ENVOY COMMUNICATIONS GROUP INC
Form 20-F
February 18, 2004

As filed with the Securities and Exchange Commission on February 17, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

o Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934

OR

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended September 30, 2003

OR

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________to ____________

Commission file number 0-30082

ENVOY COMMUNICATIONS GROUP INC.

(Exact name of Registrant as specified in its charter)

(Translation of Registrant s name into English)
Ontario, Canada

(Jurisdiction of incorporation or organization)
172 John Street, Toronto, Ontario, Canada M5T 1X5

(Address of principal executive offices)
Securities registered or to be registered pursuant to Section 12(b) of the Act: None

Securities registered or to be registered pursuant to Section 12(g) of the Act.

COMMON SHARES

(Title of Class)
The Nasdaq Small Cap Market

(Name of each exchange on which registered)
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: At September 30, 2003 there were 31,047,027 common shares outstanding.

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark which financial statement item the Registrant has elected to follow: Item 17 x Item 18 o

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Item 1. PART I

Item 1. IDENTIFY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLES

Not applicable

Item 3. KEY INFORMATION

A. Selected Financial Data

The following table sets forth in Canadian dollars selected financial data for Envoy for the fiscal years indicated below prepared in accordance with Canadian Generally Accepted Accounting Principles unless otherwise noted. The following selected financial data should be read in conjunction with the more detailed financial statements and the related notes thereto appearing elsewhere in this Form 20-F and the discussion under Item 5 Operating and Analysis of Financial Condition and Results of Operation herein. The selected financial data does not include statements of operations data or balance sheet data of any acquired operations prior to their respective acquisition effective dates.

	Fiscal Years Ended September 30,				
	2003[2]	**2002[3]**	**2001[4]**	**2000[5]**	**1999[6]**
	(all amounts in thousands, except per share data)				
Statement of Operations Data:					
Net Revenue	$42,427	$ 59,121	$ 82,786	$ 60,790	$41,787
Earnings (loss) before unusual items, gain on closure of subsidiaries, restructuring costs, income taxes, goodwill amortization and write-down	18	(6,503)	3,393	7,757	5,490
Net Earnings[7]	2,539	(53,379)	(2,895)	2,910	2,877
Net Earnings Per Share[7] Basic	$ 0.12	($2.54)	($0.14)	$ 0.15	$ 0.20
Net Earnings Per Share[7] Diluted	$ 0.09	($2.54)	($0.14)	$ 0.15	$ 0.20

1 The financial statements of Envoy are prepared in accordance with Canadian Generally Accepted Accounting Principles (Canadian GAAP), which differs in certain significant respects from U.S. Generally Accepted Accounting Principles (U.S. GAAP). Reconciliation to U.S. GAAP is set forth in Note 22 to the Notes to the audited Financial Statements of Envoy. The following would be the adjustments to the information provided above as an increase (decrease) to: Net Revenue 2003 ($3,387), 2002 ($15,825), 2001 ($34,683); Earnings (loss) before unusual items, gain on closure of subsidiaries, restructuring costs, income taxes, goodwill amortization and write-down 2003 ($1,508), 2002 $1,554, 2001 ($6,676); Net earnings 2003 $67, 2002 $3, 2001 ($935); Net Earnings per share basic 2003 $nil, 2002 $nil, 2001 ($0.04); Net earnings per share - diluted 2003 $0.03, 2002 $nil, 2001 ($0.04).

	Fiscal Years Ended September 30,				
	2003	2002	2001	2000	1999
	(all amounts in thousands)				
Balance Sheet Data:					
Current Assets	$ 18,228	$ 27,447	$ 51,138	$ 43,337	$ 44,521
Total Assets	37,351	49,174	113,850	102,308	75,748
Total Debt[8]	11,425	14,003	11,928	10,832	3,978
Shareholders Equity[9]	12,359	9,779	61,319	62,687	40,612
Retained Earnings[10]	(45,091)	(47,630)	5,603	8,403	5,493

2 The exchange rate utilized with respect to the Statement of Operations Data for the year ended September 30, 2003 of Watt Gilchrist Limited (Gilchrist) is £1.00 to $2.3425 Cdn. and with respect to the Balance Sheet Data of Gilchrist is £1.00 to $2.2448 Cdn. The exchange rate utilized with respect to the Statement of Operations Data of US activities is $1.00 U.S. to $1.4635 Cdn. and with respect to the Balance Sheet Data of US activities is $1.00 U.S. to $1.3499 Cdn. Except as set forth in footnotes 4, 5 and 6, no other acquisitions by Envoy materially affect the comparability of the information in the Selected Financial Data. During fiscal 2003, Envoy disposed of a number of subsidiaries including Sage Information Consultants Inc. Sage , Devlin Multimedia Inc. (Devlin) and Hampel Stefanides Inc. (Hampel) as described in Notes 14 and 15 to the consolidated financial statements.

3 The exchange rate utilized with respect to the Statement of Operations Data for the year ended September 30, 2002 of Gilchrist is £1.00 to $2.3119 Cdn. and with respect to the Balance Sheet Data of Gilchrist is £1.00 to $2.4894 Cdn. The exchange rate utilized with respect to the Statement of Operations Data of Hampel is $1.00 U.S. to $1.5731 Cdn. and with respect to the Balance Sheet Data of Hampel is $1.00 U.S. to $1.5872 Cdn. Except as set forth in footnotes 4, 5 and 6, no other acquisitions by Envoy materially affects the comparability of the information in the Selected Financial Data.

4 The Statement of Operations Data for the year ended September 30, 2001 includes the results of operations of The International Design Group (IDG), acquired effective as of January 1, 2001, for the nine month period from January 1, 2001 to September 30, 2001. See Item 4 Information on the Company for a description of this acquisition. The exchange rate utilized with respect to the Statement of Operations Data of Gilchrist is £1.00 to $2.2122 Cdn. and with respect to the Balance Sheet Data of Gilchrist is £1.00 to $2.3264 Cdn. The exchange rate utilized with respect to the Statement of Operations Data of Hampel is $1.00 U.S. to $1.5785 Cdn. and with respect to the Balance Sheet Data of Hampel is $1.00 U.S. to $1.5352 Cdn. Except as set forth in footnotes 4, 5 and 6, no other acquisitions by Envoy materially affect the comparability of the information in the Selected Financial Data.

5 The Statement of Operations Data for the year ended September 30, 2000 includes the results of operations of Sage, acquired effective as of June 1, 2000, for the four month period from June 1, 2000 to September 30, 2000, and the results of operations of Gilchrist, acquired effective as of July 1, 2000, for the three month period from July 1, 2000 to September 30, 2000. See Item 4 Information on the Company for a description of such acquisitions. The exchange rate utilized with respect to the Statement of Operations Data of Gilchrist is £1.00 to $2.1885 Cdn. and with respect to the Balance Sheet Data of Gilchrist is £1.00 to $2.2163 Cdn. The exchange rate utilized with respect to the Statement of Operations Data of Hampel is $1.00 U.S. to $1.4722 Cdn. and with respect to the Balance Sheet Data of Hampel is $1.00 U.S. to $1.5035 Cdn. Except as set forth in footnotes 4, 5 and 6, no other acquisitions by Envoy materially affect the comparability of the information in the Selected Financial Data.

6 The Statement of Operations Data for the year ended September 30, 1999 includes the results of operations of Hampel acquired effective as of October 1, 1998, for the entire twelve month period, the results of operations of Devlin acquired effective as of January 1, 1999 for the nine month period from January 1, 1999 to September 30, 1999, and the results of operations of Watt International, acquired effective as of May 1, 1999, for the five month period from May 1, 1999 to September 30, 1999. See Item 4 Information on the Company for a description of such acquisitions. The exchange rate utilized with respect to the Statement of Operations Data of Hampel is $1.00 U.S. to $1.5029 Cdn. and with respect to the Balance Sheet Data of Hampel is $1.00 U.S. to $1.4674 Cdn. Except as set forth in footnotes 4, 5 and 6, no other acquisitions by Envoy materially affect the comparability of the information in the Selected Financial Data.

7 As reflected in Note 22 to the Notes to the audited Financial Statements of Envoy, the net loss from operations for the years ended September 30, 2003, 2002 and 2001 were ($1,521), ($53,376) and ($3,831) respectively under U.S. GAAP. The net earnings (loss) for the years ended September 30, 2003, 2002 and 2001 was $2,606, ($53,376), and ($3,831) respectively under U.S. GAAP. The diluted net earnings (loss) per share for the years ended September 30, 2003, 2002 and 2001 was $0.12, ($2.54) and ($0.18), respectively under U.S. GAAP.

8 Total debt includes both the current and long term portion of debt.

9 As reflected in Note 22 to the Notes to the audited Financial Statements of Envoy the shareholders equity as at September 30, 2003 and 2002 was $11,765 and $9,201, respectively under U.S. GAAP.

10 Retained earnings as of September 30, 2003, 2002, 2001, and 2000 excludes the cumulative foreign currency translation adjustment of ($236), $1,348, $833 and ($314), respectively. See Note 2(f) to the Notes to the audited Financial Statements of Envoy.

Envoy has never paid any dividends on its common shares and does not anticipate that it will pay any cash dividends on its common shares in the foreseeable future.

Exchange Rates

On February 17, 2004, the noon buying rate for Canadian dollars as reported by the Federal Reserve Bank of New York was $1.00 U.S. to 1.3102 Cdn. The following table sets forth for the periods indicated certain information regarding the exchange rate into U.S. currency of Canadian dollars. The rate of exchange means the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York.

	Fiscal Year Ended September 30,				
	2003	**2002**	**2001**	**2000**	**1999**
Average*	$ 1.4553	$ 1.5731	$ 1.5353	$ 1.4724	$ 1.5033

* The average rate means the average of the exchange rates on the last day of each month during the fiscal period.

	For the month ending					
	January 2004	December 2003	November 2003	October 2003	September 2003	August 2003
High	$ 1.3300	$ 1.3373	$ 1.3385	$ 1.3451	$ 1.3918	$ 1.4072
Low	1.2712	1.2943	1.2991	1.3040	1.3470	1.3795

B. Capitalization and Indebtedness

Not applicable

C. Reasons for the Offer and Use of Proceeds

Not applicable

D. Risk factors

Envoy s business, financial condition and results of operations could be materially adversely affected by any of the following risks.

This Form 20-F contains forward-looking statements that involve risks and uncertainties. Envoy s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by Envoy described below and elsewhere in this form.

General economic conditions The marketing and communication industry is cyclical and as a result it is subject to downturns in general economic conditions and changes in client business and marketing budgets.

Interest rate risk Envoy s debt under its lending facilities is described in Note 10 to the Financial Statements. Our credit facility bears interest that is calculated at variable rates. As a result we are vulnerable to changes in interest rates. At September 30, 2003 the effective interest rate on our facility was 8.0%, compared to 8.50% at September 30, 2002.

Foreign currency risk Envoy is subject to currency risk through its activities in the United States and in the United Kingdom. Unfavourable changes in the exchange rate may affect the operating results of Envoy. Envoy does not currently use derivative instruments or foreign currency contracts to reduce its exposure to foreign currency risk.

Key personnel Envoy s success depends in part upon its ability to hire and retain key senior management and skilled technical, client service and creative personnel able to create and maintain solid relationships with clients. An inability to hire or retain qualified personnel could have a material adverse effect on Envoy.

Credit risk Envoy manages its credit risk with respect to accounts receivable by acting as an agent for its customers, by dealing primarily with large creditworthy customers and by billing whenever possible in advance of rendering services or making commitments. Management believes that Envoy is not subject to significant concentration of credit risk. As at September 30, 2003, Envoy had one customer, who represented 8% of accounts receivable and one customer who represented 11% of accounts receivable as at September 30, 2002.

Envoy s results of operations and its business depend on its relationship with a limited number of large clients. Set forth below is the percentage of net revenue during the fiscal year ended September 30, 2003 for each of Envoy s clients that accounted for 10% or more of its net revenue and for Envoy s five largest clients combined:

Client	**Fiscal Year Ended September 30, 2003**
ASDA Stores Limited	25.5%
Safeway Brands Inc.	15.9%
Wal-Mart Stores Inc.	11.7%
Five largest clients combined	58.6%

Although Envoy has over 75 clients, a relatively small number contribute a significant percentage of Envoy consolidated net revenue. For the year ended September 30, 2003, the Company s top three clients accounted for over 50% of its consolidated net revenue. As Envoy s relationships with these clients have been long-standing ones, the Company expects reliance on such clients to continue into the future. The failure to achieve continued design wins from one or more of these clients without adding new sources of net revenue could have an adverse effect on Envoy s financial results.

There can be no assurance that Envoy will be able to maintain its historical rate of growth or its current level of revenue derived from any client in the future.

Contract Risk The realization of expected revenues from certain agreements of the Company depends on the ability of Envoy to make satisfactory proposals to its clients. Expected revenues may be delayed if proposals are not submitted or accepted in the anticipated timeframe or may not be realized at all if proposals are ultimately not accepted.

Item 4. INFORMATION ON THE COMPANY

The following Information on the Company contains forward-looking statements, which involve risks and uncertainties. Envoy s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under Item 3 Risk Factors and elsewhere in this Form 20-F.

ENVOY COMMUNICATIONS GROUP INC.

General

Envoy (or the Company) is a marketing and international consumer and retail branding company with offices throughout North America and Europe. Combining strategy, creativity and innovation, Envoy s interconnected network of companies delivers business-building solutions to over 200 leading global brands and has successfully completed assignments in more than 40 countries around the world.

