or loss on foreign currency translation and unusual items. EBITDA should not be considered a measure of financial performance under generally accepted accounting principles. Items excluded from EBITDA are significant to understanding and assessing financial performance. EBITDA is a key measure used by management to evaluate the Company's operations and provide useful information to investors. EBITDA should not be considered in isolation or as an alternative to net income, cash flows from operations, investing or financing activities, or other financial statement data presented in the Consolidated Financial Statements as indicators of financial performance or liquidity. Because EBITDA is not a measurement determined in accordance with generally accepted accounting principles, EBITDA as presented may not be comparable to other similarly titled measures of other companies.*

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

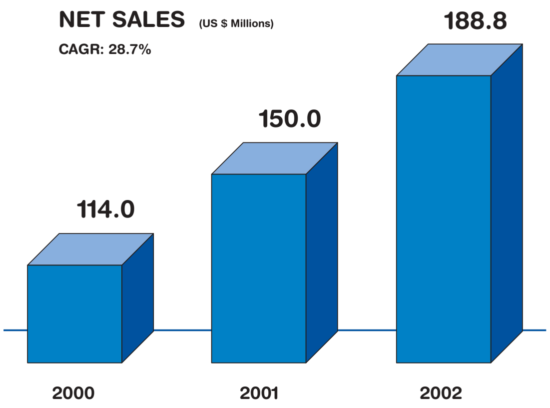
(3) *U.S. dollar financial data is converted into Canadian dollars at the December 31, 2002 year end exchange rate of CA$1.5796 per US$1.00 using the translation of convenience method.*

Net sales

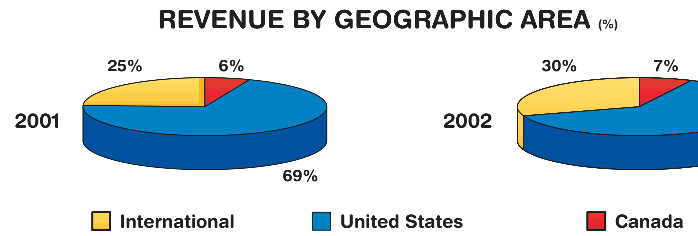
Net sales in fiscal 2002 increased 25.8% to $188.8 million from $150.0 million in the previous year.

Mega Bloks achieved its overall growth through the:

- Introduction of new items in existing product lines such as Probuilder and Transforming Blok Bots;
- Successful introduction of new innovative product lines such as Dragons, targeted at children 5 to 10, and Girl Friends, targeted at girls 2 to 5;
- Strong performance in all key international markets;
- Penetration of new retail channels such as food and drug;
- Expansion with the world's largest retailers by growing with them as they opened new stores and by capturing additional shelf space.

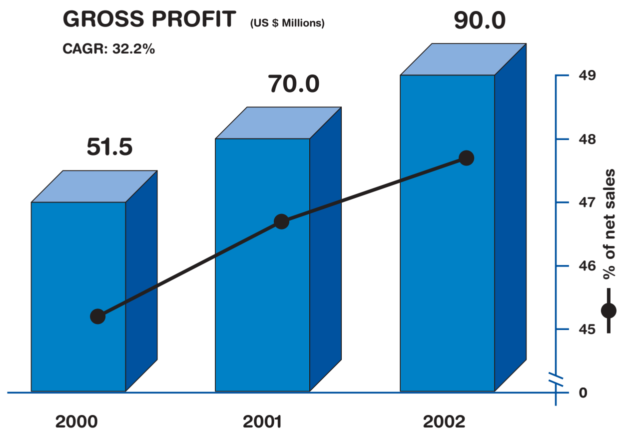


In North America, net sales grew to $132.2 million during the year from $112.8 million for fiscal 2001, representing growth of $19.4 million or 17.2%. International net sales grew to $56.6 million during the year from $37.3 million for fiscal 2001, representing growth of $19.4 million or 52.0%. In fiscal 2002, international net sales represented 30.0% of total net sales, compared to 24.8% in the prior year.



Gross profit

Gross profit for fiscal 2002 totaled $90.0 million compared to $70.0 million in 2001, an increase of $20.0 million or 28.5%. As a percentage of net sales, gross profit was 47.7% for fiscal 2002 compared to 46.7% in 2001. The increase in gross margin is primarily attributable to enhanced sales of higher margin products and efficiency improvements in manufacturing, which fully offset rising raw material costs resulting from increasing crude oil prices.



Marketing, research and development and advertising expenses

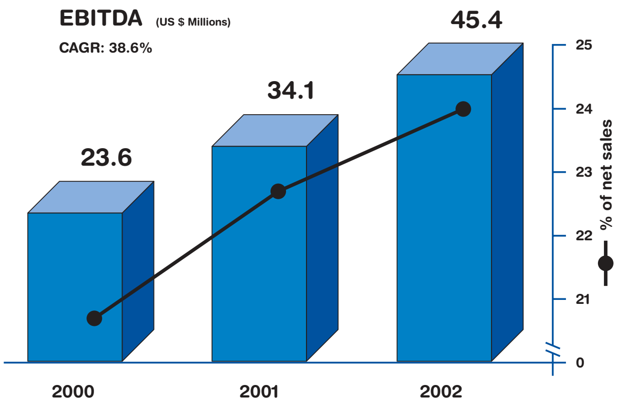
Marketing, research and development and advertising expenses for fiscal 2002 amounted to $21.7 million compared to $16.5 million in 2001, an increase of $5.2 million or 31.5%. As a percentage of net sales, marketing, research and development and advertising expenses represented 11.5% for fiscal 2002 compared to 11.0% in 2001. During 2002, the Company increased its investment in the MEGA BLOKS brand through mass-market advertising, including television commercials and print advertisements. The Company also benefited from co-op advertising with its customers, which increased proportionately in 2002 in line with net sales. In addition, the Company continued to add to its research and development infrastructure, in order to maintain its leadership in the introduction of new products that are well received by the marketplace.

Other selling, distribution and administrative expenses

Other selling, distribution and administrative expenses for fiscal 2002 amounted to $30.0 million compared to $23.6 million in 2001, an increase of $6.4 million or 27.2%. As a percentage of net sales, other selling, distribution and administrative expenses represented 15.9% for fiscal 2002 compared to 15.7% in 2001. This nominal percentage increase was mainly attributable to higher distribution costs in international markets, sales team expansion and increased pricing for the Company's insurance programs, offset by the leveraging of general and administration costs.

EBITDA

EBITDA for fiscal 2002 increased to $45.4 million compared to $34.1 million in 2001, an improvement of $11.3 million or 33.0%. This improvement was driven primarily by sales growth and higher gross profit. The EBITDA margin (EBITDA over net sales) improved to 24.0% for fiscal 2002 compared to 22.7% in 2001.



(Gain) loss on foreign currency translation

Gain on foreign currency translation for fiscal 2002 amounted to $0.2 million compared to a loss on foreign currency translation of $1.6 million in 2001, an improvement of approximately $1.8 million. The gain on foreign currency translation during 2002 was primarily attributable to the impact of the strengthening of the euro in relation to the U.S. dollar.

