MEGA Brands Inc.

Consolidated Financial Statements
December 31, 2012 and 2011
(in thousands of US dollars)

Independent Auditor's Report

To the Shareholders of MEGA Brands Inc.

We have audited the accompanying consolidated financial statements of MEGA Brands Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of MEGA Brands Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP[1]

Montreal, Quebec
February 28, 2013

[1)] FCPA auditor, FCA, public accountancy permit No. A108517

MEGA Brands Inc.

Consolidated Income Statements

For the years ended December 31, 2012 and 2011

(in thousands of US dollars, except per share amounts)

	Note	2012 $	2011 $
Net sales		**420,271**	376,827
Cost of sales		**262,452**	235,649
Gross profit		**157,819**	141,178
Marketing and advertising expenses		**16,937**	17,027
Research and development expenses		**16,218**	14,456
Other selling, distribution and administrative expenses		**87,830**	82,540
Contingent consideration on business acquisition		**383**	994
Loss on foreign currency translation		**576**	1,421
Earnings from operations		**35,875**	24,740
Financial expenses	5	**17,647**	18,666
Loss on settlement of debt	15	**-**	2,984
		17,647	21,650
Earnings before income taxes		**18,228**	3,090
Income taxes			
Current	7	**1,642**	(12,337)
Deferred	7	**-**	7,097
		1,642	(5,240)
Net earnings		**16,586**	8,330
Earnings per share			
Basic	8	**1.01**	0.51
Diluted	8	**0.84**	0.46

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

MEGA Brands Inc.
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2012 and 2011
(in thousands of US dollars, except per share amounts)

	Note	2012 $	2011 $
Net earnings		**16,586**	8,330
Other comprehensive income (loss)			
Cumulative translation adjustment		**1,099**	(1,584)
Other comprehensive income (loss)		**1,099**	(1,584)
Comprehensive income		**17,685**	6,746

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

MEGA Brands Inc.
Consolidated Statements of Financial Position
As at December 31, 2012 and 2011
(in thousands of US dollars)

	Note	December 31, 2012 $	December 31, 2011 $
Assets			
Current assets			
Cash and cash equivalents		**8,018**	6,745
Trade and other receivables	9	**130,541**	126,359
Inventories	11	**45,779**	69,560
Derivative financial instruments	10	**113**	904
Prepaid expenses		**9,370**	13,760
Total current assets		**193,821**	217,328
Non-current assets			
Property, plant and equipment	12	**39,817**	32,172
Intangible assets	13	**22,771**	23,193
Goodwill	13	**30,000**	30,000
Derivative financial instruments	10	**-**	231
Total assets		**286,409**	302,924
Liabilities			
Current liabilities			
Asset-based credit facility	15	**-**	37,279
Trade and other payables	14	**62,638**	71,762
Income taxes payable	7	**5,631**	5,832
Current portion of long-term debt	15	**8,023**	7,013
		76,292	121,886
Non-current liabilities			
Long-term debt	15	**112,992**	105,275
Derivative financial instruments	10	**206**	-
		113,198	105,275
Equity			
Share capital	16	**431,893**	429,007
Warrants	16	**24,029**	24,430
Contributed surplus		**4,478**	3,492
Deficit		**(357,736)**	(374,322)
Accumulated other comprehensive loss		**(5,745)**	(6,844)
Total equity		**96,919**	75,763
Total liabilities and equity		**286,409**	302,924

Commitments and contingencies (Note 21)

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

MEGA Brands Inc.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2012 and 2011

(in thousands of US dollars)

	Note	Share capital	Warrants	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total equity
		$	$	$	$	$	$
Balance – December 31, 2010		429,007	24,430	1,982	(382,652)	(5,260)	67,507
Net earnings		-	-	-	8,330	-	8,330
Other comprehensive loss		-	-	-	-	(1,584)	(1,584)
Stock-based compensation		-	-	1,510	-	-	1,510
Balance – December 31, 2011		429,007	24,430	3,492	(374,322)	(6,844)	75,763
Net earnings		-	-	-	16,586	-	16,586
Other comprehensive income		-	-	-	-	1,099	1,099
Options exercised	17	472	-	(148)			324
Warrants exercised	16	2,414	(401)	-	-	-	2,013
Stock-based compensation		-	-	1,134	-	-	1,134
Balance – December 31, 2012		**431,893**	**24,029**	**4,478**	**(357,736)**	**(5,745)**	**96,919**

Accumulated other comprehensive loss is comprised solely of Cumulative translation adjustment.

MEGA Brands Inc.
Consolidated Statements of Cash Flows
For the years ended December 31, 2012 and 2011
(in thousands of US dollars)

	Note	2012 $	2011 $
Operating activities			
Net earnings		**16,586**	8,330
Adjustments for:			
Depreciation of property, plant and equipment	12	**12,476**	13,074
Amortization of intangible assets	13	**422**	422
Loss on settlement of debt	15	**-**	1,236
Stock-based compensation		**1,134**	1,511
Financial expenses	5	**17,647**	18,666
Writeoff deferred financing costs	15	**-**	1,748
Income taxes	7	**1,642**	(5,240)
Loss (gain) on foreign currency		**2,316**	(374)
		52,223	39,373
Net change in non-cash working capital balances		**14,406**	(24,011)
Income taxes paid (recovered)	7	**(1,473)**	1,312
Interest paid		**(13,158)**	(13,755)
Cash flows provided by operating activities		**51,998**	2,919
Financing activities			
Repayment of debentures	15	**(7,411)**	(20,678)
Change in asset-based credit facility	15	**(37,279)**	37,279
Government loan	15	**6,591**	5,065
Issuance of long-term debt	15	**4,524**	32
Repayment of long-term debt	15	**(220)**	-
Issuance of capital stock	16	**2,337**	-
Cash flows provided by (used in) financing activities		**(31,458)**	21,698
Investing activities			
Acquisition of property, plant and equipment	12	**(19,234)**	(23,248)
Cash flows used in investing activities		**(19,234)**	(23,248)
Effect of changes in foreign exchange rates on cash and cash equivalents		**(33)**	99
Increase in cash and cash equivalents		**1,273**	1,468
Cash and cash equivalents — Beginning of year		**6,745**	5,277
Cash and cash equivalents — End of year		**8,018**	6,745

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

(Column figures are expressed in thousands of US dollars, except per share data.)

1. General information

MEGA Brands Inc. ("MEGA Brands" or the "Corporation") is incorporated under the Canada Business Corporations Act and is listed on the Toronto Stock Exchange. The Corporation's registered and principal office is located at 4505 Hickmore, Montreal, Quebec, Canada H4T 1K4.

The Corporation designs, manufactures and markets a broad line of toys, stationery and activity products. The Corporation sells and distributes its products under the MEGA BLOKS, MEGA PUZZLES, MEGA GAMES, ROSE ART and BOARD DUDES brands.

2. Summary of significant accounting policies

Basis of preparation

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles (''GAAP'') as set forth in Part 1 of the Handbook of the Canadian Institute of Chartered Accountants, which incorporates International Financial Accounting Standards (''IFRS'') as issued by the International Accounting Standards Board.

