



**MEGA BRANDS ANNOUNCES SECOND QUARTER 2008 RESULTS,  
CLOSING OF CA\$75 MILLION FINANCING AND \$9.3 MILLION INSURANCE RECOVERY**

**Montreal, August 19, 2008** – MEGA Brands Inc. (TSX: MB) (the “Corporation”) today announces its financial results for the second quarter and six-month periods ended June 30, 2008.

Concurrently, the Corporation announces the closing of a private placement offering of senior unsecured convertible debentures for gross proceeds of CA\$75 million. The proceeds of the offering, combined with amendments to the Corporation’s senior secured credit facilities, provide the Corporation with the financial resources and flexibility to meet working capital requirements leading up to the peak toy selling season and to continue the implementation of its Value Enhancement Plan.

The Corporation also announces that, subsequent to the closing of the second quarter financial statements, it has reached an agreement in principle with its insurers for the recovery of an additional \$9.3 million related to the settlement of lawsuits for magnet ingestion. The Corporation expects to receive payment shortly and to record this amount in its third quarter results. This insurance payment will bring the total recovery to \$12.9 million, nearly the full amount of the \$13.5 million settlement paid by the Corporation in 2006.

“Looking ahead, the next two quarters are traditionally the strongest in our business and our objective is to restore profitability,” stated Marc Bertrand, President and CEO of MEGA Brands. “This year’s new product launches are occurring in the third and fourth quarters and we are well positioned to build sales momentum through the balance of the year.”

**Second Quarter 2008 Results**

Net sales in the second quarter of 2008 decreased 12.4% to \$106.4 million compared to \$121.5 million in the corresponding period last year. This decrease reflects lower sales in the Toys and Stationery and Activities product lines as well as additional product recall charges.

Net sales of our Toys product lines declined to \$47.3 million compared to \$57.9 million in the second quarter of 2007. This decrease is due mainly to lower shipments of licensed toys in the Boys 5-plus category, offsetting increased sales of preschool construction toys. In the second quarter of 2007, the Corporation experienced strong sales of licensed products based on two major theatrical releases, Disney’s “Pirates of the Caribbean: At World’s End” and Marvel’s “Spider-Man 3”. The decrease in sales also reflects \$2.5 million of additional product recall charges related to MAGTASTIK and MAGNAMAN.

Net sales of Stationery and Activities product lines declined to \$59.1 million compared to \$63.6 million in the second quarter of 2007. This decrease is explained mainly by lower shipments of lower-margin children’s activity products which have been discontinued under the Corporation’s SKU rationalization program.

On a geographical basis, net sales in North America decreased to \$71.1 million compared to \$87.1 million in the second quarter of 2007. International net sales increased to \$35.3 million compared to \$34.3 million in the second quarter of 2007. International net sales accounted for 33.1% of total net sales in the second quarter of 2008 compared to 28.3% in the corresponding 2007 period.

Cost of sales was \$71.6 million compared to \$74.2 million in the second quarter of 2007. The Corporation continued to experience higher input costs and cost of sales also reflects the underutilization of its manufacturing facilities in Montreal and China.

Gross profit was \$34.8 million compared to \$47.3 million in the second quarter of 2007. Gross margin declined to 32.7% compared to 38.9% in the second quarter of 2007, mainly as a result of higher costs, unfavorable product mix due to lower sales of construction toys in the Boys 5-plus category as well as additional product recall charges.

Marketing and advertising expenses increased to \$5.3 million compared to \$4.5 million in the second quarter of 2007. This increase reflects higher advertising spending in International markets.

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Research and development expenses decreased to \$3.9 million compared to \$6.4 million in the second quarter of 2007. This decrease reflects mainly a reduction in third-party services, the completion of upfront R&D work for the new MagNext product line and cost savings resulting from the Corporation's SKU rationalization program.

Other selling, distribution and administrative expenses decreased to \$26.0 million compared to \$28.2 million in the second quarter of 2007. This decrease reflects mainly a reduction in administrative expenses as well as lower warehousing costs offset by higher direct distribution costs. The Corporation recorded integration charges of \$0.9 million during the period relating to the centralization of distribution activities in North America.

As a result of the above, loss from operations was \$2.4 million compared to earnings from operations of \$8.7 million in the second quarter of 2007.