Envoy conducts its branding services through its wholly-owned subsidiaries, Watt International Inc. and Watt Gilchrist Limited (collectively, Watt), which together form one of the world s largest brand strategy and design consultancies. With seven offices located throughout North America, the United Kingdom and Continental Europe, Watt s clients include The Great Atlantic & Pacific Tea Company (A&P), Asda Stores Ltd., Carulla Vivero S.A., Cencosud S.A, Cott Beverages Ltd., Famous Players Ltd., Giant Food Inc., Gigante, S.A. de C.V., Immobilaria Las Verbenas S.A., Longs Drug Store Corporation, Kraft Foods Inc., Next plc, Safeway Brands Inc., Shaws Supermarkets, Inc., Sobeys Inc., Smart & Final Stores Corporation and Wal-Mart Stores Inc.

Envoy provides advertising and communications services through a 70% owned subsidiary, John Street Inc. Clients of John Street include Harvey s (a division of Cara Operations Limited), Scott Paper Ltd., Tetley Canada, Moore s, Fuji Photo Film Canada Inc., The Family Channel Inc. and Viewer s Choice.

In 2003 three customers accounted for 25.5%, 15.9% and 11.7% respectively of net revenue. In 2002, three customers accounted for 18.9%, 12.9% and 12.7% of net revenue. In both years, no other customers accounted for more than 10% of net revenue.

Watt International Inc. and John Street Inc. each subsist under the laws of the Province of Ontario and Watt Gilchrist Limited subsists under the laws of the United Kingdom.

The principal place of business of Envoy is located at 172 John Street, Toronto, Canada M5T 1X5. Envoy may be reached by telephone: (416) 593-1212 facsimile: (416) 593-4434. Envoy s website is www.envoy.to. Information contained in our website does not constitute a part of this Form 20-F.

A. History and Development of the Company

Envoy was incorporated under the laws of the Province of British Columbia, Canada as Potential Mines Ltd. in December 1973 and was continued under the laws of the Province of Ontario, Canada in December 1997. Since December 1997 Envoy has shifted the nature of its business to providing marketing, communications and consumer and retail branding services for promoting clients products, services and business messages utilizing such media as print, broadcast and the Internet. Envoy has grown, in large part, through strategic acquisitions. Certain material acquisitions by Envoy are described below.

Effective as of June 1, 1998, Envoy acquired Promanad Communications Inc. (Promanad), an advertising, public relations and corporate identity agency. Envoy expanded its geographic reach into the U.S. marketplace through its acquisition of Hampel Stefanides Inc., effective as of October 1, 1998.

Effective as of January 1, 1999, Envoy acquired Devlin Multimedia Inc., a Toronto-based website design and development company.

Effective as of May 1, 1999, Envoy acquired Watt International Inc. (Watt International), through which Envoy acquired the operations, substantially all of the assets and certain of the liabilities of The Watt Design Group Inc. (Watt Design), a Toronto-based provider of design, packaging, retail environments and marketing identity services to retailers. Envoy expanded its geographical reach into the United Kingdom and the continental Europe marketplace through its acquisition of Gilchrist Brothers Limited (Gilchrist), a United Kingdom based digital imaging and design firm, effective as of July 1, 2000. Effective as of January 1, 2001, Envoy acquired The International Design Group (Canada) Inc., a Toronto-based retail planning and design firm. IDG was amalgamated with Watt International effective September 30, 2001. Watt International, Gilchrist and IDG are referred to collectively as (Watt).

Effective as of June 1, 2000, Envoy acquired Sage Information Consultants Inc., a digital professional service firm operating in the United States and Canada.

During July 2001, Envoy launched John Street Inc. a Toronto based advertising and Communications initiative to replace the advertising business previously conducted by the Communiqué Group Inc. Envoy owns 70% of John Street Inc., and the shares held by the minority shareholders are mandatorily redeemable by Envoy at September 30, 2004 for cash consideration. No amount has been accrued in the financial statements as the purchase price will be determined and paid over a three-year period based on certain future performance milestones.

Effective October 1, 2001, Envoy acquired 100% of the outstanding shares of Commordore Conference Planners Inc. (Commodore), a conference and event marketing company. Commodore was amalgamated with Communique Incentives Inc. on acquisition.

On October 30, 2002, the assets of Devlin were sold to management of the company.

On November 11, 2002, the operations of Sage were shut down and the assets of Sage were liquidated.

On February 7, 2003, Envoy decided to discontinue the operations of Hampel after conducting a review, in conjunction with Envoy s banks, of the ongoing viability, future prospects, cash needs and local debt situation of this company. Following the liquidation of the assets, the shares of Hampel were sold for nominal consideration.

B. Business Overview

Services in the Envoy Group include:

Consumer and retail branding Watt International, a wholly owned subsidiary of Envoy, that management believes to be one of the world s leading brand strategy and design consultancies provides the following services: strategic brand consulting, corporate identity and communications, retail branding and store design, and package design. Watt also provides brand management, pre-press and film through Watt Gilchrist, a sister company with more than 100 years of experience.

Marketing John St. Inc., a 70% owned subsidiary of Envoy provides advertising and communications services that include creative concept development, strategic planning and consulting, advertising production, media planning and purchasing.

Net revenue by type of service for the last three fiscal years are as follows: (all amounts in thousands)

Net revenue:	**Fiscal 2003**	**Fiscal 2002**	**Fiscal 2001**
Marketing	$ 7,822	$ 12,428	$ 24,375
Consumer and retail branding	34,313	38,204	43,437
Technology	292	8,489	14,973
	$ 42,427	$ 59,121	$ 82,785

Net revenue by geographic region, based on the region the customer is located, is as follows: (all amounts in thousands)

Net revenue:	**Fiscal 2003**	**Fiscal 2002**	**Fiscal 2001**
Canada	$ 6,967	$ 15,983	$ 21,826
United States	18,185	27,708	40,970
United Kingdom and Continental Europe	17,275	15,430	19,989
	$ 42,427	$ 59,121	$ 82,785

Our Strategic Direction

Over the past year Envoy has divested its technology services and remains focused on the expansion and prosperity of its core business of consumer and retail branding. The Watt group of companies (Watt), our branding business, has proven successful at creating and executing private label programs and landmark store design, making Envoy a world authority in brand strategy and design for the retail sector.

In November 2003, Watt announced the launch of Gilchrist North America (GNA), a state-of-the-art reprographics and brand management business, with locations in Toronto, Bentonville and Boston. GNA will leverage the highly experienced work force and sophisticated equipment of Gilchrist UK, Watt s UK based brand management company, to provide its clients with a superior product. GNA has quickly become an integral part of our new client acquisition strategy.

Also in November 2003, Watt announced the launch of Studio Watt, a niche-focused agency devoted to serving the distinct needs of style-based specialty and boutique labels throughout North America.

In January 2004, Watt announced the launch of ODIN , a web based software system that manages every stage of the design process in real-time, from concept development and package design to printing, packaging and getting the product to market. With anytime, anywhere access, ODIN provides Watt clients the ability to efficiently track and manage their projects, and know instantly if there are any project deviations, timeline extensions, or delays from suppliers. The efficiency gained through ODIN offers a significant competitive advantage for Watt and its clients, and which management believes will ensure at least a 20 percent increase in speed-to-market.

Pursue strategic acquisitions.

Our historical growth has been achieved partially by way of strategic acquisition. We have used this strategic acquisition strategy to extend Envoy s geographic reach and breadth of service offering and to add a significant degree of diversification to our business model. The opportunities for continued growth through acquisition are currently more limited as a result of a shortage of available capital to fund such acquisitions.

In November 2003, Envoy announced its intention to embark on a strategic M&A expansion plan to further enhance its leadership position in both North America and Europe, and has hired Jefferies & Company, Inc. to advise it on acquisition opportunities.

On February 10, 2004 Envoy announced that it has entered into an underwriting commitment with Canaccord Capital Corporation (Canaccord) under which Canaccord has agreed to buy from Envoy and sell to the public 26,315,800 Units (the Units) at C$1.33 per Unit, each Unit consisting of one common share of Envoy (the Common Shares) and one half of one transferable common share purchase warrant (the Warrants). Each whole Warrant will entitle the holder to purchase one Common Share at a price of C$1.80 per Common Share for a period of five years from the closing of the transaction.

The Units will be offered under Envoy s final short form prospectus dated February 13, 2004. The sale of the 26,315,800 Units will result in Envoy receiving gross proceeds of approximately Cdn. $35 million. Envoy has also granted to Canaccord an over-allotment option to purchase an additional 3,947,370 Units at Cdn. $1.33 per Unit for a period of 60 days from the closing of the offering, which is expected to occur on or about February 20, 2004.

Management believes the offering will enable Envoy to achieve two important goals. In addition to allowing Envoy to eliminate its debt, the size of this offering will permit Envoy to engage in a meaningful M&A program.

Industry Overview

Consumer and Retail Branding

In all areas of marketing and product design, we believe that companies are looking to extend their customer relationships and influence consumer behavior. Consumer and retail branding services encompass the entire customer experience, from product packaging to the retail environment, and are a key component of a company s marketing communications strategy.

The consumer and retail branding services sector is rapidly evolving into a global marketplace, as companies are increasingly looking for expertise in the development and maintenance of their brands on a global basis. Companies are looking to firms that can deliver a consistent message to consumers through packaging and retail design, regardless of geography.

Retail is the second largest industry in the U.S. and one of the largest industries worldwide. Unlike other, more volatile sectors, the retail industry continues to grow at a steady rate, particularly as developing countries achieve greater economic stability.

This reality, coupled with Watt s lengthy history of success and innovation in the retail industry, presents Envoy with a spectrum of opportunities from overall brand strategy to store design to private label program development with key customers like grocers, mass merchants, pharmacies and home improvement companies. Envoy has made a series of announcements subsequent to the 2003 fiscal year-end that highlight the significant opportunities we are pursuing.

Advertising Market

In this environment we are seeing a shift in the market with larger clients tapping into the creative and strategic resources of smaller, more entrepreneurial shops where clients work directly with the firm s senior management. Not only are large Canadian clients assigning work to Canadian boutiques, but US clients are also looking north of the border for a full range of agency services

Government Regulations

The marketing communications industry is subject to extensive government regulation, both domestic and foreign, with respect to the truth in and fairness of advertising. There are also a number of US federal and state laws and regulations directed at the advertising and marketing of specific products, such as food and drug products. In addition, there has been an increasing tendency on the part of businesses to resort to the judicial system, as well as industry self-regulatory procedures, to

challenge comparative advertising of their competitors on the grounds that the advertising is false and deceptive. There can be no assurance Envoy will not be subject to claims against it or Envoy s clients by other companies or governmental agencies or that such claims, regardless of merit, would not have a material adverse effect on Envoy s future operating performance.

C. Organizational Structure

Envoy has operations in the United States, the United Kingdom, Continental Europe and Canada. Significant subsidiaries are as follows:

Company	% of Ownership	Jurisdiction of Incorporation
Communiqué Incentives Inc.	100	Ontario
Watt International Inc.	100	Ontario
Watt Gilchrist Limited	100	United Kingdom
John Street Inc.	70	Ontario

D. Property, Plants and Equipment

We currently operate offices in the following cities: Toronto, Canada, London, UK, Leeds, UK, San Francisco, USA, Strassbourg, France, and Bentonville, USA. The terms of our principal leases are as follows:

Envoy s principal executive offices consist of a four-story office building of approximately 20,000 square foot located at 172 John Street, Toronto, Ontario. In addition to Envoy, Watt IDG, a division of Watt International, and John Street Inc. are also located at these premises. These premises have been leased pursuant to a lease with a term that commenced on July 1, 1999 and expires in June 2009 at a current annual rent of $135,000 Cdn. with rent increases each year of the lease term. In connection with the lease negotiation, the landlord advanced to Envoy $750,000 Cdn. as a loan, with an interest rate of 3.5% per annum to be repaid over 10 years. The leasehold improvements involved modernization of the facilities and other modifications expected to benefit both Envoy and the landlord. The principal balance of this loan at September 30, 2003 was $481,297 Cdn.

Until January 2003, Envoy s principal executive offices consisted of a five-story office building of approximately 35,000 square feet located at 26-28 Duncan Street, Toronto, Ontario, Canada. In January 2003, Envoy exited the Duncan Street facility after negotiating a release of the term of the lease extension. Envoy had no further obligation to the landlord beyond February 1, 2003.

In October 2002 Envoy sold the assets of Devlin to management of the subsidiary. The new company formed to acquire Devlin has been assigned all future obligations for all leases formerly held by Devlin.

In 2003 when the Hampel business was closed down, Envoy negotiated a settlement with the landlord agreeing to make 22 monthly payments of $33,316 (U.S) commencing on March 1, 2003, and a final payment of $150,000.00 (U.S.) in February 2005. The payments are secured by a letter of credit in the amount of $250,000 (U.S.) in favour of the landlord. During 2002 Envoy negotiated the exit of approximately 18,000 square feet of office space located on the 12th floor of 111 Fifth Avenue, New York, New York. Under the terms of the lease settlement agreement Envoy agreed to pay the landlord on September 30, 2002 $500,000 (U.S.) cash, issued 250,000 common shares of Envoy at a price of $.50 (U.S.) per share and agreed to make 22 additional monthly payments of $36,638 (U.S.) commencing October 1, 2002. The payments are secured by a letter of credit in the amount of $250,000 (U.S.) in favour of the landlord. The total expense relating to the 12th floor termination agreement has been reflected as restructuring costs in fiscal 2002.