These consolidated financial statements were approved by the Board of Directors on February 28, 2013.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of choosing and applying the Corporation's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value, including derivative instruments.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries since their date of acquisition.

Subsidiaries are all entities over which the Corporation has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Corporation controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Corporation and they are deconsolidated from the date that control ceases.

The Corporation uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Corporation. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Segments

The Corporation manages its operations under two product segments, Toys and Stationery & Activities.

- The Toys segment is comprised of MEGA BLOKS® construction toys, MEGA PUZZLES® and MEGA GAMES®.
- The Stationery & Activities segment is comprised of ROSE ART® art materials and craft and activity sets, BOARD DUDES® presentation boards and accessories, and writing instruments.

These operating segments are reported in a manner consistent with the internal reporting provided to the chief decision-maker. The Corporation's Chief Executive Officer is the chief decision-maker, and is responsible for making strategic decisions, allocating resources and assessing the performance of the operating segments.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Foreign currency translation

a) Functional and presentation currency

IAS 21, *''Effects of Changes in Foreign Currency Rates''*, requires entities to consider primary and secondary indicators when determining the functional currency. Primary indicators are closely linked to the primary economic environment in which the entity operates and are given more weight. Secondary indicators provide supporting evidence to determine an entity's functional currency.

Once the functional currency of an entity is determined, it should be used consistently, unless significant changes in economic facts, events and conditions indicate that the functional currency has changed.

The functional currency of MEGA Brands Inc. is the Canadian dollar; however, the consolidated financial statements are presented in US dollars which in the opinion of management remains the most appropriate presentation currency in view of its operations in the global marketplace, user needs and comparison with its major competitors.

b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statement of comprehensive income.

Foreign exchange gains and losses are presented in the consolidated income statement within ''loss (gain) on foreign currency translation''.

c) Entities of the Corporation

The results and financial position of all entities of the Corporation that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

(iii) all resulting exchange differences are recognized in other comprehensive income.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

c) Entities of the Corporation (cont'd)

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and borrowings and other currency instruments designated as hedges of such investments, are recorded in other comprehensive income. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognized in the consolidated income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Equity is translated at the historical rate.

Revenue recognition

Revenues are recognized at the fair value of the consideration received or receivable, net of allowances used to promote products.

Revenues from sales of products to clients whose terms of sale are collect and free on board (FOB) shipping point are recognized when the goods leave the Corporation's premises. For clients whose terms of sale are FOB destination, revenues are recognized when the goods are delivered to clients.

In addition, all of the following conditions must be met to recognize revenues from product sales:

- The Corporation has transferred the significant risks and rewards of ownership of the goods to the buyer;
- The Corporation retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of the sale can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the Corporation; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Vendor allowance

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 income statements and financial position.

Self-insurance

The Corporation is primarily self-insured for MAGNETIX products manufactured before May 1, 2006 and against certain product-related incidents occurring on or after December 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.

Research and development expenses

Research expenses are charged to earnings net of related tax credits. Unless development expenditures meet criteria for deferral, they are charged to earnings, net of related tax credits.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Financial expenses

Financial expenses are comprised of interest expense on borrowings, amortization of transaction costs incurred in conjunction with debt transactions and accretion of interest on debentures. All borrowing costs are recognized in earnings on an accrual basis using the effective interest method. The Corporation's financial income is not significant.

Financial instruments

Financial assets and financial liabilities are recognized when the Corporation becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Corporation has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Corporation classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

a) Financial instruments at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorized as held for trading. Assets in this category are classified as current assets if expected to be settled within twelve months; otherwise, they are classified as non-current.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated income statement.

The Corporation uses derivatives in the form of forward exchange contracts to manage risks related to foreign currency. All derivatives have been classified as held for trading, are included in the consolidated statement of financial position within derivative financial instruments, and are classified as current or non-current based on the contractual terms specific to the instrument.

Gains or losses arising from changes in the fair value are presented in the consolidated income statement within ''Loss (gain) on foreign currency translation'' in the year in which they arise.

b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than twelve months after the end of the reporting period. These are classified as non-current assets. The Corporation's loans and receivables comprise ''cash and cash equivalents'' and ''trade and other receivables'' in the consolidated statement of financial position. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Financial instruments (cont'd)

c) Financial liabilities at amortized cost

Financial liabilities at amortized cost include asset-based credit facility, trade and other payables, accrued liabilities and long-term debt. Trade payables and accrued liabilities are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables and accrued liabilities are measured at amortized cost using the effective interest method. Long-term debt is recognized initially at fair value, net of any transaction costs incurred, and subsequently measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

The following is a summary of the Corporation's categories of financial instruments:

Financial instrument	Category	Measurement
Cash and cash equivalents	Loans and receivables	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Trade and other payables	Financial liabilities at amortized cost	Amortized cost
Derivative financial instruments	At fair value through profit and loss	Fair value
Asset-based credit facility	Financial liabilities at amortized cost	Amortized cost
Long-term debt	Financial liabilities at amortized cost	Amortized cost

Impairment of financial assets

At each reporting date, the Corporation assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Corporation recognizes an impairment loss for financial assets carried at amortized cost as follows: the loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Share capital

Common shares granted as compensation for goods and services are classified as equity. Incremental costs directly attributable to the issuance of new shares or warrants are shown in equity as a deduction, net of tax, from the proceeds.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Common shares outstanding

On June 10, 2010, the Corporation's shareholders approved a share consolidation on the basis of one post-consolidation common share for every 10 to 20 pre-consolidation shares prior to June 11, 2011. On June 10, 2011, the Corporation completed the consolidation on the basis of one post-consolidation common share for every 20 pre-consolidation shares. Consequently, the weighted average number of shares outstanding and related earnings per share information, the number of common shares and options, as well as the conversion ratio and price per common share associated with the Corporation's outstanding warrants, were adjusted retroactively to give effect to the consolidation.

Share-based payments

The Corporation has a stock-based compensation plan whereby it grants stock options to certain employees. Each tranche in an award is considered a separate award with its own grant date fair value and vesting period. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period based on the number of awards expected to vest, by increasing contributed surplus. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

The Corporation has a share unit plan, which became effective February 24, 2005, which allows the Board of Directors to grant bonuses in the form of share units that are time- and performance-based, vesting 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 and are revalued at the end of each period with the (gain) loss included in ''other selling, distribution and administrative expenses'' in the consolidated income statement. The share units are expensed and credited to liabilities under cash-settled share-based payments over the vesting period.

On March 29, 2007, the Corporation adopted a deferred share unit plan for its independent directors. The share units are accounted for as liabilities on a fair value basis by using the quoted market price of the common shares and are revalued at the end of each period with the (gain) loss included in ''other selling, distribution and administrative expenses'' in the consolidated income statement. The deferred share units are expensed and credited to liabilities under cash-settled share-based payments over the vesting period.

Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net earnings for the period by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options is computed using the treasury stock method. The dilutive effect of warrants whose proceeds from exercise must be used to retire debentures is determined by assuming that the proceeds from exercise are applied to purchase the debt at its average market price rather than to purchase common shares under the treasury stock method. The treasury stock method is applied, however, to any excess of the proceeds received from the assumed exercise over the amount used for the assumed purchase of debt. Interest, net of tax, on any debt assumed to be purchased is added back as an adjustment to the numerator. The Corporation's potentially dilutive common shares comprise stock options granted to employees, and warrants.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Cash and cash equivalents

Cash and cash equivalents consist of cash and highly-liquid investments with original terms to maturity of 90 days or less, at the date of purchase.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value, and subsequently measured at amortized cost, less provision for impairment.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is established based on the first-in, first-out method and, as appropriate, includes material, labour and manufacturing overhead costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Corporation and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated income statement during the period in which they are incurred.

The major categories of property, plant and equipment are depreciated on a straight-line basis as follows:

Buildings	25 years
Machinery and equipment	3 to 15 years
Computer equipment	3 to 5 years
Leasehold improvements	over the lease terms

Residual values, the method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within ''cost of sales'' or ''other selling, distribution and administrative expenses'' in the consolidated income statement.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Government grants

Government grants are recognized only when the Corporation has reasonable assurance that it meets the conditions and will receive the grants. Government grants related to assets, including interest free loans, are recognized in the consolidated statement of financial position as a deduction from the carrying amount of the related asset. They are then recognized in profit or loss over the useful life of the depreciable asset that the grants were used to acquire, as a deduction from the depreciation expense. Other government grants are recognized in profit or loss as a deduction from the related expenses.

Intangible assets

Intangible assets with a finite service life are accounted for at cost less accumulated amortization and impairments. They consist of customer relationships which are amortized over twenty years. Intangible assets with an indefinite service life, consisting of trade names, are accounted for at cost and are carried at cost less accumulated impairment losses.

Goodwill

Goodwill represents the excess of the purchase consideration of businesses over the fair value of the identifiable net assets acquired and is carried at cost less accumulated impairment losses. Goodwill is tested for impairment annually on December 31 or more frequently if changes in circumstances indicate a potential impairment. Impairment losses on goodwill are not reversed.

Impairment of non-financial assets

Assets that are subject to amortization are reviewed for impairment by management whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or ''CGUs''). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

Goodwill and trade names are not subject to amortization and are tested annually for impairment. Goodwill acquired through a business combination is allocated to CGUs or group of CGUs that are expected to benefit from the related business combination. A group of CGUs represents the lowest level within the entity at which the goodwill is monitored for internal management purposes, which is not higher than an operating segment.

Leases

Leases are classified as finance leases when the lease arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Gains and losses on sale and operating leaseback transactions are recognized immediately in the income statement when it is clear that the transactions are established at fair value. If the sale price is below fair value, any loss is recognized immediately except that, if the loss is compensated for by future lease payments at below market price, it is deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the gain is deferred and amortized over the period for which the asset is expected to be used. In the context of sale and finance leaseback transactions, any gain on the sale is deferred and amortized over the lease term.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Current and deferred income tax

The tax expense for the year comprises current and deferred tax. Tax is recognized in the consolidated income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

The current income tax charge and any adjustment to tax payable/receivable in respect of previous years are calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Corporation and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities and prior year settlements.

Deferred income tax is recognized using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the date of financial position and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Taxes on income in interim periods are accrued using the tax rate that will be applicable to expected total annual profit and loss.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Provisions

Provisions are recognized when: the group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

Accounting standards issued but not yet applied

Unless otherwise noted, the following revised standards and amendments, which are relevant but have not yet been adopted by the Corporation, are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Corporation has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

(i) IFRS 9, *Financial Instruments,* was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement* for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

    Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39 except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income. IFRS 9 is applicable for annual periods beginning on or after January 1, 2015.

(ii) IAS 1*, Presentation of Financial Statements*, has been amended to require entities to separate items presented in Other Comprehensive Income into two groups, based on whether or not items may be recycled in the future. Entities that choose to present Other Comprehensive Income items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012.

(iii) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces *SIC-12, Consolidation – Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*. The amendment is effective for annual periods beginning on or after January 1, 2013.

(Column figures are expressed in thousands of US dollars, except per share data.)

2. Summary of significant accounting policies (cont'd)

Accounting standards issued but not yet applied (cont'd)

(iv) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities. The amendment is effective for annual periods beginning on or after January 1, 2013.

(v) IFRS 13*, Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures. The amendment is effective for annual periods beginning on or after January 1, 2013.

(Column figures are expressed in thousands of US dollars, except per share data.)

3. Critical accounting estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. These estimates and associated assumptions are based on historical experience, future operating plans and various other factors believed to be reasonable under the circumstances, and the results of such estimates form the basis of judgments about carrying values of assets and liabilities. These underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements relate to the following:

Estimates

a) Sales allowances

Sales allowances for customer promotions, discounts and returns are recorded as a reduction of revenue when the related revenue is recognized. Revenue from product sales is recognized upon passing of title to the customer, generally at the time of shipment. Revenue from product sales, less related sales allowances, is reflected as net sales in the consolidated income statements. The Corporation routinely commits to promotional sales allowance programs with customers. These allowances primarily relate to fixed programs, which the customer earns based on purchases of the Corporation's products during the year. Discounts and allowances are recorded as a reduction of related revenue at the time of sale. While many of the allowances are based on fixed amounts, certain of the allowances, such as the returns allowance, are based on market data, historical trends and information from customers, and are therefore subject to estimation.

For its allowance programs that are not fixed, such as returns, the Corporation estimates these amounts using a combination of historical experience and current market conditions. These estimates are reviewed periodically against actual results and any adjustments are recorded at that time as an increase or decrease to net sales. During 2012, there have been no material adjustments to the Corporation's estimates made in prior years.

b) Allowance for doubtful accounts

The Corporation's allowance for doubtful accounts is based on management's assessment of the business environment, customers' financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectability of specific customer accounts. If there were a deterioration of a major customer's creditworthiness, or actual defaults were higher than the Corporation's historical experience, estimates of the recoverability of amounts due could be overstated, which could have an adverse impact on operating results. The allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in depth reviews are performed based on changes in customer's financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects.

(Column figures are expressed in thousands of US dollars, except per share data.)

3. Critical accounting estimates and judgments (cont'd)

c) Reserve for inventory obsolescence

The Corporation values inventory at the lower of cost or net realizable value. Based upon a consideration of quantities on hand, actual and projected sales volume, anticipated product selling prices and product lines planned to be discontinued, slow-moving and obsolete inventory is written down to its net realizable value. Failure to accurately predict and respond to consumer demand could result in the Corporation under producing popular items or overproducing less popular items.

Furthermore, significant changes in demand for the Corporation's products would impact management's estimates in establishing its inventory provision.

Management estimates are monitored on a quarterly basis and a further adjustment to reduce inventory to its net realizable value is recorded, as an increase to cost of sales, when deemed necessary under the lower of cost or net realizable value.

d) Impairment of non-financial assets

Non-financial assets with finite lives are tested for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In addition, non-financial assets that are not amortized are subject to an annual impairment assessment. Any impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount in earnings of continuing or discontinued operations, as appropriate. The Corporation evaluates impairment losses for potential reversals, other than goodwill impairment, when events or changes in circumstances warrant such consideration. See note 13 for further discussion on key assumptions used in the determination of recoverable amounts of non-financial assets.