Total interest expense was \$1.3 million compared to \$6.7 million in the second quarter of 2007. Interest on long-term debt and other interest declined to \$6.2 million compared to \$6.5 million in the second quarter of 2007, reflecting lower indebtedness. During the second quarter of 2008, the Corporation recorded a change in fair value of \$5.6 million related to the interest rate swap on part of its Term B credit facility.

Income tax recovery was \$0.1 million compared to a recovery of \$1.9 million in the second quarter of 2007. The tax rate used to establish the income tax expense for the quarterly results is the applicable estimated effective rate of each entity of the group. The effective tax rate reflects the Corporation's structure for tax purposes as well as the financing structure put in place following the acquisition of MEGA Brands America.

Net loss was \$3.6 million or \$0.10 diluted loss per share compared to net earnings of \$4.0 million or \$0.12 diluted earnings per share in the second quarter of 2007.

### **Recent Developments**

On August 18, 2008, the Corporation executed a sixth amending agreement (the "Sixth Amendment") to its Credit Agreement dated July 26, 2005 providing for certain changes to the terms and conditions of its senior secured Credit Facilities maturing in 2012, including a waiver of the cumulative minimum EBIDTA ratio covenant for the period ended June 30, 2008. Additionally, the Sixth Amendment introduces the concept of a new definition of the calculation of EBIDTA allowing for the add-back of certain non-recurring and non-cash items. The covenant includes a minimum EBITDA at the end of each quarter up to and including June 30, 2010, at which point more stringent covenants previously in place under the Credit Agreement become effective. The revolving credit facility has been reduced to \$100 million.

On August 18, 2008, the Corporation announced the closing of a private placement offering of senior unsecured convertible debentures for gross proceeds of CA\$75 million. The proceeds of the Offering will be used as working capital and for general corporate purposes. The debentures, maturing on August 31, 2013, will bear interest at a rate of 8% payable semi-annually in arrears and will be convertible at the option of the holder at any time prior to the maturity date based on a conversion price equal to approximately CA\$3.19 per common share, subject to customary anti-dilution adjustments. The debentures will be convertible into 23,512,500 common shares, representing 39% of the common shares of the Corporation on an as converted basis. The debentures were issued to Fairfax Financial Holdings Ltd., Chiefswood Holdings Limited, The Owners Fund and Victor J. Bertrand Sr., the founder and chairman of the board of directors of the Corporation, with Fairfax investing CA\$64 million and Mr. Bertrand investing \$7 million in the offering. This financing was undertaken by the Corporation in connection with its consideration of its strategic alternatives, including the sale of its Stationery and Activities business. The financing was approved by the Toronto Stock Exchange and required certain amendments to the Corporation's credit facilities which were agreed to by the lenders.

### **MD&A Filing**

The Corporation's Management's Discussion and Analysis for the second quarter ended June 30, 2008 was filed with SEDAR on August 18, 2008 and will be available on the Corporation's Web site as of 7:00 a.m. August 19, 2008.

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**Conference Call**

An analyst conference call will be held at 9:00 a.m. on August 19, 2008 to discuss the results. Participants may listen to the call by dialing 1 (800) 814-4862. For those unable to participate, a replay will be available until August 26, 2008. The replay phone number is 1 (416) 640-1917, access code 21278141#.

**About MEGA Brands**

MEGA Brands is a trusted family of leading global brands in construction toys, games & puzzles, arts & crafts and stationery. They offer engaging creative experiences for children and families through innovative, well-designed, affordable and high-quality products that deliver on our Creativity to the Rescue promise. Visit <http://www.megabrands.com> for more information.

The MEGA logo, Creativity to the Rescue, Mega Bloks, Rose Art, MagNext and Board Dudes are trademarks of MEGA Brands Inc. or its affiliates.

**Forward-Looking Statements**

All statements in this press release that do not directly and exclusively relate to historical facts constitute "forward-looking statements". These statements represent the Corporation's intentions, plans, expectations and beliefs. In certain instances, these statements require us to make assumptions and there is significant risk that these assumptions may not be correct. Furthermore, these statements are subject to risks, uncertainties and other factors, many of which are beyond the Corporation's control. The Corporation disclaims any intention or obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by applicable legislation. Readers are cautioned not to place undue reliance on these forward-looking statements. More information about the risks that could cause our actual results to significantly differ from our current expectations can be found in the "Risks and Uncertainties" section of our 2007 annual MD&A as well as Q1 and Q2 2008 MD&A.