The offices of Envoy s wholly owned subsidiary, Watt International, consist of an office building of approximately 26,600 square feet located at 300 Bayview, Toronto, Ontario, Canada. The premises are leased pursuant to a lease with a current annual rent of $243,318 Cdn. that expires in March 2010.

The offices of Envoy s wholly-owned subsidiary, Gilchrist, consist of an industrial building of approximately 72,000 square feet located on Ring Road, West Park, Leeds, West Yorkshire, England. The premises are leased pursuant to a lease with a current annual rent of £150,000, which expires in October 2006. Gilchrist has additional office space of approximately 950 square feet located at 12 Great Newport Street, London, England. The premises are leased pursuant to a lease with a current annual rent of £57,000, which expires in August 2005.

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with, and is qualified in its entirety by, the financial statements of Envoy and notes relating thereto included elsewhere in this Form 20-F. The information contained in this Item# 5 refers to financial statements of Envoy, which are presented in Canadian dollars and are prepared in accordance with Canadian GAAP*. Canadian GAAP differs in certain significant respects from U.S. GAAP. Reconciliation to U.S. GAAP is set forth in Note 22 to the Notes to the audited Financial Statements of Envoy. Historical results of operations, percentage relationships and any trends that may be inferred therefrom are not necessarily indicative of the operating results of any future period.*

The following discussion contains forward-looking statements that are subject to significant risks and uncertainties. There are a number of important factors that could cause actual results to differ materially from historical results and percentages and results anticipated by the forward-looking statements contained in the following discussion. Statements in this Form 20-F concerning Envoy s outlook or future economic performance, anticipated profitability, revenues, commissions and fees, expenses or other financial items and statements made with respect to any future events, conditions, performance or other matters are forward looking statements as that term is defined under the U.S. federal securities laws. Forward-looking statements are subject to risks, uncertainties, and other factors, which could cause actual results to differ materially from those stated in such statements. Such risks, uncertainties and factors include, but are not limited to, (i) the uncertain acceptance of the Internet and Envoy s Internet and other technology, (ii) there can be no assurance that Envoy will continue to be able to grow profitably or manage its growth, (iii) risks associated with acquisitions, (iv) risks associated with competition, (v) that Envoy s quarterly operating results have fluctuated in the past and are expected to fluctuate in the future, and (vi) that the loss of services of certain key individuals could have a material adverse effect on Envoy s business, financial condition or operating results.

Overview

Net Revenue. (Referred to as gross margin in fiscal 1999 and prior) The Company presents as net revenue its net commission and fee income earned as compensation for its services. Further, the balance sheet reflects the following:

(i) deferred revenue representing only fees billed and collected in advance of such fees being earned; and

(ii) the reimbursable pass-through costs which are included in unbilled accounts receivable.

Net revenue represents the Company s compensation for its agency and non-agency services and is recognized only when collection of such net revenue is probable. Agency services are those that require the Company to incur external media and production costs on behalf of its clients and for which it is entitled to pass through the costs for reimbursement from its clients. The reimbursement of pass-through costs are not included in net revenue. The Company s agency and non-agency projects are short-term in nature.

Fees earned for non-agency services are recognized either upon the performance of the Company s services when the Company earns a per-diem fee, or in the case of a fixed fee, when the Company s services are substantially complete and accepted by the client. Fees earned but not yet billed are included in accounts receivable. Fees billed to clients in excess of fees recognized as net revenue are classified as deferred revenue.

When the Company s compensation for its agency services is based on commissions, net revenue is comprised of: (i) commissions earned from media expenditures, which are recognized at the time the advertising appears or is broadcast, or in respect of on-line advertising, either ratably over the period of time the advertising appears or based on the actual impressions delivered at the contractual rate per impression, depending upon the terms of the arrangement; and (ii) commissions earned on expenditures for the production of advertisements, which are recognized upon the completion of the Company s services and acceptance by the client, being the time at which the Company has no further substantial obligations with respect thereto.

When the Company s compensation for its agency services is fee-based, net revenue is comprised of non-refundable monthly agency fees, which are recognized in the month earned.

Pass-through costs related to production are accrued and recorded in accounts receivable, as unbilled reimbursable costs, at the time the third party suppliers render their services. Pass-through costs related to media are accrued at the time the advertisement appears or is broadcast.

Operating Expenses. Salaries and benefits, general and administrative expenses and occupancy costs represent our operating expenses. Salaries and benefits expenses include salaries, employee benefits, incentive compensation, contract labour and other payroll related costs, which are expensed as incurred. General and administrative costs include business development, office costs, technology, professional services and foreign exchange. Occupancy costs represent the costs of leasing and maintaining company premises.

Tax Matters. With respect to Envoy s 2003 fiscal year, Envoy had tax loss carry forwards sufficient to cover its Canadian income tax liabilities and has approximately $12.7 million in loss carry forwards. Details on income taxes are set forth in Note 13 to the Notes to the audited consolidated Financial Statements of Envoy.

A. Operating Results

Envoy s 2003 results improved significantly compared to the previous year, reflecting management s execution of the fiscal 2002 restructuring plan to more closely align costs with projected revenue, to divest of non-core assets, to reduce bank indebtedness and to focus resources on our consumer and retail branding businesses.

During the 2nd quarter of fiscal 2003, Envoy decided to discontinue the operations of our New York advertising agency, Hampel Stefanides Inc. (Hampel , or the New York Agency) after conducting a review, in conjunction with Envoy s banks, of the ongoing viability, future prospects, cash needs and local debt situation of this company. We also successfully terminated the real-estate lease commitments associated with our New York Agency. The cost associated with this termination of the real estate has been fully expensed in the Financial Statements. Following the liquidation of the assets, the shares of Hampel were sold for a nominal consideration. In the first quarter of fiscal 2003, the assets of our technology company Devlin Multimedia Inc. (Devlin) were sold, and our other technology company, Sage Information Consultants Inc. (Sage), was shutdown.

As a result of our restructuring efforts and closure of unprofitable businesses, our salaries and benefits and occupancy costs have decreased significantly.

Our salaries decreased to $28.0 million from $45.1 million or 38% from the previous year. As we stated in the second quarter, our goal was to improve our labour to net revenue ratio to 62% from 72% in the second half of fiscal 2003. We achieved our goal, as our labour to net revenue ratio was 62% for the 4th quarter and was approximately 60% for the second half of fiscal 2003. We expect our labour to net revenue ratio for fiscal 2004 to continue at these levels.

Our occupancy costs have decreased to $3.3 million from $4.7 million or 31% from the previous year. As we stated in the second quarter of fiscal 2003, we estimated that our occupancy to net revenue ratio would improve from 9% in the second quarter of fiscal 2003 to 6.5% in the second half of fiscal 2003. We achieved an occupancy to net revenue ratio of 6.2% for the 3rd quarter and 6.3% for the 4th quarter of fiscal 2003. We expect our occupancy to net revenue ratio to continue to improve and be in the 5.7% range in fiscal 2004.

In April 2003, we normalized our banking arrangements with our bankers, The Toronto-Dominion Bank and Fleet Bank. The new credit agreement with our bankers provides for a demand operating line of credit of up to $7.0 million. In order to obtain the new credit facility, we reduced our level of bank borrowings by issuing $2.0 million of convertible debentures that mature during the 2nd quarter of 2008, and renegotiated the terms of our existing debentures. Costs associated with the new credit agreement have been charged to interest expense. By September 30, 2003, we had reduced our total outstanding debt to $11.4 million from $14.0 million at the end of fiscal 2002.

Management continues to focus on our core strength, consumer and retail branding. In the 4th quarter of fiscal 2003, Watt represented 87% of our business. In the third quarter of fiscal 2003, Watt signed new client contracts valued at more than $12.0 million over a three to four year period. This new business will begin positively impacting our revenue in the second half of fiscal 2004.

Net revenue for the year ended September 30, 2003 was $42.4 million, which included net revenue of $3.4 million from subsidiaries disposed of or shut down during the year. At June 30, 2003 we had estimated that our net revenue for the 4th quarter would be consistent with our 3rd quarter in the range of $11.0 million. The actual net revenue for the 4th quarter was $10.8 million. Net revenue in the second half of fiscal 2003 increased 2.5% over the net revenue in the first half of fiscal 2003, slightly lower than our expected growth of 3.5%. This lower than anticipated growth is due to a number of factors, including slower than anticipated start up of our new Watt division (providing reprographic services in Canada), and the significant declines in the travel business impacting the operations of our corporate events subsidiary.

As a result of the operational changes and financial changes discussed above, management believes the business will continue to show improved earnings and a strengthened balance sheet. Consistent with prior years, we expect the second half of fiscal 2004 to be stronger than the first half of fiscal 2004, reflecting the seasonal patterns in our business.

Fiscal Year Ended September 30, 2003 compared to Fiscal Year Ended September 30, 2002

Net revenue for the twelve months ended September 30, 2003 was $42.4 million, compared to $59.1 million for the twelve months ended September 30, 2002, a decrease of $16.7 million or 28%.

Revenue Mix by type of service and by client location:

	Net Revenue (in millions)					
By Type of Service	**2003**	**% of total**	**2002**	**% of total**	**2001**	**% of total**
Marketing	$ 7.8	18%	$ 12.4	21%	$ 24.4	29%
Consumer and retail branding	34.3	81%	38.2	65%	43.4	52%
Technology	0.3	1%	8.5	14%	15.0	19%
	$ 42.4	100%	$ 59.1	100%	$ 82.8	100%

By Client Location	**2003**	**% of total**	**2002**	**% of total**	**2001**	**% of total**
Canada	$ 7.0	17%	$ 16.0	27%	$ 21.8	26%
United States	18.2	43%	27.7	47%	41.0	50%
Europe *	17.2	40%	15.4	26%	20.0	24%
	$ 42.4	100%	$ 59.1	100%	$ 82.8	100%

* *Europe includes the United Kingdom and Continental Europe*

Net revenue by type of service:

Approximately $8.2 million of the decrease in revenue in fiscal 2003 compared to fiscal 2002 is related to a decline in revenue from our technology business. In the first quarter of fiscal 2003, the assets of our technology company, Devlin Multimedia Inc. (Devlin), were sold and our other technology company, Sage Information Consultants Inc. (Sage), was shutdown.

Net revenue from marketing has decreased by approximately $4.6 million. After a lengthy review of all options available to us, Envoy closed its New York Agency in February 2003 (see Note 14 to the Financial Statements). The $5.0 million decrease in net revenue from the closure of our New York Agency was offset in part by growth in our Canadian advertising agency, which increased by $1.1 million. The decrease in revenue was also a result of a decrease in our corporate event business of $0.7 million, due to a decline in travel as a result of a number of factors, including the Iraq war, SARS and the slowdown in the North American economy. Based on our revenue forecast, we expect this trend in corporate events revenue to continue in the first quarter of fiscal 2004.

Net revenue from consumer and retail branding services decreased approximately $3.9 million, from $38.2 million to $34.3 million, a decline of 10%. Approximately $1.9 million of this decrease relates to the closing of certain unprofitable parts of the design business during fiscal 2002, including our operations in Sweden, Boston and New York. Although net revenue in fiscal 2003 from our consumer and retail branding services are lower than last year, there have been significant new business wins over the second half of fiscal 2003. We believe that the balance of the decline in revenue is related primarily to the timing of customer branding programs. Therefore, revenue from these sources should improve in the coming year.

Net revenue by customer location:

Net revenue from Canada decreased approximately $9.0 million, from $16.0 million in fiscal 2002 to $7.0 million in fiscal 2003, a decline of 56%. Approximately, $8.2 million of that was due to the restructuring of business in 2002, the shutdown of Sage and the sale of the assets of Devlin in 2003. Net revenue from the US has decreased approximately $9.5 million. Approximately $5.0 of the decline is due to the closure of our New York Agency, the US revenue related to our shutdown of Sage and the closure of the Boston and New York consumer and retail branding part of the business. The remainder of the decline is due to reductions in business with other US customers in our ongoing operations.

Net revenue from Europe in our consumer retail branding has increased approximately $1.8 million during fiscal 2003. We expect continued growth and improvement from Europe in fiscal 2004.

Our three largest clients in fiscal 2003 accounted for 54% of our net revenue for the current period, while our three largest clients in fiscal 2002 accounted for 43% of our net revenue. In fiscal 2003, one client accounted for 26% of our net revenue compared to fiscal 2002 when there were no clients that accounted for more than 20% of net revenue.

Operating Expenses Operating expenses decreased by 39% to $37.3 million for fiscal 2003 from $61.5 million in fiscal 2002. The primary reasons for the decrease in operating expenses were a decrease in salaries and benefits of $17.1 million, or 38%, and a decrease in general and administrative expenses of $5.7 million, or 49%, which included the recognition of deferred foreign exchange gains of $0.8 million from the closure of our New York Agency. Occupancy costs decreased from $4.7 million to $3.3 million, a decline of $1.4 million, or 31%. The decline in operating expenses is the result of the restructuring plan implemented in fiscal 2002, the closure of our New York Agency and Sage, the sale of Devlin, the continued effort by management to reduce costs by reducing or eliminating leased office space in Toronto and New York and general reductions in staffing levels.

Salaries and benefits expenses for fiscal 2003 were $28.0 million, compared to $45.1 million for fiscal 2002, a decrease of $17.1 million or 38%. We continue to closely monitor salaries and benefits to ensure that our expected revenue matches our labour costs.