Unusual items

Unusual items for fiscal 2002 amounted to $5.8 million compared to $3.7 million in 2001. In 2002, unusual items consisted primarily of expenses directly related to the Company's Offering, which included a $2.6 million non-recurring charge for the recording of a liquidity event award accrual, and a $2.3 million charge incurred in connection with the cancellation of all loan commitments under the Company's previous credit facility. In addition, the Company incurred a $0.7 million non-recurring charge for consulting and professional services rendered in connection with the settlement of the Canada Customs and Revenue Agency's ("CCRA") tax audit. In 2001, unusual items of $3.7 million consisted primarily of a $1.7 million non-recurring charge for moving expenses related to the relocation of the Company's facilities and a $1.4 million charge incurred in connection with an amendment to the Company's previous credit facility completed in February 2001.

Earnings from operations

As a result, earnings from operations for fiscal 2002 amounted to $32.7 million or 17.3% of net sales compared to $24.6 million or 16.4% of net sales in 2001, an improvement of $8.1 million or 32.9%.

Interest expense

Interest expense for fiscal 2002 amounted to $4.9 million compared to $10.3 million in 2001, a decrease of $5.5 million or 53.1%. This decrease was mainly attributable to lower borrowing levels resulting from the successful closing of the Company's Offering on May 9, 2002 and lower floating interest rates.

Income taxes

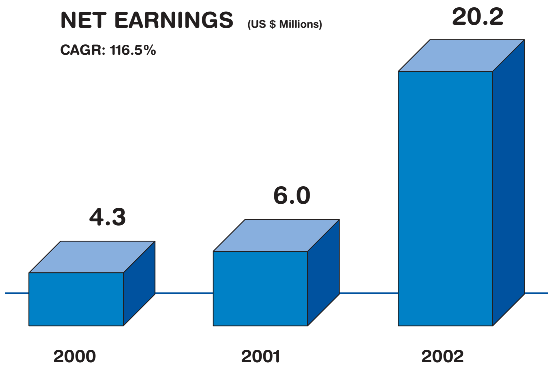
Included in income taxes for fiscal 2002 is an adjustment of approximately $1.8 million relating to the reversal of a $3.0 million non-recurring tax provision recorded in 2001 in connection with the CCRA's tax audit. Excluding the reversal of the non-recurring tax provision in 2002 and the corresponding set-up of the provision in 2001, the Company's effective income tax rate in fiscal 2002 decreased to 34.1% compared to 36.4% in fiscal 2001. The decrease reflects declining statutory tax rates.

Income tax expense for fiscal 2002 was $7.6 million compared to $8.2 million in 2001.

Net earnings

Net earnings in fiscal 2002 increased by 233.4% to $20.2 million or $0.83 per share from $6.0 million or $0.31 per share in 2001, an improvement of $14.1 million or $0.52 per share. The year-over-year increase in net earnings reflects improved earnings from operations coupled with reduced interest and income tax expenses.

The increase in earnings per share takes into account a 25.9% year-over-year increase in the weighted average number of outstanding shares. The weighted average number of shares increased primarily as a result of the issuance of shares as part of the Company's Offering in May 2002.



Quarterly fluctuations and seasonality

Sales of toy products are seasonal, with a majority of retail sales occurring from September through December. The Company has historically experienced quarterly fluctuations in operating results; in 2002, approximately 78% of its sales were made in the third and fourth quarters. Management anticipates these fluctuations to continue in the future. Quarterly operating results for any quarter are not necessarily indicative of results for any future period. The Company's first two quarters are typically less profitable as a result of lower net sales but fairly constant fixed operating expenses. This seasonality is consistent with the results of companies in the toy industry.

The seasonal nature of the toy industry also results in variable working capital requirements throughout the year. The Company's need for working capital typically grows as inventories build up in anticipation of increased sales. Accounts receivable are at their highest at the end of the fourth quarter due to heightened sales volume. Generally, these accounts receivable are not due for payment until early in the first quarter of the subsequent year.

The following table sets forth some of the Company's quarterly financial information for the years 2002 and 2001.

	2002				2001			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	(in thousands of dollars)				(in thousands of dollars)			
Net sales	$ 18,708	$ 22,558	$ 66,665	$ 80,876	$ 15,176	$ 15,232	$ 51,739	$ 67,896
As a % of full year	*9.9 %*	*11.9 %*	*35.3 %*	*42.8 %*	*10.1 %*	*10.2 %*	*34.5 %*	*45.3 %*
Gross profit	$ 8,247	$ 9,483	$ 32,524	$ 39,737	$ 5,949	$ 6,105	$ 24,796	$ 33,172
EBITDA(1)	$ 1,208	$ 1,343	$ 18,014	$ 24,790	$ 75	$ 79	$ 13,611	$ 20,346
Working capital(2)	$ 33,729	$ 32,538	$ 62,379	$ 61,221	$ 25,605	$ 24,544	$ 52,443	$ 55,813

(1) *See note (1) on page 19.*

(2) *See note (2) on page 19.*

Liquidity and financial resources

The Company has historically funded its operations and capital requirements with cash generated from operations and borrowings under a revolving credit facility. The Company's primary capital needs are related to financing inventories, funding accounts receivable, debt servicing and capital expenditures for new product initiatives.

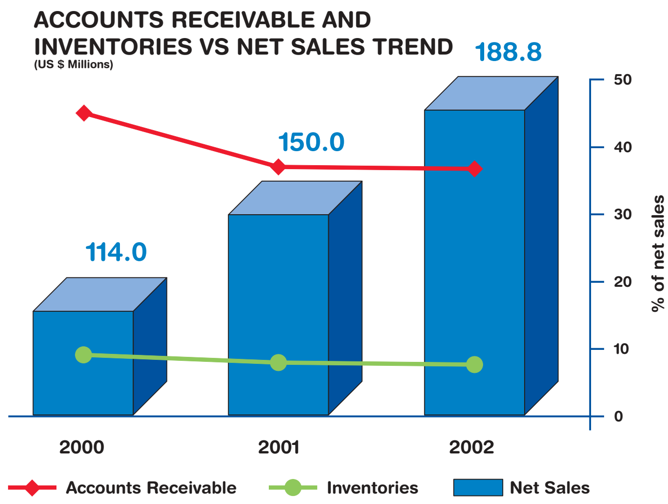
Cash flows generated from operating activities, after changes in non-cash working capital items, totaled $17.2 million in fiscal 2002 compared to $13.3 million in 2001. The increase results from higher earnings offset by a proportionate increase in accounts receivable and inventories.

Cash flows used in financing activities in fiscal 2002 were $11.9 million compared to $1.9 million in 2001. During fiscal 2002, financing activities generated approximately $101.5 million, principally through the issuance of capital stock in connection with the closing of the Company's Offering and the execution of a new credit facility with a syndicate of lenders. The borrowings under the new credit facility, together with the proceeds from the Offering, were used to repay all outstanding indebtedness under the previous credit facility.