-30-

**ANALYSTS AND INVESTORS:**

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## Consolidated statements of earnings

(in thousands of US dollars, except per share data)  
(Unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>Net sales</b>	<b>106,385</b>	121,486	<b>185,777</b>	211,592
Cost of sales	<b>71,630</b>	74,196	<b>123,219</b>	154,951
Gross profit	<b>34,755</b>	47,290	<b>62,558</b>	56,641
Marketing and advertising expenses	<b>5,294</b>	4,464	<b>9,245</b>	10,771
Research and development expenses	<b>3,856</b>	6,428	<b>8,406</b>	11,685
Other selling, distribution and administrative expenses	<b>26,008</b>	28,246	<b>53,566</b>	56,298
Voluntary product recall and replacement	-	-	-	4,700
Litigation expenses	<b>2,311</b>	1,501	<b>3,453</b>	2,313
Product liability settlement and related expenses	-	(1,000)	-	(1,000)
Loss (gain) on foreign currency translation	<b>(336)</b>	(1,027)	<b>1,019</b>	(1,458)
Earnings (loss) from operations	<b>(2,378)</b>	8,678	<b>(13,131)</b>	(26,668)
Interest expense				
Interest on long-term debt	<b>6,158</b>	6,502	<b>11,429</b>	12,549
Change in fair value of interest rate swap	<b>(5,578)</b>	-	<b>(5,578)</b>	-
Amortization of deferred financing costs	<b>874</b>	122	<b>1,814</b>	292
Other interest	<b>(172)</b>	40	<b>18</b>	(54)
	<b>1,282</b>	6,664	<b>7,683</b>	12,787
Earnings (loss) before income taxes	<b>(3,660)</b>	2,014	<b>(20,814)</b>	(39,455)
Income taxes				
Current	<b>393</b>	(342)	<b>1,314</b>	(1,768)
Future	<b>(481)</b>	(1,606)	<b>(8,908)</b>	(17,739)
	<b>(88)</b>	(1,948)	<b>(7,594)</b>	(19,507)
<b>Net earnings (loss)</b>	<b>(3,572)</b>	3,962	<b>(13,220)</b>	(19,948)
Earnings (loss) per share				
Basic	<b>(0.10)</b>	0.12	<b>(0.36)</b>	(0.61)
Diluted <sup>(1)</sup>	<b>(0.10)</b>	0.12	<b>(0.36)</b>	(0.61)

<sup>(1)</sup> The dilutive effect of outstanding options under the treasury stock method for the three-month period ended June 30, 2008 and for the six-month periods ended June 30, 2007 and June 30, 2008 is nil as it is anti-dilutive.



## Consolidated statements of deficit

(in thousands of US dollars)

(Unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>Balance, beginning of period</b>	<b>(94,148)</b>	(11,274)	<b>(84,500)</b>	12,636
Net earnings (loss)	<b>(3,572)</b>	3,962	<b>(13,220)</b>	(19,948)
<b>Balance, end of period</b>	<b>(97,720)</b>	(7,312)	<b>(97,720)</b>	(7,312)

## Consolidated statements of comprehensive income (loss) and Accumulated other comprehensive income (loss)

(in thousands of US dollars)

(Unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>Net earnings (loss) for the period</b>	<b>(3,572)</b>	3,962	<b>(13,220)</b>	(19,948)
<b>Other comprehensive income (loss), net of income taxes</b>				
Gain (loss) on derivatives designated as cash flow hedges	<b>356</b>	1,915	<b>(3,552)</b>	1,399
Comprehensive income (loss) for the period	<b>(3,216)</b>	5,877	<b>(16,772)</b>	(18,549)
<b>Accumulated other comprehensive income (loss)</b>				
Balance, beginning of period	<b>(6,173)</b>	1,235	<b>(2,265)</b>	-
Impact of adopting the new accounting policy regarding financial instruments, net of income taxes	-	-	-	1,751
Other comprehensive income (loss), net of income taxes	<b>356</b>	1,915	<b>(3,552)</b>	1,399
<b>Balance, end of period</b>	<b>(5,817)</b>	3,150	<b>(5,817)</b>	3,150