Judgement

Income taxes

The Corporation is subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes, including the probability of recovery of deferred tax assets. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Corporation recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the year in which such determination is made.

(Column figures are expressed in thousands of US dollars, except per share data.)

4. Employee benefit expense

	2012	2011
	$	$
Wages and salaries (including bonuses)	**88,120**	78,003
Stock-based compensation	**1,134**	1,511
Termination benefits	**487**	898
	89,741	80,412

5. Financial expenses

	2012	2011
	$	$
Interest on secured debentures	14,789	15,894
Interest on asset-based credit facility	1,432	1,078
Amortization of deferred financing costs	811	823
Others	615	871
Financial expenses	17,647	18,666

6. Seasonal nature of business

Historically, the Corporation has observed a higher level of activity and better results during the last two quarters of the year compared to the first two quarters.

(Column figures are expressed in thousands of US dollars, except per share data.)

7. Income taxes

a) Income tax expense

	2012	2011
	$	$
Current tax		
Current year	**496**	159
Prior year	**1,146**	(12,496)
	1,642	(12,337)
Deferred tax	**-**	7,097
Income tax expense (recovery)	**1,642**	(5,240)

The tax on the Corporation’s profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	2012	2011
	$	$
Earnings before income taxes	**18,228**	3,090
Canadian statutory tax rate	**26.90%**	28.05%
Income tax expense at Canadian statutory tax rate	**4,903**	867
Benefits arising from financing structures	**(1,455)**	(2,119)
Effects of foreign tax rate differences	**246**	1,603
Write-down of deferred tax asset	**152**	7,097
North America tax recovery attributes	**(4,341)**	(4,150)
International operations recovery	**-**	(9,396)
Others	**2,137**	858
Income tax expense (recovery)	**1,642**	(5,240)

The applicable statutory tax rates are 26.9% in 2012 and 28.05% in 2011. The Corporation’s applicable tax rate is the combined rate applicable in the jurisdictions in which the Corporation operates.

(Column figures are expressed in thousands of US dollars, except per share data.)

7. Income taxes (cont'd)

b) Deferred income tax

Deferred income tax assets are recognized to the extent that the realization of the related tax benefit is probable. In addition to the unused losses and tax credits disclosed below, the Corporation has not recognized deferred income tax assets for: $17.3 million (2011 – $21.3 million) related to interest deduction carryforwards, $15.5 million (2011 – $23.9 million) related to goodwill, $9.9 million (2011 – $9.6 million) related to property, plant and equipment and intangibles, $2.3 million (2011 – $5.5 million) related to share issue costs and $3.0 million (2011 – $4.1 million) related to other temporary differences.

The Corporation has accumulated operating loss carryforwards mainly for Canadian federal, Quebec provincial, United States and Swiss tax purposes, which are available to reduce future taxable income. These operating loss carryforwards expire as follows:

	Canada		**United States**	**Switzerland**	**Total**
	Federal	**Quebec**			
Year	**$**	**$**	**$**	**$**	**$**
2014	-	-	-	50,433	50,433
2015	-	-	-	138,963	138,963
2016	-	-	-	6,868	6,868
2017	-	-	-	14,092	14,092
2018	-	-	-	9,283	9,283
2019	-	-	-	1,768	1,768
2026	-	-	24,162	-	24,162
2027	-	-	2,055	-	2,055
2028	-	-	1,061	-	1,061
2029	32,025	34,243	3,049	-	69,318
2030	16,755	17,708	2,667	-	37,129
2031	-	-	7,849	-	7,849
2032	13,401	14,415	8,968	-	36,784
2033	-	-	2,055	-	2,055
2034	-	-	2,055	-	2,055
2035	-	-	2,055	-	2,055
	62,181	66,365	55,978	221,407	405,931

In addition, the Corporation has net capital losses in Canada of approximately $116.0 million (2011 – $113.2 million) which have not been recognized as deferred tax assets.

The Corporation has approximately $3.1 million in scientific research and experimental development expenditures available for federal tax purposes and $2.5 million for Quebec tax purposes that are available to reduce taxable income in future years and have an unlimited carryforward period. The Corporation did not recognize deferred income tax assets in respect of these scientific research and experimental development expenditures.

(Column figures are expressed in thousands of US dollars, except per share data.)

7. Income taxes (cont'd)

b) Deferred income tax (cont'd)

Finally, the non-recoverable portion of federal investment tax credits may be applied against future income taxes payable. The tax benefit arising from such tax credits has not been reflected in the consolidated financial statements as at December 31, 2012. These investment tax credits expire as follows:

Year	Total $
2022	176
2023	187
2024	107
2025	327
2026	-
2027	196
2029	69
2031	328
2032	400
	1,789

8. Earnings per share

Basic earnings per common share is calculated by dividing the net earnings attributable by the weighted average number of outstanding common shares in issue during the year.

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares.

	2012	2011
Numerator for basic net earnings per common share		
Net earnings attributable to common shareholders	$ 16,586	$ 8,330
Denominator for basic net earnings per common share		
Weighted average number of outstanding common shares	16,388,212	16,363,570
Basic earnings per share	$ 1.01	$ 0.51
Numerator for diluted net earnings per common share		
Net earnings attributable to common shares	$ 16,586	$ 8,330
Plus: Impact of repurchase of debentures	$ 7,402	$ 4,890
	$ 23,988	$ 13,220
Denominator for diluted net earnings per common share		
Weighted average number of outstanding common shares	16,388,212	16,363,570
Plus: Impact of stock options	510	111,826
Plus: Impact of warrants	12,176,899	12,192,200
	28,565,621	28,667,596
Diluted earnings per share	$ 0.84	$ 0.46

1,456,376 options (2011 – 1,117,039) have been excluded from the calculation of diluted earnings per share because they are anti-dilutive.

Diluted earnings per share for 2011 has been revised.

(Column figures are expressed in thousands of US dollars, except per share data.)

9. Trade and other receivables

	2012	2011
	$	$
Trade	125,617	121,730
Less: Allowance for doubtful accounts	(4,882)	(5,073)
	120,735	116,657
Other	9,806	9,702
	130,541	126,359

	2012	2011
	$	$
Allowance for doubtful accounts, beginning of year	**(5,073)**	(4,640)
Additions	**(1,190)**	(885)
Amounts charged off	**804**	(2)
Unused amounts reversed	**613**	368
Exchange differences	**(36)**	86
Allowance for doubtful accounts, end of year	**(4,882)**	(5,073)

The aging analysis of trade receivables is as follows:

	2012	2011
	$	$
Current	92,672	88,744
Past due up to 3 months	27,600	27,661
Past due over 3 months	463	252
	120,735	116,657

As at December 31, 2012, trade receivables and other classes within trade and other receivables do not contain impaired assets. The Corporation does not hold any collateral as security.