Cash flows used in investing activities in fiscal 2002 amounted to $9.0 million compared to $4.1 million in 2001. The Company invested in capital assets to support the introduction of new product line initiatives. During 2001, investments of $7.6 million in fixed assets were offset by $3.4 million of net proceeds received in connection with the disposition of the Company's old manufacturing facility.

Balance sheet

The Company's balance sheet improved significantly in 2002, as evidenced by the reduction in total borrowings from $113.9 million in 2001 to $43.8 million. The total debt to capitalization ratio decreased to 0.48 from 1.48 at the end of 2001. The reduction in total borrowings was primarily attributable to the successful closing of the Company's Offering on May 9, 2002.



Working capital for fiscal 2002 was $61.2 million compared to $55.8 million for fiscal 2001, an increase of $5.4 million or 9.7%. The increase in working capital was primarily due to a $13.8 million increase in trade accounts receivable driven by significant sales growth compared to fiscal 2001. Average working capital for fiscal 2002 was $48.4 million compared to $44.5 million for fiscal 2001, an increase of $3.9 million or 8.8%. Working capital for fiscal 2002 peaked during the fourth quarter at $86.3 million, compared to a peak of $70.8 million for the fourth quarter of fiscal 2001.

Based on the strong cash flow it generates, the Company expects to reduce its long-term debt during 2003. The Company's future growth will result in increased working capital requirements, primarily because of increases in trade accounts receivable and inventories.

Risk factors

Consumer preferences are difficult to predict and the introduction of new products is critical in the Company's industry.

The Company's business and operating results depend largely upon the appeal of its toy products. The Company's continued success in the toy industry will depend on its ability to enhance and extend its existing product lines and to develop, introduce and gain customer acceptance of new products. However, consumer preferences in this industry are continuously changing and are difficult to predict. Individual products typically have short life cycles. There can be no assurance that: (i) any of the Company's current product lines will continue to be popular for any significant period of time; (ii) any new products introduced by the Company will achieve an adequate degree of market acceptance; or (iii) any new products' life cycles will be sufficient to permit the Company to recover development, manufacturing, marketing and other costs. A decline in the popularity of the Company's 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 the Company's business, financial condition and results of operations.

The Company's business is dependent on a few of its largest customers, which together account for a majority of its net sales.

A small number of the Company's customers account for a large share of its net sales. For the year ended December 31, 2002, the Company's four largest customers, Toys "R" Us, Wal-Mart, Target and Kmart in the aggregate accounted for approximately 58% of net sales. Except for outstanding purchase orders for specific products, the Company does not have written contracts with or commitments from any of its customers. If some of these customers were to cease doing business with the Company or to reduce the amount of their purchases from the Company, by virtue of experiencing financial difficulty or otherwise, it could have a material adverse effect on the Company's business, financial condition and results of operations. On January 22, 2002, Kmart Corporation announced that it had filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. Although management believes that the Company's exposure to Kmart is limited because of the protective measures it has taken, including its insolvency risk insurance policy, there can be no assurance that there will not be negative developments in respect of Kmart's restructuring, financial circumstances or operations, which could in turn have a material adverse effect on the Company's business, financial condition and results of operations.

The Company is involved in certain significant litigation matters in which the outcome is uncertain and could entail substantial expense.

The Company is currently involved in litigation proceedings, which, regardless of the outcome, may result in substantial expenses and divert the attention of management. The most significant proceeding against the Company involves its principal competitor, Kirkbi AG and LEGO Canada Inc. (collectively referred to as "LEGO"). In a decision dated May 24, 2002, the Federal Court of Canada Trial Division rejected LEGO's action. LEGO appealed this decision to the Federal Court of Appeal. Although the Company and its outside counsel believe that it is unlikely that LEGO's appeal will be successful, there can be no assurance that the Company will achieve a favorable outcome. In the event that LEGO succeeds in its appeal, a permanent injunction may be issued and the Company could be forced to cease selling some or all of its "Micro" MEGA BLOKS toys in Canada. The Company may also be required to pay damages. Any or all of the foregoing could have a material adverse effect on the Company's business, financial condition and results of operations.

The toy business is seasonal and therefore the Company's annual operating results will depend, in large part, on its sales during the relatively brief holiday season.

Sales of toy products at retail are seasonal, with a majority of retail sales occurring during the period from September through December. In 2002, approximately 78% of the Company's net sales were made during the third and fourth quarters. This seasonality is increasing as large toy retailers become more efficient in their control of inventory levels through just-in-time inventory management systems. As a result, the Company's annual operating results will depend, in large part, on its sales during the relatively brief holiday season. Failure to accurately predict and respond to consumer demand could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company is exposed to fluctuations in the price of the plastic resins it uses to manufacture its products.

The principal raw material used by the Company in the manufacture of its products is plastic resin. The price of plastic resin has experienced fluctuations over the past several years due to volatility in crude oil prices. The Company protects itself against resin price fluctuations by negotiating twelve-month volume commitments with key suppliers while fixing overall prices on a quarterly basis; however, it does not hedge otherwise against adverse price fluctuations. As a result, the Company is currently not protected against plastic resin price volatility beyond a portion of the fiscal year. Should the price of plastic resin increase substantially, the Company may not be able to pass on such an increase to its customers. Substantial increases in the price of plastic resin could have a material adverse effect on the Company's financial condition and results of operations.

The Company is exposed to fluctuations in the exchange rate between the dollar and other currencies and is also exposed to fluctuations in interest rates under its borrowings.

The Company is exposed to market risks attributable to fluctuations in foreign currency exchange rates, primarily changes in the value of the U.S. dollar versus other currencies such as the Canadian dollar, the euro, the British pound and the Mexican peso. In the fiscal year ended December 31, 2002, over 65% of the consolidated net sales of the Company were denominated in U.S. dollars while the majority of its expenses were incurred in Canadian dollars. Any weakening in the value of the U.S. dollar against the Canadian dollar could have a material adverse effect on the Company's results of operations. The Company is also exposed to fluctuations in interest rates under its borrowings. Increases in interest rates could have an adverse effect on the earnings of the Company.

Recent accounting pronouncements

Foreign currency translation

Effective January 1, 2002, the Company adopted the recommendations of the CICA Handbook Section 1650, "Foreign Currency Translation". The amended recommendations require that all unrealized translation gains and losses on assets and liabilities denominated in foreign currencies be included in earnings for the year, including gains and losses on long-term monetary assets and liabilities, such as long-term debt, which were previously deferred and amortized on a straight-line basis over the remaining lives of the related items. On January 1, 2002, $544,000 was included in deferred credits, relating to unrealized foreign currency gains, which was credited to the opening deficit.