General and administrative expenses for fiscal 2003 were $6.0 million, compared to $11.7 million for the previous year. This represents a decrease of $5.7 million, or 49%. Included in general and administrative expenses for fiscal 2003 is a foreign exchange gain of $0.3 million. This gain consists of a foreign exchange loss from operations of ($0.5) million and the recognition of deferred foreign exchange gains of $0.8 million from the closure of our New York Agency, details of which are provided in Note 14 to the Financial Statements (also see Note 22 (e) for U.S. accounting for the foreign exchange). Excluding the foreign exchange gain related to the closure of our New York Agency, general and administrative expenses declined by 42%. This decline reflects the significant efforts we have been making to reduce expenses prudently and to incur expenditures that will add revenue and improve efficiencies. In addition to the cost cutting reductions in our ongoing business, our general and administrative expenses have decreased as a result of the disposal of subsidiaries.

Occupancy costs for fiscal 2003 were $3.3 million, compared to $4.7 million for fiscal 2002. This decrease of $1.4 million is a result of the termination of office space obligations in both New York and Toronto, our restructuring initiative in fiscal 2002, and the shutdown of our New York Agency. We expect our annual occupancy expense going forward to be approximately $2.8 million as the effect of our reductions impacts the full fiscal period.

Depreciation expense Depreciation expense for fiscal 2003 decreased to $2.4 from $2.9 million in fiscal 2002, due to the closure of the subsidiaries discussed earlier.

Interest expense Interest charges for the year ended September 30, 2003 were $2.7 million, compared to $1.2 million for the previous fiscal year. As described in Note 10 to the Financial Statements, the increase in interest expense is due to a number of factors as indicated below.

We issued $1.8 million of convertible debentures in April 2002, $2.0 million of convertible debentures in September 2002 and $2.0 million of convertible debentures in April 2003. The proceeds of the convertible debentures were used to help fund our restructuring costs and to pay down our outstanding bank facility. The convertible debentures carry interest at the rate of 10%, and an imputed, non-cash interest expense, details of which are explained in Note 11. During fiscal 2003, the imputed interest amounted to $0.7 million, compared to $0.1 million in fiscal 2002. We also had expenses relating to our new credit facility of $0.5 million in fiscal 2003, compared to $0.4 million in fiscal 2002. The interest rate of our bank facility increased from a blended rate of approximately 3% in fiscal 2002 to 8% by the end of fiscal 2003. During fiscal 2003, convertible debentures totaling $1.4 million were converted. Subsequent to the year-end all outstanding convertible debentures were converted to common shares of Envoy.

As a result of the above, we expect that our annual interest expense will decrease significantly by approximately $1.5 million in fiscal 2004. Most of the decrease will be realized in the third and fourth quarters of fiscal 2004.

Unusual Item During fiscal 2002, as a result of changes in the banking loan arrangements, Envoy was no longer allowed to fully utilize its $40 million line of credit and repayment terms were accelerated. Accordingly, the remaining unamortized portion of deferred financing charges, totaling $0.8 million, was written off. In fiscal 2003, all charges on the credit facility were expensed as part of interest expense and financing costs.

Restructuring During fiscal 2002, management implemented a restructuring plan, downsizing its workforce, exiting excess office space and writing off redundant capital assets. Accordingly, Envoy recorded a restructuring expense of $10.9 million in fiscal 2002. The restructuring included a reduction of 156 people, as well as the abandonment of 18,000 square feet of leased office space in New York City and 35,000 square feet of leased office space in Toronto. The annual expense savings in salaries, benefits and occupancy costs associated with the restructuring was approximately $17.2 million. During fiscal 2003, a recovery of $0.3 million of restructuring costs was recorded.

Gain on Closure of Subsidiaries During the 2nd quarter of fiscal 2003, Envoy decided to discontinue the operations of Hampel after conducting a review, in conjunction with Envoy s banks, of the ongoing viability, future prospects, cash needs and local debt situation of Hampel. As Envoy s banks held a first charge on the assets of Hampel, the net proceeds from the liquidation of those assets were applied in reduction of Envoy s debt obligations to the banks. Consequently, there were not sufficient proceeds from the liquidation to make any payment to the unsecured creditors of Hampel. Following the liquidation of the assets, the shares of Hampel were sold for nominal consideration. As Envoy has no obligation to pay the creditors of Hampel, the consolidated accounts of Envoy reflect a gain on the shutdown of Hampel. We also successfully terminated the real-estate lease commitments associated with Hampel. The cost associated with the termination of this real estate has been fully expensed in the Financial Statements. Further details are provided in Note 14 to the Financial Statements. In the first quarter, we discontinued our technology operations by disposing of Devlin, and shutting down Sage.

As a result of the above, we experienced a gain on closure of subsidiaries of $2.5 million. Further detail is provided in Note 15 to the Financial Statements. Also see Note 22 to the Financial Statements for U.S. accounting.

Income taxes In 2003, our effective income tax rate, as a percentage of pretax earnings before goodwill write-down and amortization, was 8.9% compared to the 2002 recovery rate of (26.7%). The difference relates primarily to Envoy having a pretax loss in fiscal 2002, compared to a pretax profit in fiscal 2003. Details are provided in Note 2(g) and Note 13 to the Financial Statements.

The major components of the 2003 income tax adjustments from the statutory rates were items that were not taxable (or tax deductible) including the gain on disposal of subsidiaries, differences in tax rates for income earned by subsidiaries in both the UK and USA, and an increase in the valuation allowance in Canada.

Envoy currently has recorded a substantial valuation allowance for losses generated in Canadian companies that are not expected to be fully utilizable against future income. Canada does not have a consolidated tax filing process like the USA, and as such, losses that exist must be applied only against income of that company. Where the losses are not expected to be available to offset future income, the full value of these losses have not been recorded.

Goodwill In accordance with the new accounting standards outlined in sections 1581 and 3062 of the CICA Handbook, goodwill is no longer amortized, but is tested at least annually for impairment. As a result, there was no amortization of goodwill during fiscal 2003. Transition rules in effect for fiscal 2002 had allowed for the amortization of goodwill on businesses acquired before July 1, 2001. Goodwill amortized in fiscal 2002 was $2.2 million.

During fiscal 2002, Envoy performed an assessment of the carrying values of goodwill recorded in connection with its various businesses. The assessment was performed, because a number of factors indicated that impairment had arisen. Accordingly, Envoy recorded a write-down of $37.9 million in fiscal 2002, primarily related to the goodwill associated with the businesses of Sage, Promanad and Hampel. See Note 8 to the Financial Statements. At September 30, 2003, Envoy determined that no further charge for goodwill impairment was required.

Net Earnings (loss) Envoy earned net income of $2.5 million in fiscal 2003, compared to a loss of ($53.4) million in fiscal 2002. Included in the loss for fiscal 2002 is a writedown of goodwill in the amount of ($37.9) million, and an amortization of goodwill of ($2.2) million. The loss in fiscal 2002 before the goodwill writedown and amortization was ($13.3) million.

Fiscal Year Ended September 30, 2002 compared to Fiscal Year Ended September 30, 2001

Net revenue decreased by 29%, to $59.1 million in the fiscal year ended September 30, 2002, from $82.8 million in the fiscal year ended September 30, 2001. This decrease resulted from a combination of general economic slowdown in the North American and U.K. marketplace as well as specific slowdown within the advertising and technology markets, particularly in New York. Our revenue from marketing activities decreased $12.0 million from $24.4 million to $12.4 million, the largest portion of this decrease being a decline in revenue in New York of $11.7 million and a further decrease of approximately $300,000 in revenue relating to the Canadian marketing group. Technology revenue decreased $6.5 million from $15.0 million to $8.5 million. Again, part of the reduction in revenue relates to the decline in business at our New York operations. Net revenue from consumer and retail branding services decreased $5.2 million from $43.4 to $38.2 million.

Our five largest clients in fiscal 2002 accounted for 48.6% of our net revenue for such period, while our five largest clients in fiscal 2001 accounted for 37.5% of our net revenue for such period. No single client accounted for over 20% of our net revenue in either of such years.

Operating Expenses Salaries and benefits, general and administrative and occupancy costs represent our operating expenses. Salaries and benefits expenses include salaries, employee benefits, incentive compensation, contract labour, and other payroll related costs, which are expensed as incurred. General and administrative costs include business development, office costs, technology and professional services. Occupancy costs represent the costs of leasing and maintaining company premises.

Operating expenses decreased by 19% to $61.5 million for fiscal 2002 from $75.8 million in fiscal 2001. The primary reasons for the decrease in operating expenses were a decrease in salaries and benefits of $8.6 million, or 16%, and a decrease in general and administrative expenses of $5.7 million, or 33%. Occupancy costs decreased slightly from $4.8 million to $4.7 million.

In response to the significant decrease in revenues experienced by the Company in the first six months of the year, management implemented a plan to reduce salary and benefit expenses during the second quarter. As a result of this downsizing, a reduction of approximately $15.2 million in annual salary and benefit expenses was achieved, although all of these savings were not realized during the current year. General and administrative expenses also decreased as a result of both cost saving measures initiated by management and the overall decline in revenues. During fiscal 2002, the Company exited from excess office space in New York and subsequent to year-end the Company exited from excess office space in Toronto.

EBITDA Earnings before interest, taxes, depreciation and amortization before unusual items, restructuring costs and goodwill write-down (Adjusted EBITDA), we have excluded these charges as management believes such costs are non-recurring in nature. In fiscal 2002, we had a loss of ($2.4) million in Adjusted EBITDA, as defined, compared with income of $7.0 million in fiscal 2001.

Depreciation expense Depreciation expense remained consistent at $2.9 million in fiscal 2002 and fiscal 2001.

Interest expense Interest expense increased from $744,000 to $1.2 million. The increase in interest was largely due to an increase in interest rates year over year on our borrowing under our credit facility. Our effective rate of interest on this debt increased during the year to 8.5% from 4.5%. In addition, interest expense increased because of the issuance of $3.8 million convertible debentures during the year with interest being paid at 10% per annum. The convertible debentures also have a non-cash interest expense resulting from the accounting for the conversion features of the debentures. See Note 11 to the audited consolidated financial statements. Interest expense also includes fees associated with the restructuring of our bank loan facility of $290,000.

Unusual Item During 2002, as a result of changes in the banking loan arrangements, the Company was no longer allowed to fully utilize its $40 million line of credit and repayment terms were accelerated. Accordingly, the remaining unamortized portion of deferred financing charges totaling $751,000 was written off.

Restructuring As mentioned above, in response to a general economic downturn impacting the Company s business, management implemented a restructuring plan during the first half of fiscal 2002. The restructuring involved downsizing its workforce, exiting excess office space and writing off redundant capital assets. Accordingly, the Company has recorded a restructuring expense of $10.9 million. The restructuring includes a reduction of 156 employees, as well as the abandonment of 18,000 square feet of leased office space in New York City, and 35,000 square feet of leased office space in Toronto. The annual expense savings in salaries, benefits and occupancy costs associated with this restructuring is expected to be approximately $17.2 million.

The above factors resulted in a decrease in our earnings (loss) before income taxes and goodwill amortization and goodwill write-down from $1.5 million to ($18.1) million.

Income taxes In 2002, our effective income tax rate as a percentage of net income before goodwill amortization was (26.7%) compared to our 2001 effective tax rate of 92.2%. The difference relates primarily to the Company having a pretax loss in fiscal 2002, compared to pretax income in fiscal 2001, and certain expenses deducted in the accounts which have no corresponding deduction for income taxes as set forth in Note 13 in our audited consolidated financial statements. These expenses increased in 2002 due to the write-down of goodwill, certain costs incurred in connection with equity financing, and certain compensation expenses, which may not be deductible for tax purposes. See also Note 2(g) in our audited consolidated financial statements. In 2002 management recorded a valuation allowance of approximately $2.4 million in the carrying value of the deferred tax assets. The valuation allowance was considered appropriate because, in the opinion of management it is likely not able to realize the benefits.

Goodwill amortization Goodwill amortization decreased from $3.0 million to $2.2 million due largely to the write-down of goodwill during the year. Goodwill is largely not deductible for income tax purposes.

Write-down of goodwill During the year the Company performed an assessment of the carrying values of goodwill recorded in connection with its various businesses. The assessment was performed because a number of factors indicated that an impairment had arisen commencing in the period ended March 31, 2002, as well as later in fiscal 2002. Accordingly, the Company recorded a write-down of $37.9 million, which primarily related to the goodwill associated with the businesses of Sage, Promanad and Hampel. See Note 8 to the audited consolidated financial statements.

Net Earnings (loss) Primarily as a result of the foregoing factors, net loss increased from ($2.9) million in fiscal 2001 to ($53.4) million in fiscal 2002.

B. Liquidity and Capital Resources

In September 2002, Envoy entered into a forbearance agreement with the lenders under its bank credit facility, under which Envoy was required to meet certain financial tests and to make a series of principal payments, with the balance due on April 30, 2003.

In April 2003, the Company finalized the amendments to its banking arrangements and thereby normalized its credit facilities with its bankers. This new amendment gives the Company a demand operating line of $7,000,000. Interest rates are variable based on certain leverage ratios ranging from Prime plus 2.5% to 5.0% and at September 30, 2003 the effective interest rate was 8.0% (2002 8.5%). The demand operating facility is to be repaid and cancelled by April 30, 2004. Of the outstanding borrowings as at September 30, 2003, $nil (2002 Cdn. $3,178,691; US $2,002,704) is denominated in U.S. dollars. The facility is secured by a general security agreement against the Company and all of its subsidiaries.