(Column figures are expressed in thousands of US dollars, except per share data.)

9. Trade and other receivables (cont'd)

The carrying amounts of the Corporation's trade and other receivables are denominated in the following currencies:

Currency (in thousands of US dollars)	**2012** **$**	**2011** **$**
US dollar	72,865	66,588
Mexican Pesos	20,527	20,651
CA$	14,673	14,291
Euros	11,363	11,793
British pound	8,011	9,803
Australian dollar	3,102	3,234
	130,541	126,359

Included in other accounts receivable is $2.3 million of insurance recoveries related to a minor fire at the Corporation's Montreal facility on November 19, 2012. This amount relates primarily to damaged in-process inventory as well as certain restoration and clean-up costs. The Corporation has received partial settlements of $3 million as at December 31, 2012, and $2.5 million subsequent to year-end. The Corporation is working with its insurer to finalize the claim in the first half of 2013. Any proceeds received over and above the manufacturing costs of inventory will relate to lost profits on the inventory as stipulated in the Corporation's insurance policy and will be recognized in income at such time.

10. Derivative financial instruments

	December 31, 2012		**December 31, 2011**	
	Assets	**Liabilities**	**Assets**	**Liabilities**
	$	**$**	**$**	**$**
Forward foreign exchange contracts	113	206	1,135	-
Less: Current portion	113	-	904	-
Total non-current derivatives	-	206	231	-

(Column figures are expressed in thousands of US dollars, except per share data.)

11. Inventories

	2012	2011
	$	$
Raw materials and supplies	2,345	5,246
Work in progress	10,222	16,370
Finished goods	33,212	47,944
	45,779	69,560

As at December 31, 2012, the Corporation had provided for writedowns of inventories of $1.9 million (2011 – $3.2 million).

The cost of inventories recognized as an expense in 2012 included in cost of sales amounts to $229.8 million (2011 – $211.3 million).

(Column figures are expressed in thousands of US dollars, except per share data.)

12. Property, plant and equipment

	Buildings	Machinery and equipment	Computer equipment	Leasehold improvements	Total
	$	$	$	$	$
For the year ended December 31, 2011					
Opening net book amount	12	18,773	1,974	742	21,501
Additions [1)]	-	20,893	1,427	928	23,248
Depreciation for the year	2	11,260	989	823	13,074
Exchange differences	-	421	40	36	497
Closing net book amount	10	28,827	2,452	883	32,172
As at December 31, 2011					
Cost	19	88,080	6,613	9,134	103,846
Accumulated depreciation	9	59,253	4,161	8,251	71,674
Net book amount	10	28,827	2,452	883	32,172
For the year ended December 31, 2012					
Opening net book amount	10	28,827	2,452	883	32,172
Additions [1)]	7	17,695	978	554	19,234
Depreciation for the year	2	11,204	945	325	12,476
Exchange differences	-	751	71	64	886
Closing net book amount	16	36,069	2,556	1,176	39,817
As at December 31, 2012					
Cost	26	110,844	8,070	10,002	128,942
Accumulated depreciation	9	74,775	5,515	8,826	89,125
Net book amount	17	36,069	2,555	1,176	39,817

[1)] Net additions to property, plant and equipment in 2012 include an amount of $1.9 million (2011 - $1.5 million) of government grants.

The Corporation leases various computer equipment and machinery and equipment under non-cancellable finance leases. The lease terms are between one and six years.

(Column figures are expressed in thousands of US dollars, except per share data.)

13. Intangible assets and goodwill

	Trade names*	Customer relationships	Goodwill	Total
	$	$	$	$
For the year ended December 31, 2011				
Opening net book amount	17,250	6,365	30,000	53,615
Depreciation for the year	-	422	-	422
Closing net book amount	17,250	5,943	30,000	53,193
As at December 31, 2011				
Cost	17,250	8,530	30,000	56,990
Accumulated depreciation	-	2,587	-	3,797
Net book amount	17,250	5,943	30,000	53,193
For the year ended December 31, 2012				
Opening net book amount	17,250	5,943	30,000	53,193
Depreciation for the year	-	422	-	422
Closing net book amount	17,250	5,521	30,000	52,771
As at December 31, 2012				
Cost	17,250	8,530	30,000	55,780
Accumulated depreciation	-	3,009	-	3,009
Net book amount	17,250	5,521	30,000	52,771

*Unamortized intangible asset with indefinite service life

(Column figures are expressed in thousands of US dollars, except per share data.)

13. Intangible assets and goodwill (cont'd)

Impairment tests for goodwill

Goodwill is tested at least annually for impairment. The Corporation performed its impairment test as at December 31, 2012. For the purpose of impairment testing, goodwill is tested for impairment at the CGU level. In assessing the goodwill for impairment, the Corporation compares the aggregate recoverable amount, based on the value-in-use of the Toys CGU to its carrying value. If the carrying value exceeds the recoverable amount, an impairment charge is recognized to the extent that the carrying value exceeds the recoverable amount.

The recoverable amount of the Toys CGU has been determined based on pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The growth rate does not exceed the long-term average growth rate for the toy business in which the CGU operates.

The key assumptions used for value-in-use calculations are as follows:

- Discount rate 15.0% (2011: 15.0%)
- Terminal year growth rate 3.0% (2011: 3.0%)
- Year-over-year revenue growth 5.0% (2011: 5.0%)

Management determined budgeted gross margin based on past performance and its expectations of market developments. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the relevant CGU.

No impairment charge has arisen as a result of the review performed as at December 31, 2012 and 2011. Reasonably possible changes in key assumptions would not cause the recoverable amount of CGU to fall below the carrying value.

Impairment tests for indefinite-lived intangible assets

An annual impairment review is conducted on all intangible assets that have an indefinite life. The Corporation performed its impairment test as at December 31, 2012. The ROSE ART master brand and trademark and the BOARD DUDES brand name are considered to have an indefinite life. The impairment review is carried out at the individual asset level. A summary of the allocation of the indefinite-lived intangible assets is presented below.

- ROSE ART master brand and trademark $14.0 million (2011: $14.0 million)
- BOARD DUDES brand name $3.3 million (2011: $3.3 million)

(Column figures are expressed in thousands of US dollars, except per share data.)

13. Intangible assets and goodwill (cont'd)

Impairment tests for indefinite-lived intangible assets (cont'd)

The recoverable amount has been determined using a discounted royalty cash flow model, using the following key assumptions:

- ROSE ART master brand and trademark
  - Discount rate 15.5% (2011: 14.0%)
  - Royalty rate 4.0% (2011: 4.0%)
  - Terminal year growth rate 2.5% (2011: 2.5%)
  - Year-over-year revenue growth 5.0% (2011: 5.0%)

- BOARD DUDES brand name
  - Discount rate 15.5% (2011: 15.5%)
  - Royalty rate 2.0% (2011: 2.0%)
  - Terminal year growth rate 2.0% (2011: 2.0%)
  - Year-over-year revenue growth 2.0% (2011: 2.0%)

The estimated value of the ROSE ART and BOARD DUDE brands is $21.7 million and $4.9 million, respectively, and therefore exceeds their respective carrying values.