Stock-based compensation plans

Effective January 1, 2002, the Company adopted the new recommendations of the CICA Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments". This section establishes standards for the recognition, measurement and disclosure of stock-based compensation made in exchange for goods and services. This Section requires that direct awards of stock and liabilities based on the price of common stock be measured at fair value at each reporting date, with any change in fair value reported in the statement of earnings and encourages, but does not require, the use of the fair value method for all other types of stock-based compensation plans. The new standard also requires pro forma disclosures relating to net earnings and earnings per share figures as if the fair value method of accounting had been used. This section applies to awards granted on or after January 1, 2002.

None of the Company's plans qualify as direct awards of stock or as plans that create liabilities based on the price of the Company's stock, and as a result, the implementation of the Section had no impact on the Consolidated Financial Statements. The Company has chosen not to use the fair value method to account for stock-based compensation plans. For fiscal 2002, the Company's pro forma net earnings would have been $18.7 million or $0.77 per share.

The Company has two stock-based compensation plans. No compensation is recognized when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital.

Future accounting pronouncements

Impairment of long-lived assets

Effective April 1, 2003, CICA Handbook Section 3063 provides guidance on the recognition, measurement and disclosure of the impairment of long-lived assets. It replaces the write-down provisions in Section 3061 "Property, Plant and Equipment".

The Section:

- Requires an impairment loss for a long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition; and,
- Requires an impairment loss for a long-lived asset to be held and used to be measured as the amount by which its carrying amount exceeds its fair value.

The Company does not believe that the adoption of this new Section will have a material impact on its Consolidated Financial Statements.

Disposal of long-lived assets and discontinued operations

Effective for disposal activities initiated by an enterprise's commitment to a plan on or after May 1, 2003, CICA Handbook Section 3475 provides guidance on the recognition, measurement, presentation and disclosure of long-lived assets to be disposed of. It replaces the disposal provisions of "Property, Plant and Equipment", Section 3061, as well as "Discontinued Operations", Section 3475.

The Section:
- Provides criteria for classifying assets as held for sale;
- Requires an asset classified as held for sale to be measured at fair value less cost to sell;
- Provides criteria for classifying a disposal as a discontinued operation; and,
- Specifies presentation and disclosures for discontinued operations and other disposals of long-lived assets.

The Company does not believe that the adoption of this new Section will have a material impact on its Consolidated Financial Statements.

Forward-looking statements

Certain statements made in this Annual Report may constitute forward-looking statements and are subject to significant risks and uncertainties which are difficult to predict and assumptions which may prove to be inaccurate. The results or events predicted in these statements may differ materially from actual results or events. Certain of the risk factors which could cause results or events to differ materially from current expectations include the following: difficulty in predicting customer preferences and importance of new products, dependence on a few large customers, litigation, seasonality of the toy industry, fluctuations in the price of plastic resins and interest rate and currency fluctuations. The forward-looking statements contained in this Annual Report represent the expectations of Mega Bloks as of February 27, 2003 and, accordingly, are subject to change after such date. However, Mega Bloks disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's responsibility for financial statements

The accompanying Consolidated Financial Statements of Mega Bloks Inc. have been prepared by management and approved by the Board of Directors. Management is responsible for the information and representation contained in these financial statements and in other sections of this Annual Report.

To meet its responsibility for the integrity and objectivity of data in the Consolidated Financial Statements, management has developed and maintains a system of internal accounting controls. Management believes that this system of internal accounting controls provides reasonable assurance that the financial records are reliable and form a proper basis for preparation of financial statements, and that the assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for financial statements in this Annual Report principally through its Audit Committee. The Company's auditors have full access to the Audit Committee, with and without management being present. The Consolidated Financial Statements have been examined by the Company's auditors, Deloitte & Touche LLP Chartered Accountants, and their report is shown as part of the Consolidated Financial Statements.

Marc Bertrand
President and Chief Executive Officer

Alain Tanguay
Vice President and Chief Financial Officer

February 7, 2003

Auditors' report

To the Shareholders of Mega Bloks Inc.

We have audited the consolidated balance sheets of Mega Bloks Inc. (formerly Ritvik Holdings Inc.) as at December 31, 2002 and 2001 and the consolidated statements of earnings, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants

February 7, 2003

Consolidated statements of earnings

(in thousands of U.S. dollars, except per share amounts)	Years ended December 31, 2002	2001
Net sales	**$ 188,807**	$ 150,043
Cost of sales	**98,816**	80,021
Gross profit	**89,991**	70,022
Marketing, research and development, and advertising expenses	**21,701**	16,502
Other selling, distribution and administrative expenses	**30,047**	23,623
(Gain) loss on foreign currency translation	**(223)**	1,609
Unusual items (Note 10)	**5,816**	3,716
Earnings from operations	**32,650**	24,572
Interest expense		
Long-term debt	**4,516**	10,218
Other	**340**	130
	4,856	10,348
Earnings before income taxes	**27,794**	14,224
Income taxes (Note 11)		
Current	**9,854**	4,082
Future	**(2,226)**	4,094
	7,628	8,176
Net earnings	**$ 20,166**	$ 6,048
Earnings per share (Note 8)		
Basic	**$ 0.83**	$ 0.31
Diluted	**0.76**	–

Consolidated statements of deficit

(in thousands of U.S. dollars)	Years ended December 31, 2002	2001
Balance, beginning of period	**$ (126,504)**	$ (132,552)
Net earnings	**20,166**	6,048
Change in accounting policy (Note 2)	**544**	–
Related party transaction adjustment (Note 9)	**(220)**	–
Balance, end of period	**$ (106,014)**	$ (126,504)

See accompanying notes to consolidated financial statements.

Consolidated balance sheets

(in thousands of U.S. dollars)	As at December 31, 2002	2001
Assets		
Current assets		
Cash and cash equivalents	$ 2,876	$ 7,954
Accounts receivable - trade	69,556	55,707
Accounts receivable - other	3,092	3,151
Inventories (Note 3)	14,486	12,026
Prepaid expenses	1,774	663
	91,784	79,501
Capital assets (Note 4)	30,318	27,018
Deferred charges (Note 5)	1,592	–
	$ 123,694	$ 106,519
Liabilities		
Current liabilities		
Bank overdraft	$ –	$ 1,416
Accounts payable and accrued liabilities	22,880	16,613
Income taxes	3,941	562
Current portion of long-term debt (Note 5)	3,742	5,097
	30,563	23,688
Deferred credits (Note 2)	–	544
Long-term debt (Note 5)	40,015	108,753
Future income taxes (Note 11)	6,067	10,321
	76,645	143,306
Shareholders' equity (deficiency)		
Capital stock (Note 6)	153,063	89,717
Deficit	(106,014)	(126,504)
	47,049	(36,787)
	$ 123,694	$ 106,519

See accompanying notes to consolidated financial statements.