As a condition to the credit facility amendment, the Company amended the terms of the existing debentures as described in Note 11 to the Financial Statements.

As a condition to the amendment, the Company was required to raise $2,000,000 to reduce its bank debt. On April 24, 2003 the Company issued $2,000,000 convertible debentures as part of the refinancing plan. These debentures may be converted into common shares, at a price of $0.15 each, for a total of 13,333,333 common shares.

As a condition of the amendment, the Company issued to its bankers warrants to purchase 2,300,000 common shares of the Company. Costs associated with this new banking amendment have been charged to interest expense and financing costs.

On October 31, 2003, the Company borrowed the amount of $4,500,000, of which $4,000,000 was raised by way of secured debentures and $500,000 by way of unsecured term notes. The loans bear interest at the rate of 10% per annum, mature on October 31, 2006, and carry warrants entitling the lenders to purchase, on or before April 24, 2008, one Envoy common share for each $2.00 principal amount of the loan at a price of $0.15 per share. These warrants were part of the Warrants previously issued to Envoy s bankers as described in Note 10(a) and Note 10 (c), and released to Envoy as part of its commitment to the bankers to raise additional funds to further reduce its bank indebtedness. All of these warrants have been exercised subsequent to the year-end. $3,800,000 of the loan proceeds were used to pay down the bank debt.

Our principal capital requirements have been used to fund acquisitions, including related earnout, capital expenditures and working capital purposes. The Company does not have any substantial earnout payments remaining on its previous acquisitions.

We had a working capital deficit of ($1.9) million and a cash balance of $2.7 at September 30, 2003. At September 30, 2002, we had a working capital deficit of ($7.7) million and a cash balance of $470,000. Working capital includes the reclassification of bank debt of $6.1 million in fiscal 2003, and $9.8 million in fiscal 2002, as a current liability due to the terms of the amended banking agreement entered into with the lenders, which requires full repayments of outstanding balances by April 30, 2004. The Company has used any excess cash balances to fund its working capital requirements however, such cash balance can vary significantly depending on client spending patterns and collection results. Subsequent to year-end, the Company has arranged a $4.5 million replacement of a portion of the lending facility as described above.

Net cash provided by (used in) operating activities was $5.3 million for the year ended September 30, 2003, ($20.9) million for the year ended September 30, 2002, and $19.9 million for the year ended September 30, 2001. Net cash provide by (used in) operating activities before any increase or decrease in non-cash operating working capital was $2.5 million for the year ended September 30, 2003, ($7.6) million for the year ended September 30, 2002, and $2.5 million for the year ended September 30, 2001. The increase in working capital is primarily a result of the higher earnings during 2003 and 2001.

Net cash provided by (used in) financing activities was ($2.1) million for the year ended September 30, 2003, $3.0 for the year ended September 30, 2002, and ($0.3) million for the year ended September 30, 2001. The higher use of cash related to financing activities has been the result of the changes in the banking arrangements of Envoy over the past two years. Envoy has issued $2.0 million and $3.8 million of convertible debentures in fiscal 2003 and 2002 respectively (see Notes 10 and 11 to the consolidated financial statements) as part of financing for this change in the bank borrowings of the Company.

Net cash used in investing activities was ($1.1) million for the year ended September 30, 2003, ($3.7) million for the year ended September 30, 2002, and ($5.4) million for the year ended September 30, 2001. The decrease is a result of lower expenses relating to acquisitions during 2003 and a reduction in capital expenditures over both of the previous two years.

At September 30, 2003 we had restricted cash of $1.0 million. At September 30, 2002 we had restricted cash of $1.8 million. This cash represents customer deposits held in trust for travel. See Note 4 to our audited consolidated financial statements.

Prospectus

On February 6, 2004, Envoy filed with the securities regulatory authorities of British Columbia, Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island, a preliminary short form prospectus qualifying the distribution in such provinces of units (Units) comprised of common shares of Envoy and common share purchase warrants.

In connection with the distribution, Envoy will appoint Canaccord Capital Corporation as its agent to offer Units for sale on an underwritten basis . This transaction is subject to certain conditions including normal regulatory approvals. Closing is anticipated to occur in late February 2004. The proceeds will be used to repay, subject to negotiation with certain lenders, all of Envoy s outstanding loan indebtedness, with the balance to be used for possible future acquisitions and for general corporate and working capital purposes.

On February 10, 2004 Envoy announced that it has entered into an underwriting commitment with Canaccord Capital Corporation (Canaccord) under which Canaccord has agreed to buy from Envoy and sell to the public 26,315,800 Units (the Units) at C$1.33 per Unit, each Unit consisting of one common share of Envoy (the Common Shares) and one half of one transferable common share purchase warrant (the Warrants). Each whole Warrant will entitle holder to purchase one Common Share at a price of C$1.80 per Common Share for a period of five years from the closing of the transaction.

The Units will be offered under Envoy s final short form prospectus dated February 13, 2004. The sale of the 26,315,800 Units will result in Envoy receiving gross proceeds of approximately Cdn. $35 million. Envoy has also granted to Canaccord an over-allotment option to purchase an additional 3,947,370 Units at Cdn. $1.33 per Unit for a period of 60 days from the closing of the offering, which is expected to occur on or about February 20, 2004.

Management believes the offering will enable Envoy to achieve two important goals. In addition to allowing Envoy to eliminate its debt, the size of this offering will permit Envoy to engage in a meaningful M&A program.

Critical Accounting Policies

The significant accounting policies used by Envoy in preparing its consolidated financial statements are described in Note 2 to the Financial Statements and should be read to ensure a proper understanding and evaluation of the estimates and judgements made by management in preparing those Financial Statements. Envoy s Financial Statements are prepared in accordance with Canadian generally accepted accounting principles. Envoy also prepares a reconciliation to United States generally accepted accounting principles, which is included in Note 22 to the Financial Statements.

Inherent in the application of some of those policies is the judgement by management as to which of the various methods allowed under generally accepted accounting principles is the most appropriate to apply in the case of Envoy. As well, management must take appropriate estimates at the time the financial statements are prepared.

Although all of the policies identified in Note 2 to the Financial Statements are important in understanding the Financial Statements, the policies discussed below are considered by management to be central to understanding the Financial Statements, because of the higher level of measurement uncertainties involved in their application.

Goodwill Goodwill represents the price paid for acquisitions in excess of the fair market value of net tangible and intangible assets acquired. Effective October 1, 2002, the Company adopted the recommendations of the CICA Handbook Section 3062 Goodwill and Other Intangible Assets . These standards require that goodwill and other intangible assets determined to have indefinite lives are no longer amortized but tested for impairment based on the fair value of the Company s reporting units on adoption of the standard and at least annually thereafter. Transitional impairment tests for goodwill were completed as at October 1, 2002 and an annual impairment test completed on March 31, 2003 and, as a result no write-down was required. Prior to 2003, the Company amortized goodwill on a straight-line basis over periods ranging from 7 to 25 years and goodwill was considered to be impaired since the future anticipated undiscounted cash flows from the acquired businesses were less than the carrying value of goodwill. Goodwill arising on acquisitions completed after June 30, 2001 was not amortized.

Income Taxes Envoy accounts for income taxes using the liability method. Under this method, future income taxes are recognized at the enacted or substantially enacted tax rate expected to be applicable at the anticipated date of the reversal for all significant temporary differences between the tax and accounting bases of assets and liabilities and for certain tax carry forward items. Future income tax assets and liabilities are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future operating results and future tax rates could vary materially, and accordingly the value of income tax assets and liabilities could change by material amounts.

Envoy currently has recorded a substantial valuation allowance for losses generated in Canadian companies that are not expected to be fully utilizable against future income. Canada does not have a consolidated tax filing process like the USA, and as such, losses that exist must be applied only against income of that company. Where the losses are not expected to be available to offset future income, the full value of these losses have not been recorded.

Impact of Recently Issued Canadian Accounting Standards

Stock Based Compensation and Other Stock-based Payments

In accordance with the requirements of the CICA Handbook, effective October 1, 2002, Envoy adopted the new standards of the CICA Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments. The standard requires either the recognition of a compensation expense for grants of stock, stock options and other equity instruments to employees, based on the estimated fair value of the instrument at the grant date or, alternatively, the disclosure of pro forma net earnings and earnings per share data, as if stock-based compensation had been recognized in earnings. Envoy has elected to record as an expense, only amounts given to directors and other non-employees as compensation for work performed beyond the normal duties of the position and to disclose pro forma net earnings and earnings per share data. See Note 12 to the Financial Statements for more information.

Goodwill

In accordance with the new accounting standards outlined in sections 1581 and 3062 of the CICA Handbook, goodwill is no longer amortized, but is tested at least annually for impairment. Transition rules in effect for fiscal 2002 had allowed for the amortization of goodwill on businesses acquired before July 1, 2001.

C. Research and Development, Patents and Licenses, etc.
Not applicable

D. Trend Information
Not applicable

E. Off-balance sheet arrangements
None

F. Commitments and Contractual Commitments
Set out below is a summary of the amounts due and committed under contractual cash obligations at September 30, 2003 (all amounts in thousands):

	Total	Due in 1 year or less	Due between years 2 and 3	Due between years 4 and 5	Due after 5 years
Bank credit facility and other debt	$ 8,193	$ 6,858	$ 942	$ 258	$ 135
Operating leases	8,562	1,904	3,225	2,142	1,291
Restructuring and shut down of subsidiaries commitments	1,352	1,015	337		
Convertible debentures*	4,390			4,390	
Total contractual cash obligations	$ 22,497	$ 9,777	$ 4,504	$ 6,790	$ 1,426

* *The convertible debentures are repayable in cash at maturity on April 24, 2008. See Notes 10 and 11 to the Financial Statements. Subsequent to the year-end, all convertible debentures have been converted into common shares of Envoy.*

Other Commitments

The Company has letters of credit outstanding of U.S. $500,000 which expire on April 30, 2004.

The shares held by the minority shareholders of John Street Inc., representing a 30% interest, are mandatorily redeemable by the Company at September 30, 2004 for cash consideration and as such represents a financial liability of the Company. No amount has been accrued in the financial statements as the purchase price will be determined and paid over a three-year period based on certain performance milestones.

G. Safe Harbor
Not applicable

Item 6. DIRECTORS AND SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management
The following table sets forth certain information regarding the directors and senior managers of Envoy as of January 31, 2004. Each director is elected at the annual meeting of shareholders to serve until the next annual meeting or until a successor is elected or appointed.

Name	Age	Positions Held with Envoy
Geoffrey B. Genovese	49	President, Chairman and Chief Executive Officer and Director
John H. Bailey	58	Executive Vice President, Corporate Secretary and Director
David Hull[1,2]	47	Director
Hugh Aird[1,2]	50	Director
David Parkes[1,2]	57	Director
Linda Gilbert	35	Chief Financial Officer

[1] Member of the Audit Committee.

[2] Member of the Compensation Committee.

The principal occupations and positions for the past five years and, in certain cases, prior years of the directors and executive officers of Envoy are as follows:

Geoffrey B. Genovese. Mr. Genovese founded The Incentive Design Company Ltd., a business and marketing communications company, in 1981. Envoy acquired IDC in July 1991. Mr. Genovese currently serves as Chairman, President and Chief Executive Officer of Envoy Communications Group Inc. and Chief Executive Officer of Watt International Inc. Mr. Genovese was appointed Chairman in September 2001. Mr. Genovese has been a Director of Envoy since July 1991.

John H. Bailey. Mr. Bailey is a barrister and a solicitor who has been in private practice since 1973. Mr. Bailey earned a Bachelor of Commerce and a Bachelor of Laws degree from the University of Toronto, and a Master of Laws degree from York University. Mr. Bailey has been a Director of Envoy since April 1994, Corporate Secretary since August 1997, and Executive Vice-President since February 2004.

David Hull. Mr. Hull has been the President of Hull Life Insurance Agencies Inc. since May 1991. Hull Life Insurance Agencies Inc. specializes in estate planning and life and disability insurance. Prior thereto, Mr. Hull served as Executive Vice President of Hull Life Insurance Agencies Ltd. and Thomas I. Hull Insurance Ltd., members of The Hull Group of Companies. Mr. Hull has been a Director of Envoy since January 1995.

Hugh Aird. Mr. Aird is presently Senior Relationship Manager, Morgan Stanley Canada. Prior to joining Morgan Stanley Canada in 2003, Mr. Aird was Vice President, Business Development, Mulvihill Capital Management Inc. Prior to joining Mulvihill Capital Management Inc. in 2001, Mr. Aird was Vice Chairman of Merrill Lynch Canada Inc. (formerly Midland Walwyn Capital Inc.). Mr. Aird first became a director of Envoy on August 20, 1997. As a result of personal commitments, Mr. Aird resigned as a director on April 1, 2003. On November 24, 2003, Mr. Aird was re-elected as a director of Envoy.

David Parkes Mr. Parkes is presently President of Freefone Inc. Prior to joining Freefone Inc. in 2003, Mr. Parkes founded David Parkes & Assoc. in 2001. Mr. Parkes was President and CEO of Look Communications Inc. until 2001 and President and CEO of TeleSpectrum Canada Inc. until 1999. Mr. Parkes has been a Director of Envoy since October 2002.

Linda Gilbert,CA Mrs. Gilbert joined Envoy in 1999 as Director of Finance. In 2003, Mrs. Gilbert was promoted to the position of Chief Financial Officer. Prior to joining Envoy, Mrs. Gilbert was a manager of KPMG LLP in Canada, an accounting firm.