## Consolidated balance sheets

(in thousands of US dollars)

	June 30, 2008 (Unaudited)	December 31, 2007 (Audited)	June 30, 2007 (Unaudited)
	\$	\$	\$
<b>Assets</b>			
Current assets			
Cash and cash equivalents	7,728	8,505	4,603
Accounts receivable	122,760	125,784	131,092
Inventories	112,236	91,681	162,566
Income taxes	9,902	8,219	9,234
Future income taxes	3,986	4,286	8,064
Derivative financial instruments	-	306	-
Prepaid expenses	21,991	19,650	11,506
	<b>278,603</b>	<b>258,431</b>	<b>327,065</b>
Property, plant and equipment	43,239	42,620	48,199
Intangible assets	74,274	74,606	79,149
Goodwill	298,938	298,938	301,988
Derivative financial instruments	-	-	5,089
Future income taxes	49,086	35,119	47,210
	<b>744,140</b>	<b>709,714</b>	<b>808,700</b>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities	112,289	136,592	112,229
Additional consideration accrued on business combination	54,775	54,775	58,642
Derivative financial instruments	1,682	-	535
Current portion of long-term debt	5,521	8,303	8,861
	<b>174,267</b>	<b>199,670</b>	<b>180,267</b>
Long-term debt	325,328	252,441	364,279
Derivative financial instruments	4,260	3,659	-
Future income taxes	34,587	31,550	30,693
	<b>538,442</b>	<b>487,320</b>	<b>575,239</b>
<b>Shareholders' equity</b>			
Capital stock	308,677	308,601	237,071
Contributed surplus	558	558	552
Deficit	(97,720)	(84,500)	(7,312)
Accumulated other comprehensive income (loss) net of income taxes	(5,817)	(2,265)	3,150
	<b>205,698</b>	<b>222,394</b>	<b>233,461</b>
	<b>744,140</b>	<b>709,714</b>	<b>808,700</b>



## Consolidated statements of cash flows

(in thousands of US dollars)

(Unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>Cash flows from operating activities</b>				
Net earnings (loss)	(3,572)	3,962	(13,220)	(19,948)
Items not affecting cash and cash equivalents				
Amortization of property, plant and equipment	3,853	3,389	7,460	6,409
Amortization of intangible assets	166	183	332	368
Stock-based compensation plans	(203)	25	(632)	(100)
Future income taxes	(481)	(1,606)	(8,908)	(17,739)
Gain on disposal of property, plant and equipment	-	(20)	-	(240)
Loss on foreign currency	245	246	890	383
	8	6,179	(14,078)	(30,867)
Changes in non-cash operating working capital items	(13,075)	(45,740)	(43,244)	(32,215)
	(13,067)	(39,561)	(57,322)	(63,082)
<b>Cash flows from financing activities</b>				
Repayment of long-term debt	(2,312)	(2,330)	(4,665)	(4,719)
Change in revolving credit facility	26,500	45,800	75,000	69,000
Amortization of deferred financing costs	875	122	1,815	292
Amortization of comprehensive loss on interest rate swap	575	-	575	-
Unrealized gain on derivative financial instruments related to interest rate swap	(6,153)	-	(6,153)	-
Addition to deferred financing costs	-	-	(2,666)	-
Issuance of capital stock	-	72	76	774
	19,485	43,664	63,982	65,347
<b>Cash flows from investing activities</b>				
Acquisition of property, plant and equipment	(2,763)	(5,540)	(7,437)	(11,776)
Proceeds from disposal of property, plant and equipment	-	-	-	798
Business combinations	-	-	-	(342)
	(2,763)	(5,540)	(7,437)	(11,320)
Increase (decrease) in cash and cash equivalents	3,655	(1,437)	(777)	(9,055)
Cash and cash equivalents, beginning of period	4,073	6,040	8,505	13,658
<b>Cash and cash equivalents, end of period</b>	<b>7,728</b>	<b>4,603</b>	<b>7,728</b>	<b>4,603</b>
Supplementary disclosure of cash flow information				
Interest paid	2,538	6,143	8,231	12,531
Income taxes paid (recovered)	2,863	1,908	2,553	(2,094)
Non cash item				
Property, plant and equipment acquired by means of capital leases	-	-	622	-