To monitor potential exposure, the Corporation performs a sensitivity analysis. A 10% change in either discount rate or royalty rate would not cause the recoverable amount to fall below the carrying value.

14. Trade and other payables

	2012	2011
	$	$
Trade payables	**32,925**	45,644
Accrued liabilities	**29,713**	26,118
	62,638	71,762

(Column figures are expressed in thousands of US dollars, except per share data.)

15. Long-term debt

	As at December 31, 2012	As at December 31, 2011
	$	$
Secured debentures a)	**107,916**	109,513
Government loans, secured, maturing in March 2018 and July 2022 b)	**8,803**	3,627
Finance lease obligations, maturing up to November 2018 c)	**4,500**	144
	121,219	113,284
Less: Unamortized deferred financing cost	**204**	996
	121,015	112,288
Less: Current portion of long-term debt	**8,023**	7,013
	112,992	105,275

a) In 2010, the Corporation issued secured debentures for a principal amount of CA$141.7 million. The debentures are denominated in Canadian dollars and bear interest at a rate of 10% per annum, payable semi-annually in arrears on June 30 and December 31 in each year until the maturity date in 2015.

The debentures are direct senior obligations of the Corporation and have a first ranking security interest in the debenture priority collateral and a second ranking security interest in the Corporation's asset-based credit facility priority collateral.

b) In 2011, the Corporation received a grant from the Government of Canada in the form of a non-interest bearing long-term obligation in the amount of CA$5.0 million. This loan is repayable in five consecutive equal payments beginning in April 2014. The initial fair value of this debt was CA$3.5 million. An amount of CA$1.5 million was credited to property, plant and equipment.

In 2012, the Corporation received a grant from a provincial authority in the form of a non-interest bearing long-term obligation in the amount of CA$6.6 million, repayable in 60 consecutive equal payments beginning in August 2017. The initial fair value of this debt was CA$4.7 million. An amount of CA$1.9 million was credited to property, plant and equipment. This loan is secured by a first-ranking security on specific production molds.

c) In 2012, the Corporation entered into a capital lease financing agreement with GE Capital in the amount of $4.5 million, repayable in 72 equal monthly payments until November 2018. The financing is denominated in US dollars and bears interest at a rate of 4.33% per annum.

(Column figures are expressed in thousands of US dollars, except per share data.)

15. Long-term debt (cont'd)

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

Year	Finance Lease Obligations			Government loans	Secured debentures	Total principal repayment
	Minimum payment	Interest	Principal			
	$	$	$	$	$	$
December 31, 2013	890	180	710	-	7,122	7,832
December 31, 2014	884	149	735	998	14,245	15,978
December 31, 2015	880	117	763	998	93,856	95,617
December 31, 2016	878	89	789	998	-	1,787
December 31, 2017	853	44	809	1,220	-	2,029
More than five years	708	14	694	7,411	-	8,105
	5,093	**593**	**4,500**	**11,625**	**115,223**	**131,348**

Covenants

The secured debentures do not contain any financial covenants but the Corporation needs to respect certain non-financial covenants. As at December 31, 2012, the Corporation was in compliance with all covenants.

Asset-based credit facility

On March 30, 2010, the Corporation entered into an asset-based credit facility (''ABL'') with a term of 36 months and maximum borrowings of up to $45 million. In the second quarter of 2011, the Corporation amended the terms of this facility to increase availability to $55 million and extended the duration by one year to December 31, 2014. Under the terms of the ABL, the Corporation is not subject to financial covenants. However, the ABL credit agreement contains certain non-financial covenants. As at December 31, 2012, the amount outstanding under this facility was nil and the Corporation was in compliance with all covenants. The interest rate on this facility is prime +1-1.5% and Libor 2.25-2.75%.

The obligations under the ABL are secured by: (i) a first priority security interest in all of the credit parties' present and future accounts and receivables, (other than receivables whose account debtors are located outside of Canada and the United States that are sold or financed under the additional revolving facilities), inventory, deposit accounts and investment property, and all present and future general intangibles, chattel paper, documents, instruments, supporting obligations, letters of credit, letter of credit rights and other assets relating to the accounts and receivables, inventory, deposit accounts and investment property, and all products and proceeds thereof; and (ii) a second priority security interest upon all of the credit parties' present and future real property, leasehold interest in real property, substantially all of the equipment and other fixed assets related to the real property, any stock or other equity or ownership interests in the subsidiaries and affiliates of each credit party, and all products and proceeds thereof.

International financing

On March 31, 2012, the Corporation entered into a financing agreement for a two-year term of up to 10 million euros. The agreement contains certain non-financial covenants. As at December 31, 2012, the Corporation had drawn 0.1 million euros under this agreement and was in compliance with all covenants. The interest rate on this facility is Euribor +1.85%.

(Column figures are expressed in thousands of US dollars, except per share data.)

16. Capital stock and warrants

Capital

Authorized
An unlimited number of common shares without par value

Issued and outstanding

	December 31, 2012		December 31, 2011	
	Number of shares	Amount $	Number of shares	Amount $
Balance - Beginning of year	**16,363,570**	**429,007**	16,363,570	429,007
Options exercised	**35,813**	**472**	-	-
Warrants exercised	**200,000**	**2,414**	-	-
Shares consolidation adjustment	**90**	**-**	-	-
Balance - End of year	**16,599,473**	**431,893**	16,363,570	429,007

Share consolidation

On June 10, 2010, the Corporation's shareholders approved a share consolidation on the basis of one (1) post-consolidation common share for every 10 to 20 pre-consolidation shares prior to June 11, 2011. On June 10, 2011, the Corporation completed the consolidation on the basis one (1) post-consolidation common share for every 20 pre-consolidation shares. Consequently, the weighted average number of shares outstanding and related earnings per share information, the number of common shares and options, as well as the conversion ratio and price per common share associated with the Corporation's outstanding warrants, were adjusted retroactively to give effect to the consolidation.

Warrants

In 2010, the Corporation issued 243,844,000 warrants exercisable at a price of CA$0.50 each, with each warrant entitling the holder to purchase one common share until their expiry on March 30, 2015. Subsequent to a share consolidation completed in the second quarter of 2011, the number of warrants outstanding did not change. However, on a post-consolidation basis, warrant holders are entitled to purchase one common share for every 20 warrants at a price of CA$9.94 per common share. The exercise price of the warrants was adjusted pursuant to the terms of the warrant indenture which required the adjustment in case of potential dilution for the warrant holders. The proceeds from the exercise of the warrants are contractually restricted and will be used to repurchase the Corporation's outstanding debentures.

In 2012, 4,000,000 warrants were exercised for $2.4 million. Of this amount, $0.4 million was reclassified from the warrant proceeds to share capital. As at December 31, 2012, there were 239,844,000 warrants outstanding.

(Column figures are expressed in thousands of US dollars, except per share data.)