On behalf of the Board,

Marc Bertrand
Director

Vic Bertrand
Director

Consolidated statements of cash flows

	Years ended December 31,	
(in thousands of U.S. dollars)	**2002**	2001
Cash flows from operating activities		
Net earnings	**$ 20,166**	$ 6,048
Items not affecting cash		
Amortization of capital assets	**6,649**	4,572
Amortization of deferred charges	**463**	165
Amortization of deferred credits	**–**	(524)
Loss on disposal of capital assets	**11**	149
(Gain) loss on foreign currency translation	**(223)**	1,609
Future income taxes	**(2,226)**	4,094
Write-off of deferred charges	**–**	229
	24,840	16,342
Changes in non-cash operating working capital items (Note 12)	**(7,596)**	(2,997)
	17,244	13,345
Cash flows used in financing activities		
Issue of capital stock	**61,514**	7,500
Proceeds of long-term debt	**40,000**	270
Repayment of long-term debt	**(71,555)**	(5,935)
Change in revolving term bank loan balance	**(39,500)**	(4,500)
Related party transaction adjustment	**(319)**	–
Increase in deferred charges	**(2,055)**	–
Increase in deferred credits	**–**	743
	(11,915)	(1,922)
Cash flows used in investing activities		
Acquisition of capital assets	**(9,069)**	(7,551)
Proceeds on disposal of capital assets	**78**	3,413
	(8,991)	(4,138)
Increase (decrease) in cash and cash equivalents	**(3,662)**	7,285
Cash and cash equivalents, beginning of period	**6,538**	(747)
Cash and cash equivalents, end of period	**$ 2,876**	$ 6,538

See accompanying notes to consolidated financial statements.

Cash and cash equivalents are net of bank overdraft for 2001.
Supplementary disclosure of cash flow information (Note 12).

Notes to consolidated financial statements

For the years ended December 31, 2002 and 2001

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

1. Nature of operations

Mega Bloks Inc. (the "Company") designs, manufactures and markets a broad line of construction toys under the MEGA BLOKS brand name that incorporates its system of interlocking plastic building blocks. The Company sells and distributes its products in over 100 countries. On March 19, 2002, the Company changed its name from Ritvik Holdings Inc. to Mega Bloks Inc.

2. Significant accounting policies

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

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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation

Consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

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 at the date of acquisition.

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.

Capital assets

Capital assets are recorded at cost and are amortized over their estimated useful lives using the straight-line method at the following annual amortization rates:

Machinery and equipment	3 to 15 years
Computer equipment	5 years
Leasehold improvements	over terms of the leases

The Company evaluates the carrying value of its long-lived assets for potential impairment on an ongoing basis. The Company considers projected future operating results, trends and other circumstances in making such evaluations. Impaired assets are written down to estimated fair value, being determined based on undiscounted expected future cash flows. No impairment charges have been recorded based on Management's review.

Income taxes

Future income taxes relate to the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

2. Significant accounting policies (cont'd)

Revenue recognition

Revenue is recognized upon shipment of products to customers. Accruals for customer discounts, rebates and defective allowances are recorded as the related revenues are recognized.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange at the balance sheet date. Other balance sheet items denominated in foreign currencies are translated at the rates prevailing at the respective transaction dates. Revenue and expense items arising from transactions in foreign currencies and from the 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.

Effective January 1, 2002, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1650, "*Foreign Currency Translation*". The amended recommendations require that all unrealized translation gains and losses on assets and liabilities denominated in foreign currencies be included in earnings for the year, including gains and losses on long-term monetary assets and liabilities, such as long-term debt, which were previously deferred and amortized on a straight-line basis over the remaining lives of the related items. On January 1, 2002, included in deferred credits was $544,000 relating to unrealized foreign currency gains, which was credited to opening deficit.

Financial instruments

The Company uses a combination of financial instruments to manage risks related to fluctuations in exchange rates. The derivative instruments entered into by the Company comprise principally of foreign currency contracts. Gains and losses on foreign currency contracts are recognized through income and generally offset transaction losses or gains on the foreign currency cash flows, which they are intended to hedge. The Company does not use derivative financial instruments for trading purposes.

Stock-based compensation plans

Effective January 1, 2002, the Company adopted the new recommendations of the CICA Handbook Section 3870, "*Stock-based Compensation and Other Stock-based Payments*". This section establishes standards for the recognition, measurement and disclosure of stock-based compensation made in exchange for goods and services. This Section requires that direct awards of stock and liabilities based on the price of common stock be measured at fair value at each reporting date, with any change in fair value reported in the statement of earnings and encourages, but does not require, the use of the fair value method for all other types of stock-based compensation plans. The new standard also requires pro forma disclosures relating to net earnings and earnings per share figures as if the fair value method of accounting had been used. This section applies to awards granted on or after January 1, 2002.

None of the Company's plans qualify as direct awards of stock or as plans that create liabilities based on the price of the Company's stock, and as a result, the implementation of the Section had no impact on the consolidated financial statements. The Company has chosen not to use the fair value method to account for stock-based compensation plans. The pro forma disclosure is presented in Note 8.

The Company has two stock-based compensation plans. No compensation is recognized when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital.

Government grants

Government grants for capital asset acquisitions are netted against capital assets 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 (see Note 14).

2. Significant accounting policies (cont'd)

Future accounting changes

The CICA has issued the following new Handbook Sections:

1. Handbook Section 3063, "*Impairment of long-lived assets*". Effective April 1, 2003, this Section provides guidance on the recognition, measurement and disclosure of the impairment of long-lived assets. It replaces the write-down provisions in Section 3061 "*Property, Plant and Equipment*".

   The Section:
   - Requires an impairment loss for a long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition; and,
   - Requires an impairment loss for a long-lived asset to be held and used to be measured as the amount by which its carrying amount exceeds its fair value.

   The Company does not believe that the adoption of this new Section will have a material impact on its consolidated financial statements.

2. Handbook Section 3475, "*Disposal of long-lived assets and discontinued operations*". Effective for disposal activities initiated by an enterprise's commitment to a plan on or after May 1, 2003, this Section provides guidance on the recognition, measurement, presentation and disclosure of long-lived assets to be disposed of. It replaces the disposal provisions of "*Property, Plant and Equipment*", Section 3061 as well as "*Discontinued Operations*", Section 3475.

   The Section:
   - Provides criteria for classifying assets as held for sale;
   - Requires an asset classified as held for sale to be measured at fair value less cost to sell;
   - Provides criteria for classifying a disposal as a discontinued operation; and,
   - Specifies presentation and disclosures for discontinued operations and other disposals of long-lived assets.

   The Company does not believe that the adoption of this new Section will have a material impact on its consolidated financial statements.