The Ontario Business Corporations Act requires that a majority of Envoy s directors be Canadian residents. There are no arrangements or understandings between any director or executive officer of Envoy pursuant to which he was selected as such.

B. Compensation

The following table sets forth in Canadian dollars all compensation for the fiscal year ended September 30, 2003 paid to the Chief Executive Officer of Envoy and the four other most highly compensated officers who served as executive officers of the Company (the Named Executive Officers):

Name and Principal Position	Annual Compensation Salary ($)	Annual Compensation Bonus ($)	Annual Compensation Other Annual ($)	Long Term Compensation – Awards Securities Under Option/SARs Granted (#)	Long Term Compensation – Awards Restricted Shares or Restricted Share Units ($)	Long Term Compensation – Payouts LTIP Payouts ($)	All Other Compensation ($)
Geoffrey B. Genovese, Chairman, President and Chief Executive Officer	496,903		135,000[1]				
Linda Gilbert, Chief Financial Officer, Envoy	131,810			75,000			
Stephen Bloomfield, Executive Vice President, Watt Gilchrist	70,000[2]			100,000			
Arthur Fleischmann, President, John Street Inc.	225,000			150,000			
Patrick Rodmell Managing Director, Watt International Inc.	204,288		30,000	100,000			

[1] The amount was paid to a corporation related to Mr. Genovese as an annual management fee.

[2] The amount paid to Stephen Bloomfield is paid in Pounds sterling. For the year ended September 30, 2003 the exchange rate for this payment would be done at a rate of $2.3425 per pound.

The following table sets forth options granted under the Stock Option Plan to the Named Executive Officers of the Company in the most recently completed fiscal year:

Name	Shares Under Options Granted (#)	Percentage of Total Options Granted to Employees in Financial Year	Date of Grant	Exercise Price ($/Security)	Market Value of Shares Underlying Options on Date of Grant ($/Security)	Expiry Date
Geoff Genovese	Nil	Nil	Nil	Nil	Nil	Nil
Linda Gilbert	25,000[1]	1.37%	October 28, 2002	$0.25	$0.25	October 27, 2007
	50,000[3]	2.75%	July 7, 2003	$0.40	$0.40	July 6, 2008
Arthur Fleischmann	100,000[2]	5.49%	October 28, 2002	$0.25	$0.25	October 27, 2007
	50,000[3]	2.75%	July 7, 2003	$0.40	$0.40	July 6, 2008
Patrick Rodmell	100,000[2]	5.49%	October 28, 2002	$0.25	$0.25	October 27, 2007
Stephen Bloomfield	100,000[2]	5.49%	October 28, 2002	$0.25	$0.25	October 27, 2007

NOTES:

1. These options vest at the rate of 1/3rd during each of the 1st, 2nd and 3rd years of a five year term.

2. These options vest at the rate of 1/3rd during each of the 2nd, 3rd and 4th years of a five year term.

3. These options vest immediately.

The following table sets forth options exercised under the Stock Option Plan to the Named Executive Officers of the Company in the most recently completed fiscal year and the value of unexercised options held by them as at the most recent fiscal year:

Stock Options Exercised During 2003 Fiscal Year

Name	**Number of Shares Acquired on Exercise**	**Aggregate Value Realized ($)**	**Unexercised Options at FY-End (#) Exercisable/ Unexercisable**	**Value of Unexercised In-the Money Options at FY-End ($) Exercisable/Unexercisable[1]**
Geoff Genovese	Nil	Nil	Nil	Nil
Linda Gilbert	38,334	$31,350	40,000/16,666	$14,000/$14,166
Arthur Fleischmann	50,000	$44,750	150,000/100,000	0/$85,000
Patrick Rodmell	Nil	Nil	7,500/100,000	0/$85,000
Stephen Bloomfield	Nil	Nil	0/100,000	0/$85,000

1 The closing stock price of the Common Shares of the Company on the Toronto Stock Exchange on September 30, 2003 was $1.10.

The Company does not provide any pension, retirement plan or other remuneration for its directors or officers that constitutes an expense to the Company, nor are there any plans or arrangements in respect of compensation received or that may be received by executive officers in the Company s most recently completed or current fiscal year to compensate such officers in the event of the termination of employment or a change in control of the Company.

Employment Contracts and Termination Agreements

The Company and its subsidiaries, John Street Inc. (John St.), Watt International Inc. (Watt) and Watt Gilchrist Limited (Gilchrist), have entered into employment contracts with the Named Executive Officers.

Geoffrey B. Genovese has agreed to act as the Company s Chairman and President and Chief Executive Officer at an annual base salary of $550,000, together with a discretionary bonus based on the achievement of agreed upon criteria established from time to time by the Compensation Committee. Mr. Genovese has agreed to a 10% reduction in his base salary for an indefinite period of time, commencing February 1, 2002. This agreement provides for a severance payment equivalent to $300,000 plus an amount equal to three times the total remuneration and other compensation paid to Mr. Genovese and his management company during the 12 month period preceding termination, if Mr. Genovese s employment is terminated, without cause, by the Company and a severance payment equivalent to $300,000 plus an amount equal to two times the total remuneration and other compensation paid to Mr. Genovese and his management company during the 12 month period preceding termination, if there is a change of control of the Company or Mr. Genovese ceases to be Chairman of the Board of the Company, other than as a result of his resignation, disqualification or death. An annual fee of $150,000, also reduced by 10% since February 1, 2002, is also payable to Mr. Genovese s management company pursuant to a management agreement with the Company. The management agreement has a fixed term ending on September 30, 2004.

Linda Gilbert has agreed to act as the Company s Chief Financial Officer at an annual salary of $150,000. This agreement provides for a severance payment equivalent to her base salary for a period of up to six months, if her employment is terminated, without cause, by the Company.

Arthur Fleischmann has agreed to act as the President of John St. at an annual base salary of $300,000, together with an annual cash bonus based on the performance of John St. This agreement provides for a severance payment equivalent to his base salary and benefits for a period of ten months, if his employment is terminated, without cause, by the Company.

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Patrick Rodmell has agreed to act as the Managing Director of Watt at an annual base salary of $225,000 together with an annual cash bonus based on the performance of Watt. This agreement provides for a severance payment equivalent to his base salary and benefits for a period of up to four months, if his employment is terminated, without cause, by the Company.

Stephen Bloomfield has agreed to act as Vice President and Chief Executive Officer of Gilchrist at an annual base salary of £70,000 together with an annual cash bonus based on the performance of Gilchrist. This agreement provides for a severance payment equivalent to his base salary for a period of twelve months, if his employment is terminated, without cause, by the Company.

Compensation of Directors

Certain directors, who are not officers of the Company or any of its affiliates, are compensated for their services as directors and members of a committee through a combination of annual and meeting attendance fees. Messrs. Aird and Parkes are each entitled to receive an annual director s fee of $25,000.00. In addition, each of Messrs. Aird, Parkes and Hull are entitled to receive a fee of $500.00 for each Board meeting and $1,000.00 for each committee meeting attended. No compensation is paid to the other directors for their services as directors or members of a committee. Directors are also entitled to participate in the Company s Stock Option Plan.

In the fiscal year ended September 30, 2003, Envoy paid approximately $313,000 Cdn. to John H. Bailey, Barrister & Solicitor, for legal services provided to Envoy.

Directors and Officers Liability Insurance

The Company maintains liability insurance for the benefit of the directors and officers of the Company and its subsidiaries against liability incurred by them in their respective capacities. The current annual policy limit is $5,000,000. Under the policy, individual directors and officers are reimbursed for losses incurred in their capacities as such, subject to a deductible of $250,000 for claims arising in the United States and $150,000 for all other claims. The deductible is the responsibility of the Company. The Company paid the annual premium of $125,000.

C. Board Practices
CORPORATE GOVERNANCE

The following describes the Company s corporate governance practices with specific reference to the guidelines contained in the Report of the TSX Committee on Corporate Governance in Canada (the TSX Report).

Mandate of the Board

The Board of Directors (the Board) holds meetings whenever appropriate to oversee the conduct of the Company s business and monitor and evaluate the day-to-day management of the Company. With respect to risk management activities, the Board is presented, at each meeting, reports on operations, financial status, material contracts and litigation.

In addition to the Board s statutory responsibilities under the Business Corporations Act of Ontario, the Board s stewardship responsibilities include the following: (a) assessing the principal risks arising from or incidental to the business activities of the Company; (b) appointing all senior executives of the Company and, through the Compensation Committee of the Board, developing and implementing the executive compensation policies and reviewing the performance of senior executives with reference to the Company s policies, stated budget and other objectives; (c) overseeing the Company s policies regarding public communications, investor relations and shareholder communications; and (d) monitoring and assessing, through the Audit Committee of the Board, the scope, implementation and integrity of the Company s internal information, audit and control systems.

The Board has delegated the responsibility for monitoring the effectiveness of the Company s internal information systems to the Company. The Audit Committee is also responsible for reviewing and appraising the soundness, adequacy and application of financial and other operating controls, determining the extent of compliance with established policies, plans and procedures and ascertaining the reliability and timeliness of management data developed within the organization.

Composition of the Board

The articles of the Company provide that there shall be a Board of not less than 3 or more than 10 directors. There are currently five directors of the Company, one of whom is an inside and related (as such terms are defined in the TSX Report) director; one of whom is an outside and related director; and three of whom are outside and unrelated directors. Geoffrey B. Genovese, the Chairman and President of the Company is the inside and related director. Hugh Aird, David Hull and David Parkes are the outside and unrelated directors of the Company. John H. Bailey is an outside director but, as counsel who provides ongoing legal services to the Company, may be considered to be a related director. The Board intends to periodically examine its size and constitution to ensure responsible corporate governance and effective corporate management.

Governing Committees

The directors have established the Audit Committee and the Compensation Committee to focus resources and expertise in certain areas of the Board s mandate.

Audit Committee

The Board has delegated to the Audit Committee of the Board responsibility for ensuring management has designed and implemented an effective management system and for reviewing internal information, audit, control and management systems. The Audit Committee is comprised of three directors, Hugh Aird, David Parkes and David Hull. All three members of the Audit Committee are outside and unrelated directors of the Company.

The Audit Committee is responsible for reviewing the Company s annual consolidated financial statements and reporting to the Board in connection therewith. The Audit Committee is also responsible for monitoring the Company s internal controls and information gathering systems and dealing with the Company s external auditors. On February 22, 2000, the Audit Committee adopted a formal written audit committee charter, which specifies the auditor s accountability to the Board and the authority and responsibilities of the Audit Committee.

Compensation Committee

The Compensation Committee is comprised of three directors, David Hull, David Parkes and Hugh Aird, all of whom are outside and unrelated directors. The Compensation Committee reviews, administers and monitors the Company s executive compensation plans, policies and programs, including the compensation of all executive officers and, if requested by the President, reviews the compensation of any other officer or senior employee.

Corporate Governance Committee

The Board has not, as yet, established a Corporate Governance Committee as recommended in the TSX Report and believes that the matters ordinarily considered by such a committee are effectively administered by the Board s outside and unrelated directors. Although, at present, the Board has determined this to be the most practical approach to responsible corporate governance, the Board will continue to evaluate this determination as circumstances dictate.

Expectations of the Board

The Board expects management of the Company to report to the Board in a comprehensive, accurate and timely fashion on the business and affairs of the Company generally and on specific matters that it considers to have material consequences for the Company and its shareholders. Management is expected to continually develop and review the Company s strategic plan to make the decisions necessary to give effect to the plan; to adhere to the Company s operational policies; and to monitor the Company s financial performance in comparison to the annual budget, with the ultimate goal of enhancing shareholder value.

Shareholder Communication

The objective of the Company s shareholder communication policy is to ensure open and timely exchange of information relating to the Company s business, affairs and performance, subject to the requirements of applicable securities legislation and other statutory and contractual obligations limiting the disclosure of such information. Information material to the Company s business is released through news wire services, the general media, telephone conferences and shareholder mailings, thereby ensuring timely dissemination. Additionally, individual queries, comments or suggestions can be made at any time directly to the Company s secretarial department located at its head office.

D. Employees

As at January 31, 2004, Envoy has 154 full time employees based in Toronto, Canada, 12 based in the United States, and 73 based in the United Kingdom and Continental Europe. Of this total, 17 employees were engaged in marketing, and 222 in consumer and retail branding.

As at January 31, 2003, Envoy has 175 full time employees based in Toronto, Canada, 31 based in the United States, and 133 based in the United Kingdom and Continental Europe. Of this total, 29 employees were engaged in marketing, and 310 in consumer and retail branding.

As at January 31, 2002, Envoy had 292 full time employees based in Toronto, Canada, 60 based in the United States, and 158 based in the United Kingdom and Continental Europe. Of this total, 75 employees were engaged in marketing, 361 in consumer and retail branding, and 73 in technology.

E. Share Ownership

As of January 31, 2004, the options and other rights to purchase common shares of Envoy consisted of stock options to purchase 1,229,748 common shares.

Options

Stock Option Plan

The Company has established a Stock Option Plan pursuant to which options to purchase Common Shares and stock appreciation rights may be granted to directors, officers, employees or certain consultants to the Company or any of its subsidiaries, as determined by the Board, at prices to be fixed by the directors, subject to limitations imposed by any Canadian stock exchange on which the Common Shares are listed for trading and any other regulatory authority having jurisdiction in such matters. The Common Shares subject to each option shall become purchasable at such time or times as may be determined by the directors. Stock appreciation rights (SARs) may only be granted in conjunction with an option and, when exercised, entitle the holder to receive an amount equal in value to the excess of the market value of the Common Shares over the price of the related option. The excess amount is payable in Common Shares having a market value equal to such excess. Options are non-assignable and non-transferable by the option-holder and shall be exercisable during the option-holder s lifetime only by the option-holder. Stock appreciation rights are non-transferable and terminate when the related option terminates.