17. Stock options, share unit plan and deferred share unit plan

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

The following table summarizes total stock options outstanding and exercisable under the Corporation's stock option plan:

(in Canadian dollars)	December 31, 2012		December 31, 2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
		CA$		CA$
Options outstanding, beginning of year	**1,228,865**	**20.78**	1,159,271	21.69
Granted	**433,577**	**9.54**	107,379	9.19
Exercised	**(35,813)**	**8.94**	-	-
Forfeited[1)]	**(169,743)**	**92.71**	(37,785)	15.96
Options outstanding, end of year	**1,456,886**	**9.34**	1,228,865	20.78
Options exercisable, end of year	**389,458**	**9.45**	264,892	63.22

1) As options reach term, any unexercised options are forfeited at such date.

(in Canadian dollars)

	Options Outstanding			Options Exercisable	
Range of exercice price	Number oustanding	Weighted average remaining contractual life in years	Weighted average exercise price	Number oustanding	Weighted average exercise price
CA$			CA$		CA$
7.35	16,541	6.6	7.35	-	-
7.97	27,944	8.6	7.97	5,589	7.97
9.00	885,181	7.3	9.00	354,072	9.00
9.25	54,384	8.9	9.25	10,877	9.25
9.63	417,036	4.9	9.63	-	-
11.40	17,975	8.3	11.40	3,595	11.40
12.00	37,500	7.9	12.00	15,000	12.00
365.00 to 513.00	325	0.1	398.29	325	398.29
	1,456,886	6.7	9.34	389,458	9.45

(Column figures are expressed in thousands of US dollars, except per share data.)

17. Stock options, share unit plan and deferred share unit plan (cont'd)

On July 31, 2012, the Corporation granted an aggregate of 16,541 options exercisable at $7.35. These options vest over the first five years following the date of grant, at a rate of 20% per year and all expire on July 31, 2019.

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.36%
Expected option life	6 years
Expected volatility	50.49%
Expected dividends	Nil

The fair value of each option granted was CA$3.57.

On November 6, 2012, the Corporation granted an aggregate of 416,667 options exercisable at $9.63. These options vest over the first three years following the date of grant at a rate of 33% per year, and all expire on November 6, 2017.

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.37%
Expected option life	5 years
Expected volatility	45.7%
Expected dividends	Nil

The fair value of each option granted was CA$3.97.

The Corporation also granted an aggregate of 369 options exercisable at $9.63. These options vest over the first five years following the date of grant at a rate of 20% per year, and all expire on November 6, 2019.

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.53%
Expected option life	6 years
Expected volatility	42.7%
Expected dividends	Nil

The fair value of each option granted was CA$4.11.

(Column figures are expressed in thousands of US dollars, except per share data.)

17. Stock options, share unit plan and deferred share unit plan (cont'd)

b) The Corporation's share unit plan (the "Share Plan"), approved on February 24, 2005 and subsequently amended, allows the Board of Directors to grant bonuses in the form of restricted share units to officers and other key employees of the Corporation and its subsidiaries. Restricted share units may be time- and/or performance-vesting, and will generally vest no later than during the third calendar year following the date of grant. The plan is non-dilutive, and restricted share units are 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 and exercisable under the Corporation's share unit plan:

	December 31, 2012	December 31, 2011
Share units outstanding, beginning of year	**310,688**	207,746
Granted	**271,170**	224,231
Exercised	**(97,019)**	(53,706)
Forfeited	**(93,278)**	(67,583)
Share units outstanding, end of year	**391,561**	310,688

On April 12, 2012, the Corporation granted 271,170 restricted share units ("RSUs") to certain senior management and key employees under the Share Plan. The grant-date fair value was CA$6.25 and the RSUs vest one-third each year. An amount of $2.3 million is payable on December 31, 2012 (2011: $1.2 million).

c) The Corporation adopted a deferred share unit plan (the "DSU Plan") for its non-employee directors on March 29, 2007. The DSU Plan is intended to align the interests of such directors with those of the Corporation's shareholders. An amount of $0.8 million is payable on December 31, 2012 (2011: $0.4 million).

Under the DSU Plan, each non-employee director may elect to receive up to 100% of his or her retainer fees, payable on a quarterly basis, in the form of deferred share units ("DSUs"). The number of DSUs credited to each non-employee director, as of the last day of each fiscal quarter of the Corporation, is determined by dividing a) the amount of deferred remuneration payable to such director in respect of such quarter by b) the weighted average trading price of the Common Shares on the TSX for the three trading days immediately preceding the last day of each fiscal quarter of the Corporation. In compliance with the share ownership guidelines established by the Board, until a non-employee director has reached said ownership guidelines, at least 50% of the director's basic annual Board retainer fee shall be paid in DSUs (or such lesser percentage which may be necessary to reach the share ownership guidelines). DSUs will be redeemable, and the value thereof payable, only after the director ceases to act as a director of the Corporation.

The following table summarizes the DSU Plan:

	December 31, 2012	December 31, 2011
Deferred units outstanding, beginning of year	**71,394**	58,948
Granted	**17,840**	21,023
Exercised	**-**	(8,577)
Deferred units outstanding, end of year	**89,234**	71,394

(Column figures are expressed in thousands of US dollars, except per share data.)

18. Note to consolidated statement of cash flows

Changes in working capital items

	2012	2011
	$	$
Trade and other receivables	**(4,182)**	(3,165)
Inventories	**23,781**	(18,425)
Prepaid expenses	**4,390**	(2,721)
Trade and other payables	**(9,124)**	9,138
Foreign currency translation relating to working capital items	**(459)**	(8,838)
	14,406	(24,011)

19. Financial risk management

Financial risk factors

The Corporation is exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives for growth. The main objectives of the Corporation's risk management process are to ensure that risks are properly identified and that the capital base is adequate in relation to these risks. The principal financial risks to which the Corporation is exposed are described below.

a) Liquidity risk

Liquidity risk is the risk that the Corporation is not able to meet its financial obligations as they fall due or can only do so at excessive cost. The Corporation manages this risk by maintaining detailed cash forecasts and long-term operating and strategic plans. The management of consolidated liquidity requires a constant monitoring of expected cash inflows and outflows which is achieved through a detailed forecast of the Corporation’s consolidated liquidity position to ensure adequacy and efficient use of cash resources. The adequacy of liquidity is assessed in view of seasonal needs and the maturity profile of indebtedness. The Corporation monitors potential financing opportunities on an ongoing basis to maintain adequate financial flexibility.

(Column figures are expressed in thousands of US dollars, except per share data.)

19. Financial risk management (cont'd)

a) Liquidity risk (cont'd)

The following are the contractual commitments of the financial liabilities as at December 31, 2012:

	Carrying amount	Contractual cash flows	Less than one year	Between one and three years	Between four and five years	More than five years
	$	$	$	$	$	$
Trade and other payables	62,638	62,638	62,638	-	-	-
Government loans	8,803	11,625	-	1,996	2,218	7,411
Secured debentures	107,914	138,300	18,111	120,189	-	-
Foreign currency forward contracts	206	206	-	206	-	-
Finance lease obligations	4,500	5,093	890	1,764	1,731	708
	184,061	**217,862**	**81,639**	**124,155**	**3,949**	**8,119**

b) Market risk

i) Foreign exchange risk

The Corporation is exposed to market risks attributable to fluctuations in foreign exchange rates, primarily changes in the value of the US dollar versus the euro and British pound sterling for its international operations and the variation of the Canadian dollar to the US dollar for its Canadian operations. The Corporation's policy is to stabilize earnings by limiting foreign currency exposure mainly through foreign currency forward contracts. The Corporation's risk management approach is to have hedging mechanisms in place for a maximum period of 24 months. The Corporation's hedging policy strictly prohibits speculative foreign exchange transactions. The Corporation only enters into forward contracts with acceptable credit profile financial counterparties.