3. Inventories

	2002	2001
Raw materials	**$ 259**	$ 309
Work in progress	**5,594**	5,451
Finished goods	**8,633**	6,266
	$ 14,486	$ 12,026

4. Capital assets

		2002	
	Cost	**Accumulated amortization**	**Net book value**
Machinery and equipment	**$ 48,116**	**$ 23,173**	**$ 24,943**
Computer equipment	**3,502**	**1,905**	**1,597**
Leasehold improvements	**2,780**	**323**	**2,457**
Computer equipment held under capital leases	**1,454**	**812**	**642**
Machinery and equipment held under capital leases	**741**	**62**	**679**
	$ 56,593	**$ 26,275**	**$ 30,318**

4. Capital assets (cont'd)

	2001		
	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 41,000	$ 17,663	$ 23,337
Computer equipment	2,620	1,362	1,258
Leasehold improvements	1,796	76	1,720
Computer equipment held under capital leases	1,250	547	703
	$ 46,666	$ 19,648	$ 27,018

5. Long-term debt

	2002	2001
Term loan of $25.0 million, secured, maturing in May 2008[1]	**$ 24,875**	$ –
Term loan of $15.0 million, secured, maturing in May 2007[2]	**13,500**	–
Revolving term bank loan of $35.0 million, secured, of which the revolving period matures in May 2007[3]	**4,000**	–
Obligations under capital leases maturing at various dates up to November 2007[4]	**1,247**	663
Loans, secured, maturing at various dates up to June 2004[5]	**135**	217
Term loans, secured, repaid in 2002[6]	**–**	69,470
Revolving term bank loan, secured, repaid in 2002[6]	**–**	43,500
	43,757	113,850
Current portion	**3,742**	5,097
	$ 40,015	$ 108,753

(1) Bearing interest at floating rates based on U.S. Base Rate plus 2.00% to 3.50% or LIBOR rate plus 3.00% to 4.50%, at the option of the Company, of which 95% is repaid at maturity, secured by a moveable hypothec on all assets of the Company.

(2) Bearing interest at floating rates based on U.S. Base Rate plus 1.50% to 3.00% or LIBOR rate plus 2.50% to 4.00%, at the option of the Company, repayable in equal annual instalments, secured by a moveable hypothec on all assets of the Company.

(3) Bearing interest at floating rates based on U.S. Base Rate plus 1.50% to 3.00% or LIBOR rate plus 2.50% to 4.00%, at the option of the Company, secured by a moveable hypothec on all assets of the Company.

(4) Bearing interest at rates ranging between 6.91% and 10.57%.

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

(6) On May 9, 2002, the Company used the net proceeds of its Initial Public Offering closed on that date together with the proceeds from its new term loans to repay all its outstanding term and revolving term bank loans under its previous credit facility. A prepayment penalty for the cancellation of the previous credit facility totalling $2.3 million was incurred and recorded as an unusual item (see Note 10). In addition, the Company incurred $2.1 million of expenses to close its new credit facility comprising of fees paid to the lenders at closing and professional fees. These expenses are capitalized and deferred over the term of the new credit facility.

Payments required in each of the next five years to meet the retirement provision of the long-term debt are as follows:

	Obligations under capital leases			Other debt	Total
Years	Minimum payments	Interest	Principal	Principal	principal payments
2003	$ 496	$ 96	$ 400	$ 3,342	$ 3,742
2004	448	61	387	3,293	3,680
2005	168	31	137	3,250	3,387
2006	153	20	133	3,250	3,383
2007	200	10	190	5,625	5,815
Thereafter	–	–	–	23,750	23,750
	$ 1,465	$ 218	$ 1,247	$ 42,510	$ 43,757

6. Capital stock

The capital stock of the Company is as follows:

Authorized

An unlimited number of Common Shares without par value.
An unlimited number of Preferred Shares issuable in series, without par value, non-voting, entitling the holder to receive dividends in priority to the holders of Common Shares as and when declared by the Board of Directors.

Issued and outstanding

	2002		2001	
	Shares	**Book value**	Shares	Book value
Class A Common Shares				
Balance, beginning of period	**19,226,331**	**$ 19,908**	17,718,864	$ 12,408
Converted from Class B	**141,923**	**99**	–	–
Converted from Class C	**155,997**	**69,710**	–	–
Redesignated to Common Shares	**(19,524,251)**	**(89,717)**	–	–
Issued	**–**	**–**	1,507,467	7,500
Balance, end of period	**–**	**–**	19,226,331	19,908
Class B Common Shares				
Balance, beginning of period	**141,923**	**99**	141,923	99
Converted to Class A	**(141,923)**	**(99)**	–	–
Balance, end of period	**–**	**–**	141,923	99
Class C Common Shares				
Balance, beginning of year	**155,997**	**69,710**	155,997	69,710
Converted to Class A	**(155,997)**	**(69,710)**	–	–
Balance, end of year	**–**	**–**	155,997	69,710
Common Shares				
Balance, beginning of period	**–**	**–**	–	–
Redesignated from Class A	**19,524,251**	**89,717**	–	–
Issued pursuant to Initial Public Offering	**7,250,000**	**62,853**	–	–
Issued pursuant to US Employee Plan	**34,110**	**315**	–	–
Issued pursuant to exercise of Stock Options	**72,700**	**178**	–	–
Balance, end of period	**26,881,061**	**153,063**	–	–
Total	**26,881,061**	**$ 153,063**	19,524,251	$ 89,717

Share capital reorganization and Initial Public Offering

On March 20, 2002, the Company amended its articles of incorporation thereby cancelling all the authorized but unissued Class A through Class G preferred shares.

6. Capital stock (cont'd)

On May 9, 2002, immediately prior to the closing of the Initial Public Offering, the Company completed a share capital reorganization whereby:

(i) All holders of the issued and outstanding Class B and Class C common shares converted such shares into Class A common shares on a share for share basis and;

(ii) The Company's articles were amended to:
- (a) Modify certain provisions attached to Class A common shares;
- (b) Subdivide all the issued and outstanding Class A common shares on the basis of 13 Class A common shares for each Class A common share;
- (c) Redesignate the Class A common shares to Common Shares; and
- (d) Cancel all authorized but unissued classes of common shares.

On May 9, 2002, the Company successfully closed its Initial Public Offering. Through this Initial Public Offering, the Company issued 7,250,000 common shares from the treasury at a price of CA$14.50 per share, resulting in gross proceeds of CA$105.1 million or $66.9 million before share issue costs of $4.0 million (net of income taxes of $1.8 million). Concurrently with the Initial Public Offering, the Company issued 34,110 common shares from the treasury at a price of CA$14.50 per share, resulting in net proceeds of CA$0.5 million or $0.3 million.

All share and per share amounts presented herein have been adjusted to reflect the subdivision of shares for all periods presented.

7. Stock-based compensation plans

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

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

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

At December 31, 2002, a total of 6,398,154 common shares remained authorized for issuance under the Company's stock-based compensation plans. Options are exercisable during a period not to exceed ten years after the date of the grant. The right to exercise the options accrues over a period of three years of continuous employment. However, if there is a change of control of the Company, the options become immediately exercisable. Options are adjusted proportionately for any stock dividends or stock splits attributed to the common shares of the Company.