The maximum number of Common Shares currently reserved for issuance upon exercise of options under the Stock Option Plan is 4,000,000 Common Shares. As at September 30, 2003 options to purchase 1,741,416 Common Shares have been granted and are outstanding under the Stock Option Plan. There are no SARs outstanding under the Stock Option Plan. The aggregate number of Common Shares reserved for issuance to any one individual under the Stock Option Plan may not exceed 5% of the issued and outstanding Common Shares.

During fiscal 2003, the President of the Company, Geoffrey B. Genovese, elected to cancel his stock options to purchase 950,000 Common Shares, being all of the options to purchase Common Shares granted to Mr. Genovese under the Stock Option Plan. The cancellation of these stock options resulted in an additional 950,000 Common Shares being available for grant, without increasing the maximum number of Common Shares reserved for issuance upon exercise of options under the Stock Option Plan.

The following table describes the options to acquire common shares that are outstanding pursuant to the Stock Option Plan or otherwise as of January 31, 2004:

Class of Optionee	Number of Common Shares Under Options Granted	Exercise Price	Date of Expiry
Linda Gilbert	8,333	$ 0.25	October 27, 2007
Linda Gilbert	5,000	$ 3.05	August 1, 2007
Linda Gilbert	15,000	$ 3.90	March 7, 2004
Arthur Fleischmann	66,666	$ 0.25	October 27, 2007
Arthur Fleischmann	150,000	$ 3.05	August 1, 2007
Patrick Rodmell	66,666	$ 0.25	October 27, 2007
Patrick Rodmell	7,500	$ 3.05	June 27, 2006
Stephen Bloomfield	100,000	$ 0.25	October 27, 2007
	408,333	$ 0.25	October 27, 2007
	75,000	$ 0.61	May 29, 2007
	232,250	$ 3.05	August 1, 2007
	35,000	$ 3.90	March 7, 2004
	15,000	$ 6.20	August 10, 2004
Other	45,000	$ 7.40	March 30, 2005
Total	1,229,748		

The following table sets forth shares owned by the Chairman, President and Chief Executive Officer of Envoy and the four other most highly compensated officers who served as executive officers of the Company as of January 31, 2004 (the Named Executive Officers):

Identity of Person	Number of Common Shares Owned	Percent of Outstanding Class
Geoff Genovese	1,138,551	1.80%
Linda Gilbert	733	Nil
Arthur Fleischmann	Nil	Nil
Patrick Rodmell	Nil	Nil
Stephen Bloomfield	Nil	Nil

Convertible Debentures

As described in Note 11 to the audited consolidated financial statements, Envoy issued one series of convertible debentures in fiscal 2003 for proceeds of $2.0 million, and two series of convertible debentures in 2002 for proceeds of $3.8 million. The debentures are convertible until their respective maturity dates into a maximum of 38,666,667 common shares.

As at September 30, 2003 convertible debentures with a face value of $1,410,000 were converted into 9,400,000 common shares. Subsequent to the year-end, all of the outstanding convertible debentures were converted into 29,266,667 common shares by January 31, 2004.

Share Purchase Warrants

As described in Note 10 to the financial statements, Envoy issued 2,300,000 share purchase warrants to its bankers as part of normalizing its banking facilities. These warrants were part of the Warrants previously issued to Envoy s bankers as described in Note 10(a) and Note 10 (c), and released to Envoy as part of its commitment to the bankers to raise additional funds to further reduce its bank indebtedness. All of these warrants have been exercised subsequent to the year-end, and 2,300,000 common shares have been issued.

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Ownership of Envoy s securities are recorded on the books of its transfer agent in registered form, however the majority of such shares are registered in the name of intermediaries such as brokerage firms and clearing houses on behalf of their respective clients and in general Envoy does not have knowledge of the beneficial owners thereof, except for the beneficial ownership by officers and directors of Envoy. Envoy is not directly or indirectly owned or controlled by another corporation or entity or by any foreign government. Envoy is not a party to any arrangement, and does not know of any other arrangements, the operation of which may at a subsequent date result in a change in control of Envoy.

At a special meeting of the shareholders Envoy held on January 8, 2004, the shareholders approved an amendment to the Articles of the Company to increase its authorized share capital from 50,000,000 common shares to 200,000,000.

As of January 31, 2004, Envoy had an authorized share capital of 200,000,000 common shares without par value, of which 62,950,363 shares were issued and outstanding.

The following table sets forth certain information regarding the ownership of outstanding common shares of Envoy as of January 31, 2004 with respect to each person known by Envoy to be the owner either of record or beneficially of more than 5% of the issued and outstanding common shares of Envoy. As used in this table, beneficial ownership refers to the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security. A person is deemed to be the beneficial owner of securities that can be acquired within 60 days from the date of this Form 20-F through the exercise of any option, warrant or right. Common shares subject to options, warrants or rights which are currently exercisable or exercisable within 60 days are deemed outstanding for computing the ownership percentage of the person holding such options, warrants or rights, but are not deemed outstanding for computing the ownership percentage of any other person.

Identity of Person or Group	Number of Common Shares	Percent of Outstanding Class
CDS & Co[1] NCI Account P.O. Box 1038 Station A 25 The Esplanade Toronto, Ontario M5W 1G5	58,403,014	92.8%
Cede & Co.[1] P.O. Box 20 Bowling Green Station New York, NY 10274 USA	3,146,987	5.0%
Geoffrey B. Genevose[2]	1,138,551	1.8%

1 CDS & Co. and Cede & Co., respectively, are the record holders of these shares and in general the ultimate beneficial owners of these shares are not known to Envoy.

2 Includes common shares held by family members.

See also Item 6.E. Share Ownership for information regarding outstanding stock options to purchase 1,229,748 common shares.

As of January 31, 2004 there were 62,950,363 outstanding common shares of Envoy of which 59,467,161 were held of record by 35 Non-U.S. residents and 3,483,202 of which were held of record by 136 U.S. residents. The foregoing information regarding the number and the country of residence of Envoy s shareholders does not reflect those shareholders whose shares are being held of record by brokerage clearing houses and in general the ultimate beneficial owners of these shares are not known to Envoy.

As disclosed in Note 6 to the Financial statements, the following are transactions that took place during fiscal 2003 that involved related parties:

B. Related Party Transactions

In October and November 2002 the Company sold the operations of Devlin Multimedia Inc. (Devlin) to Catherine Devlin and Sage to a management group of that company (see Note 15).

During the year, Richard Genovese, brother of the CEO and Christine Genovese, wife of the CEO, loaned the Company $225,000 of which $150,000 was outstanding to Richard Genovese at year-end. The loan bears interest at 10% per annum and is repayable on demand.

During the year, Claudine Bailey, wife of the director and corporate secretary, loaned the Company $75,000 which was repaid prior to year end. The loan bore an interest rate of 10% per annum, and was repayable on demand.

During the year, Richard Genovese, Christine Genovese and Claudine Bailey were part of the group that loaned the Company $2,000,000 of convertible debentures described in Note 11. In total, these relatives of officers loaned the Company $1,850,000, of which $1,070,000 was outstanding at year-end, and were all converted by January 31, 2004.

Richard Genovese loaned $1,200,000 of which $870,000 was outstanding at year-end. Christine Genovese loaned $400,000 of which $100,000 was outstanding at year-end. Claudine Bailey loaned $250,000 of which $100,000 was outstanding at year-end.

Except as disclosed above, no director or executive officer, and no relative or spouse of the foregoing persons (or relative of such spouse) who has the same house as such person or is an executive officer, or director, of any parent or subsidiary of Envoy, has, or during the last fiscal year of Envoy had, any material interest, direct or indirect, in any transactions, or in any proposed transaction, which in either such case has materially affected or will materially affect Envoy.

Under the applicable Canadian provincial securities laws, insiders (generally officers and directors of the Registrant and its subsidiaries) are required to file individual insider reports of changes in their ownership in the Registrant s securities within 10 days following any trade in Envoy s securities. Copies of such reports are available for public inspection at the offices of the British Columbia Securities Commission, Suite 1100, 865 Hornby Street Vancouver, British Columbia V6Z 21-14 (telephone 604/660-4800), at the offices of the Alberta Securities Commission, 410-300 5th Avenue, S.W., Calgary, Alberta T2P 3C4 (telephone 403/297-6454), at the offices of the Quebec Securities Commission, Stock Tower Exchange, 800 Victoria Square, Montreal, Quebec M42 1G3 (telephone 514/940-2150) and at the offices of the Ontario Securities Commission, 20 Queen Street West, 18th Floor, Toronto, Ontario M5H 358 (telephone 416/597-0681).

Item 8. FINANCIAL INFORMATION

See Item 17 Financial Statements .

Item 9. THE OFFER AND LISTING

A. Offer and Listing Details

Envoy s common shares are listed for trading on the Toronto Stock Exchange (the TSX) under the symbol ECG and on the Nasdaq Small Cap Market (Nasdaq) under the symbol ECGI . The common shares began trading on Nasdaq on June 6, 2000 and on the TSX on September 3, 1997. From March 1984 until September 2, 1997 Envoy s shares traded on the Vancouver Stock Exchange.

The following table sets forth the reported high and low sale prices in Canadian dollars for the common shares on the TSX for the fiscal, quarterly and monthly periods indicated.

	High	Low
Fiscal 1999	9.20	3.40
Fiscal 2000	10.35	4.80
Fiscal 2001	8.75	2.10
Quarterly 2002		
First Quarter	2.90	1.45
Second Quarter	1.75	0.76
Third Quarter	1.16	0.41
Fourth Quarter	0.49	0.20
Quarterly 2003		
First Quarter	0.47	0.14
Second Quarter	0.32	0.11
Third Quarter	0.58	0.11
Fourth Quarter	1.55	0.39

	High	Low
For the month ending		
January 31, 2004	1.82	0.87
December 31, 2003	1.26	1.04
November 30, 2003	1.45	1.20
October 31, 2003	1.39	1.18
September 30, 2003	1.55	1.10
August 31, 2003	1.25	0.69

The following table sets forth the reported high and low sale prices in US dollars of trading for the common shares as reported on Nasdaq for the fiscal, quarterly and monthly periods indicated.

	High	Low
Fiscal 2000	$10.50	$4.34
Fiscal 2001	5.88	1.40
Quarterly 2002		
First Quarter	1.74	0.95
Second Quarter	0.70	0.51
Third Quarter	0.70	0.30
Fourth Quarter	0.34	0.13
Quarterly 2003		
First Quarter	0.29	0.09
Second Quarter	0.22	0.06
Third Quarter	0.42	0.06
Fourth Quarter	1.14	0.28
For the month ending		
January 31, 2004	1.40	0.66
December 31, 2003	0.94	0.80
November 30, 2003	1.10	0.89
October 31, 2003	1.14	0.92
September 30, 2003	1.14	0.81
August 31, 2003	0.92	0.50

On January 31, 2004 the closing price of the common shares as reported on the TSX was $1.82 and on Nasdaq was US $1.34.

See Item 6.E. with respect to Share Ownership for information regarding outstanding stock options to purchase 1,229,748 common shares.

B. Plan of Distribution
Not applicable

C. Markets
See above section A. Offer and listing details

D. Selling Shareholders
Not applicable

E. Dilution
Not applicable

F. Expenses of the issue
Not applicable

Item 10. ADDITIONAL INFORMATION

A. Share Capital
Not applicable

B. Memorandum and Articles of Association
Envoy s memorandum and articles of association were previously filed with our registration statement on Form 20-F dated April 20, 2000 for the fiscal year ended September 30, 1999.

C. Material Contracts
None

D. Exchange Controls and Other Limitations Affecting Security Holders
There is no governmental law, decree or regulation in Canada that restricts the export or import of capital, or that affects the remittance of dividends, interest or other payments to a non-resident holder of common shares of Envoy, other than withholding tax requirement. See Item 10.E. Taxation.

There is no limitation imposed by the laws of Canada, the laws of Ontario or British Columbia or by the charter or other constituent documents of Envoy on the right of a non-resident to hold or vote common shares of Envoy, other than as provided in the Investment Canada Act (Canada) (the Investment Act). The following discussion summarizes the material provisions of the Investment Act which relate to the acquisition by a non-resident of common shares of Envoy. This summary is not a substitute for independent advice from an investor s own advisor, and it does not take into account any future statutory or regulatory amendments.

The Investment Act generally prohibits implementation of a reviewable investment by an individual, government or agency thereof, corporation, partnership, trust or joint venture that is not a Canadian as defined in the Investment Act (a non-Canadian), unless after review the minister responsible for the Investment Act (the Minister) is satisfied that the investment is likely to be of net benefit to Canada. An investment in common shares of Envoy by a non-Canadian, other than a WTO investor (as defined in the Investment Act) at any time Envoy is not controlled by a WTO investor, is reviewable under the Investment Act if the investment is to acquire control of Envoy and the value of the assets of Envoy is over $5,000,000 Cdn. for a direct acquisition and over $50,000,000 Cdn. for an indirect acquisition or if an order for review is made by the Federal Cabinet on the grounds that the investment relates to Canada s cultural heritage or national identity. An investment in common shares of Envoy by a WTO investor, or by a non-Canadian at any time Envoy is controlled by a WTO investor, is reviewable under the Investment Act if the investment is to acquire control of Envoy and the value of the assets of Envoy is not less than Cdn. $150,000,000 in terms of constant 1992 dollars , which for 2003 is Cdn. $223,000,000. A non-Canadian would acquire control of Envoy for the purposes of the Investment Act if such investor acquired a majority of the common shares of Envoy unless it could be established that, on the acquisition, Envoy was not controlled in fact by the acquiror through the ownership of common shares.