The following table presents a summary of the Corporation's foreign currency commitments as at December 31, 2012:

Foreign currency contracts		**Notional amount**	**Average exchange rate**	**Maturing up to**	**Notional equivalent**	**Fair market value**
(in thousands of US dollars)		$			$	$
Sell	- US$ to CA$	6,500	1.0265	December 2013	6,672	(190)
	- Euro to US$	14,400	1.3165	December 2014	18,958	102
	- GBP to US$	7,200	1.5972	December 2014	11,500	181

(Column figures are expressed in thousands of US dollars, except per share data.)

19. Financial risk management (cont'd)

i) Foreign exchange risk (cont'd)

The following table details the Corporation's sensitivity to a 10% strengthening of the Canadian dollar, euro, British pound sterling and Mexican peso, which management believes is reasonably possible, on net earnings and equity against the US dollar. This sensitivity analysis relates to foreign currency-denominated financial instruments and adjusts their translation at period-end for a 10% change in foreign exchange rates.

	Year ended December 31, 2012	
Currency	**Earnings**	**Equity**
	$	$
CA$	-	(10,328)
Euro	1,097	
GBP	970	-
MXN	-	2,196

ii) Interest rate risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation is exposed to interest rate risk resulting from fluctuations in interest rates on cash and cash equivalents that earn interest at market rates, as well as on the asset-based credit facility (ABL) that fluctuates according to interest rates. As at December 31, 2012, the amount outstanding under the ABL was nil and Corporation was not subject to any significant interest rate risk.

The Corporation does not use derivative instruments to reduce its exposure to interest rate risk. The Corporation manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the necessary liquidity to conduct its day-to-day operations.

c) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Corporation reduces its credit risks arising from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions by dealing with large financial institutions.

The Corporation's receivables consist of invoices to customers net of provisions for chargebacks for customer-related programs. This risk is reduced through the analysis of the financial position of its customers and the regular review of their credit limits, and by taking steps to mitigate the risk of loss by obtaining credit insurance. The top three customers accounted for 25%, 17% and 10% of total net sales in 2012 (2011 – 21%, 17% and 10%). Due to the geographic diversity of its customers and its procedures for the management of commercial risks, the Corporation believes there is no particular concentration of credit risk.

(Column figures are expressed in thousands of US dollars, except per share data.)

19. Financial risk management (cont'd)

Fair value estimates

The Corporation has determined that the carrying value of its short-term financial assets and financial liabilities approximates fair value as at the balance sheet date because of the short-term maturity of those instruments. The fair value of the Corporation's debentures approximates $123.3 million and bears interest at a fixed rate. The fair value of the interest-free government loans approximates $11.6 million.

The fair value, determined by quoted prices in an active market, of the Corporation's long-term debt is different from its carrying value.

The fair value hierarchy under which the Corporation's financial instruments are valued is as follows:

- Level 1 - quoted market prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 - unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The following table summarizes the fair value hierarchy under which the Corporation's financial instruments are valued as at December 31, 2012:

	Level 1	Level 2	Level 3	Total
	$	$	$	$
Instruments measured at fair value				
Foreign currency forward contracts	-	(93)	-	(93)
	-	(93)	-	(93)

(Column figures are expressed in thousands of US dollars, except per share data.)

19. Financial risk management (cont'd)

Capital risk management

Capital is defined as long-term debt net of cash and cash equivalents, capital stock, contributed surplus, warrants and deficit. The Corporation's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns to shareholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain the capital structure, the Corporation may issue new shares or sell assets to reduce debt. It may also induce the conversion of its issued and outstanding warrants.

The following table summarizes certain information with respect to the Corporation's capital structure at the end of each indicated period:

	As at December 31, 2012	As at December 31, 2011
	$	$
Cash and cash equivalents	**(8,018)**	(6,745)
Long-term debt, including current portion	**121,015**	112,288
	112,997	105,543
Equity, excluding accumulated other comprehensive loss	**102,664**	82,607
Total capital	**215,661**	188,150

(Column figures are expressed in thousands of US dollars, except per share data.)

20. Compensation of key management

Key management includes the members of the Corporation's Board of directors and members of senior management including and above the title of vice-president. Compensation awarded to key management included:

	2012	2011
	$	$
Salaries and other short-term employee benefits	**8,296**	3,708
Share-based compensation	**2,186**	1,039
	10,482	4,747

21. Commitments and contingencies

The Corporation has entered into operating leases for premises which it occupies and royalty commitments totaling $28.6 million. The minimum annual payment for each of the next five years and thereafter is as follows:

	$
2013	11,599
2014	9,096
2015	6,392
2016	1,149
2017	320
Thereafter	-
	28,556

As at December 31, 2012, the Corporation had outstanding letters of guarantee totaling $0.5 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 asset-based credit facility (note 15).

The Corporation is party to certain legal proceedings, as well as certain asserted and unasserted claims that arise in the normal course of business. In addition, the Corporation is subject to compliance requirements and audit by various levels of government authorities in the normal course of operations. Amounts accrued, as well as the total amount of reasonably possible losses with respect to such matters, individually and in the aggregate, are not deemed to be material to the consolidated financial statements.

As at December 31, 2012, an amount of $0.6 million (2011 - $4.8 million) was accrued as a provision for litigation. The Corporation paid an amount of $3.8 million for settlements in 2012. No additional provisions were required and the Corporation reversed an amount of $0.4 million.

(Column figures are expressed in thousands of US dollars, except per share data.)

22. Segmented information

Product segments	**2012**	2011
	$	**$**
Net sales		
Toys	**315,540**	280,493
Stationery and activities	**104,731**	96,334
	420,271	376,827
Earnings from operations		
Toys	**33,774**	24,263
Stationery and activities	**2,101**	477
	35,875	24,740

Geographic segments		
	$	$
Net sales		
North America[1]	**291,360**	242,664
International	**128,911**	134,163
	420,271	376,827
Earnings from operations		
North America	**26,614**	13,526
International	**9,261**	11,214
	35,875	24,740
Amortization of property, plant and equipment and intangible assets		
North America	**12,271**	12,742
International	**627**	754
	12,898	13,496
Property, plant and equipment, intangible assets, and goodwill		
North America[2]	**69,121**	61,945
International	**23,467**	23,420
	92,588	85,365

[1] Includes net sales for Canada of $28.8 million in 2012 (2011 - $28.4 million)
[2] Includes property, plant and equipment for Canada in 2012 of $37.2 million (2011 - $30.0 million).