The following table summarizes total stock options outstanding as at December 31 under the Company's Stock Option plans:

	2002		2001	
(in Canadian dollars)	**Number of options**	**Weighted average exercise price**	Number of options	Weighted average exercise price
Options outstanding, beginning of period	**2,578,173**	**$ 3.85**	2,621,983	$ 3.85
Granted	**1,462,629**	**14.60**	101,114	3.85
Exercised	**(72,700)**	**3.85**	–	3.85
Forfeited	**(42,619)**	**12.67**	(144,924)	3.85
Options outstanding, end of period	**3,925,483**	**$ 7.76**	2,578,173	$ 3.85
Options exercisable, end of period	**2,435,676**	**$ 3.85**	–	$ –

7. Stock-based compensation plans (cont'd)

The following table summarizes information about stock options outstanding as at December 31, 2002:

(in Canadian dollars)	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercice price
Range of exercise price					
$ 3.85	**2,498,154**	**6.8**	**$ 3.85**	**2,435,676**	**$ 3.85**
$ 14.50 to $ 18.25	**1,427,329**	**9.4**	**14.61**	**–**	**–**
Total	**3,925,483**	**7.7**	**$ 7.76**	**2,435,676**	**$ 3.85**

All share and per share amounts presented herein have been adjusted to reflect the subdivision of shares for all periods presented.

8. Earnings per share

A reconciliation between basic and diluted earnings per share is as follows:

	2002	2001
Numerator for basic and diluted net income per common share:		
Net income attributable to common shareholders	**$ 20,166**	$ 6,048
Denominator for basic net income per common share:		
Weighted average number of common shares outstanding	**24,261,617**	19,273,020
Basic earnings per share	**$ 0.83**	$ 0.31
Denominator for diluted net income per common share:		
Weighted average number of common shares outstanding	**24,261,617**	–
Plus impact of stock options	**2,205,793**	–
Diluted common shares	**26,467,410**	–
Diluted earnings per share	**$ 0.76**	–

The dilutive effect of outstanding options under the treasury stock method for the fiscal year 2001 could not be determined since the average market price of common shares for the period was not reasonably determinable.

Had compensation cost for the Company's stock-based compensation plan been determined using the fair value method for options granted on or after January 1, 2002, the Company's pro forma consolidated net earnings would have been as follows:

	2002
Net earnings	
As reported	**$ 20,166**
Pro forma	**18,679**
Earnings per share	
As reported - basic	**$ 0.83**
As reported - diluted	**0.76**
Pro forma - basic	**0.77**
Pro forma - diluted	**0.70**

8. Earnings per share (cont'd)

The fair value of the options granted on or after January 1, 2002 was estimated at the date of grant using the Black-Scholes option-pricing model using the following weighted-average assumptions:

Dividend yield	0%
Expected volatility	33%
Risk-free interest rates	5.64%
Expected life	8 years

The weighted average fair value of the options granted during 2002 was CA$7.37.

All share and per share amounts presented herein have been adjusted to reflect the subdivision of shares for all periods presented.

9. Related party transactions

a) Related party transaction adjustment

On November 22, 2002, the Company closed a secondary offering through a filing of a Base PREP Prospectus with the Canadian securities regulatory authorities. The secondary offering qualified the distribution of 6,250,000 common shares (the "Offered Shares") of the Company owned by certain shareholders. The Company did not receive any proceeds from the sale of the Offered Shares. The expenses (other than the Underwriters' fees) of the offering paid by the Company in the amount of approximately $319,000 ($220,000 net of income taxes) were recorded as a related party transaction adjustment reflected as an increase in deficit.

b) Other

During the year, monitoring and consulting fees in the amount of $571,000 ($541,000 in 2001) were charged by certain shareholders of the Company. Accounts payable and accrued liabilities as at December 31, 2002 include an amount of $190,000 ($1,435,000 as at December 31, 2001) payable to certain shareholders of the Company.

10. Unusual items

	2002	2001
Liquidity event award(1)	$ **2,567**	$ –
Cancellation of previous credit facility(2)	**2,309**	–
Charges incurred to settle CCRA's tax audit(3)	**720**	–
Manufacturing facility move	**–**	1,715
Refinancing credit facility	**–**	1,389
Write-off of deferred charges	**–**	229
Others	**220**	383
	$ **5,816**	$ 3,716

(1) The Company granted selected executives and other key employees a Liquidity Event Award that entitles the holder to receive a bonus based upon the occurrence of certain future corporate events ("Liquidity Event"). These future events have been identified as a change in control or a public offering that would result in an active market of at least 25% of Common Stock. The amount of the liquidity bonus would be payable upon the date on which stock options become vested and exercisable pursuant to the Initial Stock Option Plan. On May 9, 2002, the Initial Public Offering constituted a Liquidity Event under the Liquidity Event Award and accordingly, the Company recorded a provision of $2.6 million, of which $2.2 million was paid during 2002.

(2) See Note 5 for a description regarding the cancellation of the previous credit facility.

(3) See Note 11 for a description of the Canada Customs and Revenue Agency's ("CCRA") tax audit and its outcome.

11. Income taxes

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

	2002	2001
Income tax expense at statutory rate	**$ 10,137**	$ 5,229
Manufacturing tax credit	**(927)**	(915)
Non-deductible items	**174**	516
Income tax reduction arising from losses carried forward not previously accounted for	**–**	(156)
Tax provision and other(1)	**(1,756)**	3,502
Income tax expense	**$ 7,628**	$ 8,176

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

	2002	2001
Future income tax assets		
Share issue costs	**$ 1,699**	$ –
Other	**219**	–
	1,918	–
Future income taxes liabilities		
Capital assets	**6,146**	5,480
Tax provision and other(1)	**1,839**	4,841
	7,985	10,321
Future income taxes, net	**$ (6,067)**	$ (10,321)

(1) The 2001 amount includes the non-recurring tax provision in connection with the CCRA's tax audit described below.

c) CCRA's tax audit

During 2002, the Company received a proposal for reassessment from CCRA covering the Company's 1996 to 1999 taxation years, which it accepted. Through this proposal, CCRA disallowed treatment of certain expenses deducted by the Company. Expenses disallowed by CCRA were mostly related to the 1996 re-capitalization transaction. The Company estimates that the total amount of income taxes otherwise payable, including all interest to be accrued following the disallowance of these expenses would total approximately $1.2 million. During 2001, the Company recorded a non-recurring tax provision of $3.0 million in connection with the tax audit performed by CCRA. Accordingly, approximately $1.8 million of the non-recurring tax provision was reversed against earnings as a reduction of income tax expense during 2002.

12. Statement of cash flows

	2002	2001
a) Changes in non-cash operating working capital items:		
Accounts receivable - trade	**$ (13,849)**	$ (4,148)
Accounts receivable - other	**59**	1,068
Inventories	**(2,460)**	(1,507)
Income taxes	**3,379**	226
Prepaid expenses	**(1,111)**	1,921
Accounts payable and accrued liabilities	**6,267**	1,053
Foreign currency translation relating to working capital items	**119**	(1,610)
	(7,596)	$ (2,997)
b) Supplementary information:		
Interest paid	**$ 5,216**	$ 10,434
Income taxes paid	**$ 7,199**	$ 3,856

c) During the year, capital assets were acquired at an aggregate cost of $10,016,000 ($7,948,000 in 2001) of which $947,000 ($398,000 in 2001) were acquired by means of capital leases and which is netted from a government grant of $498,000 ($417,000 in 2001), received for acquisition of capital assets.

13. Financial instruments

Foreign currency risk management

The Company is exposed to market risks attributable to fluctuations in foreign currency exchange rates, primarily changes in the value of the U.S. dollar versus other currencies such as the Canadian dollar, the euro, the British pound and the Mexican peso. Sales are primarily denominated in U.S. dollars while the majority of its expenses are incurred in Canadian dollars.

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

The following table summarizes the Company's foreign currency commitments as at December 31, 2002 and 2001:

Foreign currency contracts		Notional amount	Average exchange rate	Maturing up to	Notional equivalent US $	Fair market value US $
2002	**- US $ to CA $**	**79,500**	**1.5887**	**Dec. 2004**	**77,500**	**77,583**
	- Euro to US $	**18,400**	**1.0074**	**Dec. 2004**	**18,537**	**17,933**
	- Euro to CA $	**6,000**	**1.6489**	**Dec. 2004**	**6,180**	**6,153**
2001	- Euro to US $	5,200	0.9000	August 2002	4,680	4,632

Credit risk

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of trade receivables.

The Company regularly monitors its credit risk exposure and takes steps to mitigate the risk of loss, including obtaining credit insurance. The Company's extension of credit is based on an evaluation of each customer's financial condition and the Company's ability to obtain credit insurance coverage for that customer.

13. Financial instruments (cont'd)

Fair value

The Company has determined that the carrying value of its short-term financial assets and liabilities approximates fair values as at the balance sheet dates because of the short-term maturity of those instruments.

The fair value of the Company's long-term debt approximates its carrying value as the majority of long-term debt bears interest at rates that vary with the LIBOR rate.

Interest rates

The Company is exposed to market risks from changes in interest rates on its long-term debt and does not currently hold any financial instruments that mitigate this risk.

14. Commitments and contingencies

a) Legal proceedings have been initiated by a competitor against the Company which may result in substantial costs and expenses. On May 30, 2002, the Federal Court of Canada, Trial Division dismissed an action against the Company which commenced on December 20, 1996 by Kirkbi AG and LEGO Canada Inc. (collectively referred to as "LEGO"). Through this action, LEGO claimed exclusive rights in the "look" of the knobs on its standard LEGO brick and alleged that the manufacture and sale of the Company's "Micro" MEGA BLOKS construction blocks constituted passing off pursuant to the Trade-marks Act. On June 20, 2002, LEGO filed an appeal to the Federal Court of Appeal. The Company and its outside counsel believe that it is unlikely that Lego's appeal will be successful.

b) The Company is also defending other claims, which arise in the ordinary course of business. The Company believes that the outcome of any individual claim or the aggregate of all such claims will not have a material impact on the Company's business, financial condition and results of operations.

c) The Company has entered into operating leases for premises, which it occupies, for an amount of $25,577,000. The minimum annual rent payable (excluding certain occupancy charges) for each of the next five years, is as follows:

2003	$ 2,616
2004	2,884
2005	2,911
2006	2,914
2007	3,055

d) In connection with an agreement with Investissement Québec, an aggregate amount of CA$3,900,000 will be granted to the Company over a period of three years. This grant is conditional upon acquiring a certain level of capital assets and to the creation and maintenance of a certain level of employment for a period of five years. During the year, the Company received a grant in an amount of $498,000 to acquire certain capital assets which was accounted for as a reduction of capital assets. During 2001, the Company received a grant in an amount of $525,000 to acquire certain capital assets and to create employment. 80% of the grant received in 2001 was accounted for as a reduction of capital assets. The remaining portion of the grant will be recorded in earnings as a reduction of related expenses when conditions are met (see Note 2).

e) As at December 31, 2002, the Company had outstanding letters of guarantee in the amount of $1,161,000 ($1,007,000 in 2001) relating to financial guarantees issued in the normal course of business. These guarantees are issued under standby facilities available to the Company through various financial institutions.

15. Segmented information

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

Major customers and revenue by geographic area:

a) Net sales to the Company's two largest customers amounted to $50.3 million ($35.0 million in 2001) and $33.6 million ($26.0 million in 2001).

b) Net sales were derived from customers located in the following geographic areas:

	2002	2001
Canada	**$ 13,445**	$ 9,708
United States	**118,715**	103,062
International	**56,647**	37,273
	$188,807	$ 150,043

Capital assets by geographic areas are as follows:

	2002	2001
Canada	**$ 30,072**	$ 26,853
International	**246**	165
	$ 30,318	$ 27,018

Directors, officers and senior management

Directors

Victor J. Bertrand
Chairman of the Board
Mega Bloks Inc.

Marc Bertrand
President and Chief Executive Officer
Mega Bloks Inc.

Vic Bertrand
Executive Vice President and Chief Operating Officer
Mega Bloks Inc.

Michel Coutu
President and Chief Executive Officer
Jean Coutu Group (PJC) USA, Inc.

Jean-Guy Desjardins
Chief Executive Officer
Fiera Capital Inc.

David I. Foley
Executive in the Private Equity Group
of The Blackstone Group

Howard A. Lipson
Executive in the Private Equity Group
of The Blackstone Group

Peter T. Main
Former Executive Vice President
Nintendo of America Inc.

Anjan Mukherjee
Executive in the Private Equity Group
of The Blackstone Group

Officers and senior management

Marc Bertrand
President and Chief Executive Officer

Vic Bertrand
Executive Vice President and Chief Operating Officer

Alain Tanguay
Vice President and Chief Financial Officer

Brahm Segal
Vice President Corporate Affairs and Corporate Secretary

Drew Stevenson
Vice President North American Sales

Gerardo Yepez Reyna
Vice President International Sales

Jean-François Albert
Vice President Human Resources

Yvon Barbeau
Vice President Supply Chain

Daniel Bourgeois
Vice President Product Management

Sylvain Duval
Vice President Manufacturing

Alain Pilon
Vice President Product Development & Engineering

Preschool collection

Micro collection

Shareholder information

Headquarters

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Tel.: 514.333.5555
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Listing

The Toronto Stock Exchange
Ticker Symbol: MB

Shares outstanding

26,881,061 Common Shares
(as of December 31, 2002)

Fiscal 2002 trading history

High:	CA$ 24.30
Low:	CA$ 16.00
Close:	CA$ 23.50
Average daily volume:	53,009 shares

Transfer agent

CIBC Mellon Trust Company
1.800.387.0825

Auditors

Deloitte & Touche LLP

Investor relations

For further information about the Company, additional copies of this report or other financial information, please contact:

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You may also contact us by e-mail at **info_invest@megabloks.com** or by visiting our Web site at **www.megabloks.com**.

Annual general meeting of shareholders

Thursday, May 1, 2003 at 10:00 a.m.
Hotel Omni Mont-Royal
Salon des Saisons
1050 Sherbrooke Street West
Montreal, Quebec

This Annual Report is also available on the Internet at **www.megabloks.com**.

Le rapport annuel 2002 de Mega Bloks est également publié en français.

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