Certain transactions relating to common shares of Envoy would be exempt from the Investment Act including:

(a) an acquisition of common shares of Envoy by a person in the ordinary course of that person s business as a trader or dealer in securities,

(b) an acquisition of control of Envoy in connection with the realization of security granted for a loan or other financial assistance and not for a purpose related to the provision of the Investment Act,

(c) an acquisition of control of Envoy by reason of an amalgamation, merger, consolidation or corporate reorganization following which the ultimate direct or indirect control in fact of Envoy through the ownership of common shares, remained unchanged,

(d) an acquisition of voting interests by any person in the ordinary course of a business carried on by that person that consists of providing, in Canada, venture capital on terms and conditions not inconsistent with such terms and conditions as may be fixed by the Minister, and

(e) an acquisition of control of a Canadian business for the purpose of facilitating its financing and not for any purpose related to the provisions of the Investment Act on the condition that the acquirer divest itself of control within two years after it is acquired or within such longer period as is approved by the Minister.

E. Taxation

The following discussion is intended to be a general summary of certain material Canadian federal income tax considerations applicable to holders of common shares described below and is not intended to be, nor should it be construed to be, legal or tax advice to any particular person, and no opinion or representation with respect to income tax considerations is hereby given or made. It does not take into account any particular party s individual circumstances and does not address consequences peculiar to any party subject to special provisions of Canadian income tax law. Each person should consult their own tax advisors with respect to the tax consequences of an investment in the common shares in their own particular circumstances.

The following summary is based upon the current provisions of the Income Tax Act (Canada) (the ITA), and the regulations thereunder and the Canada-United States Income Tax Convention (1980) as amended (the Convention), all proposed amendments to the ITA and the regulations thereunder and the Convention publicly announced by the Department of Finance, Canada prior to the date hereof, and the current published administrative policies and assessing practices of the Canada Customs and Revenue Agency. Except for the foregoing, this summary does not take into account or anticipate any changes in the law or the Convention or the administrative policies or assessing practices of the Canada Customs and Revenue Agency whether by legislative, governmental or judicial action or decision, and does not take into account or anticipate provincial, territorial or foreign tax legislation or considerations, which may differ significantly from the Canadian federal income tax considerations described herein.

The summary discusses the principal Canadian federal income tax considerations under the ITA and the regulations thereunder generally applicable to purchasers of common shares who at all times: (i) for purposes of the ITA, are not, have not been and will not be or be deemed to be resident in Canada while they held or hold common shares, deal at arm s length with Envoy, are not affiliated with Envoy, hold their common shares as capital property, do not use or hold, and will not and will not be deemed to use or hold their common shares in, or in the course of carrying on a business in Canada, and are not financial institutions for the purposes of the mark-to-market rules, and (ii) for purposes of the Convention, are residents of the U.S. and not residents of Canada and will not hold their common shares as part of the business property of, or so that their common shares are effectively connected with, a permanent establishment in Canada or in connection with a fixed base in Canada (a U.S. Holder).

Amounts in respect of common shares paid or credited or deemed to be paid or credited as, on account or in lieu of payment of, or in satisfaction of, dividends to a U.S. Holder will generally be subject to Canadian non-resident withholding tax. Such withholding tax is levied at a rate of 25%, which may be reduced pursuant to the terms of the Convention. Under the Convention, the rate of Canadian non-resident withholding tax on the gross amount of dividends beneficially owned by a U.S. Holder is 15%. However, where such beneficial owner is a company which owns at least 10% of the voting stock of Envoy, the rate of such withholding is 5%.

A U.S. Holder will not be subject to tax under the ITA in respect of any disposition of common shares (other than a disposition to Envoy) unless at the time of such disposition such common shares constitute taxable Canadian property of the holder for purposes of the ITA. If the common shares are listed on a prescribed stock exchange, for the purposes of the ITA, such as the TSX, at the time they are disposed of, they will generally not constitute taxable Canadian property of the U.S. Holder at the time of a disposition of such shares unless at any time during the 60-month period immediately preceding the disposition of the common shares, 25% or more of the issued shares of any class or series of Envoy, or an interest therein or an option in respect thereof, was owned by the U.S. Holder, by persons with whom the U.S. Holder did not deal at arm s length or by the U.S. Holder and persons with whom the U.S. Holder did not deal at arm s length. The common shares may also be taxable Canadian property in certain other circumstances. Under the Convention, gains derived by a U.S. Holder from the disposition of common shares will generally not be taxable in Canada unless the value of the common shares is derived principally from real property situated in Canada. If the common shares are listed on a prescribed stock exchange for the purposes of the ITA at the time they are disposed of by a U.S. Holder, the U.S. Holder will generally not be required to comply with the provisions of section 116 of the ITA, which requires notification to be given to the Canada Customs and Revenue Agency when certain property is disposed of.

F. Dividend and Paying Agents

Not applicable

G. Statement by experts

Not applicable

H. Documents on Display

Any statement in this Annual Report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to this Annual Report, the contract or document is deemed to modify our description. You must review the exhibits themselves for a complete description of the contract or document. You may review a copy of our filings with the SEC, including exhibits and schedules filed with this Annual Report, at the SEC s public reference facilities in Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. The SEC maintains a 67 Web site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. We began to file electronically with the SEC in May 2000. You may read and copy any reports, statements or other information that we file with the SEC at the addresses indicated above and you may also access some of them electronically at the Web site set forth above. These SEC filings are also available to the public from commercial document retrieval services. We also file reports, statements and other information with the Canadian Securities Administrators, or the CSAs, and these can be accessed electronically at the CSAs System for Electronic Document Analysis and Retrieval web-site at http://www.sedar.com.

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Except as described below, Envoy does not have any material position or exposure with respect to any market risk sensitive instruments (as defined in Item 11 in Form 20-F).

Interest rate risk The Company s debt under its lending facilities is described in Note 10 to the audited consolidated financial statements. Our credit facility bears interest that is calculated at variable rates. As a result we are vulnerable to changes in interest rates. At September 30, 2003 the effective interest rate on our facility was 8.0%.

Foreign Currency Risk The Company is subject to currency risk through its activities in the United States and United Kingdom. Unfavourable changes in exchange rate may affect the operating results of the Company. The Company does not actively use derivative instruments to reduce its exposure to foreign currency risk. However, dependent on the nature, amount and timing of foreign currency receipts and payments, the Company may enter into foreign currency contracts to mitigate the associated risks. As at September 30, 2003, there were no foreign currency contracts outstanding. As at September 30, 2003, the Company has no balance outstanding on the U.S. portion of the bank credit facility.

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable

PART II

Item 13. DEFAULTS, DIVIDENDS ARREARAGES AND DELINQUENCIES

A. There has been no material default in the payment of principal, interest, a sinking or purchase fund installment.

B. There is no preferred stock of Envoy or any of its significant subsidiaries and accordingly there has been no material arrearage in the payment of dividends or any other material delinquency not cured within 30 days, with respect to any class of preferred stock of Envoy or any of its significant subsidiaries.

Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

A. There have been no material modifications in the constituent instruments defining any class of registered securities of Envoy.

B. There has been no material limitation or qualification of the rights evidenced by any class of registered securities of Envoy by the issuance or modification of any other class of securities of Envoy.

C. There has been no material withdrawal or substitution of assets securing any class of registered securities of Envoy.

D. Not applicable

E. Not applicable

Item 15. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. After evaluating the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) September 30, 2003, the our Chief Executive Officer and Chief Financial Officer have concluded that as of such date, the Company s disclosure controls and procedure were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities.

There were no significant changes in our internal controls or in other factors that could significantly affect these disclosure controls and procedures during the fiscal year, including any significant deficiencies or material weaknesses of internal controls that would require corrective action.

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Item 16. RESERVED

A. Audit Committee Financial Expert

The Board of Directors has determined that Envoy has at least one financial expert serving on its audit committee, and that David Parkes is that audit committee financial expert. David Parkes is an independent audit committee member.

B. Code of Ethics

The Board of Directors has not, as yet, adopted a code of ethics for Envoy s CEO, CFO, chief accounting officer or controller, or for persons performing similar functions. The Board believes that Envoy s existing internal control procedures and current business practices are adequate to promote honest and ethical conduct and to deter wrongdoing on the part of these executives. Nonetheless, Envoy is currently developing and will implement during its 2004 fiscal year a code of ethics that will apply to these executives. In accordance with applicable rules, the code of ethics, when adopted, will be filed with the appropriate bodies and posted on Envoy s website.

C. Principal Accountant Fees and Services

(a) Audit Fees were $165 in 2003 and $304 in 2002.

(b) Audit-Related Fees were $28 in 2003 and $35 in 2002 for accounting assistance for specific issues, review of MD&A and responses regulatory bodies.

(c) Tax Fees were $40 in 2003 and $62 in 2002.

(d) All Other Fees were $nil in 2003 and $nil in 2002.

D. Exemptions from the Listing Standards for Audit Committees

Not Applicable

E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None

PART III

Item 17. FINANCIAL STATEMENTS

Item 18. FINANCIAL STATEMENTS

Envoy has elected to provide financial statements pursuant to Item 17.

Item 19. EXHIBITS

(a) Exhibit 1 By-Law No. 1 of Envoy (as amended on May 2, 2000) & Articles of Incorporation. Incorporated by reference from the annual report, on form 20-F previously filed the Securities Exchange Commission on May 15, 2000.

Exhibit 2 Not Applicable

Exhibit 3 Not Applicable

Exhibit 4 Not Applicable

Exhibit 5 Not Applicable

Exhibit 6 Not Applicable

Exhibit 7 Not Applicable

Exhibit 8

Subsidiaries of Registrant

Envoy has operations in the United States, the United Kingdom, Continental Europe and Canada. Significant subsidiaries are as follows:

Company	**% of ownership**	**Jurisdiction of incorporation**
Communique Incentives Inc.	100	Ontario
Watt International Inc.	100	Ontario
Watt Gilchrist Limited	100	United Kingdom
John Street Inc.	70	Ontario

Exhibit 9 Not Applicable

Exhibit 10 Not Applicable

Exhibit 11	Not Applicable
Exhibit 12	See attached
Exhibit 13	See attached

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Envoy Communications Group Inc.

Date: February 17, 2004

/s/ Geoffrey B. Genovese

Name: Geoffrey B. Genovese
Title: Chairman, President and Chief Executive Officer

Envoy Communications
Group Inc.
Consolidated Financial Statements
(Expressed in Canadian dollars)
For the years ended September 30, 2003, 2002 and 2001

Contents

Auditors Report

To the Directors of Envoy Communications Group Inc.

We have audited the consolidated balance sheet of Envoy Communications Group Inc. as at September 30, 2003 and the consolidated statement of operations, retained earnings (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

(signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
February 2, 2004

Comments by Auditor for U.S. Readers
On Canada-U.S. Reporting Difference

In the United States, reporting standard for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the Company s financial statements, such as the change described in Note 2 (e) and 2 (h) of the financial statements. Our report to the Shareholders dated February 2, 2004 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the Auditors Report when the change is properly accounted for and adequately disclosed in the financial statements.

(signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
February 2, 2004

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Auditors Report

To the Shareholders of Envoy Communications Group Inc.

We have audited the consolidated balance sheet of Envoy Communications Group Inc. as at September 30, 2002 and the consolidated statement of operations, retained earnings (deficit) and cash flows for the years ended September 30, 2002 and 2001. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2002 and the results of its operations and its cash flows for the years ended September 30, 2002 and 2001 in accordance with Canadian generally accepted accounting principles.

(signed) KPMG LLP

Chartered Accountants

Toronto, Ontario
January 9, 2003, (except as to notes 22(d) and 22(e) which are as of February 2, 2004)

Envoy Communications Group Inc.
Consolidated Balance Sheets
(Expressed in Canadian dollars)

September 30	2003	2002
Assets		
Current		
Cash	**$ 2,696,300**	$ 469,909
Restricted cash (Note 4)	**1,047,997**	1,831,085
Accounts receivable (Note 5)	**13,100,827**	20,528,048
Income taxes recoverable		2,779,717
Future income taxes (Note 13)	**498,172**	855,000
Prepaid expenses	**884,892**	983,068
	18,228,188	27,446,827
Capital assets (Note 7)	**5,861,317**	7,836,728
Goodwill (Note 8)	**10,525,785**	11,314,283
Other assets (Note 9)	**63,468**	116,649
Future income taxes (Note 13)	**2,672,228**	2,459,228
	$ 37,350,986	$ 49,173,715
Liabilities and Shareholders Equity		
Current		
Accounts payable and accrued liabilities	**$ 10,787,930**	$ 21,019,267
Income taxes payable	**322,244**	
Deferred revenue	**1,283,265**	1,475,671
Amounts collected in excess of pass-through costs incurred	**836,722**	2,104,522
Bank credit facility and current portion of long-term debt (Note 10)	**6,857,953**	10,589,114
	20,088,114	35,188,574
Long-term debt (Note 10)	**4,566,962**	3,413,697
Long-term portion of restructuring costs (Note 17)	**337,407**	792,275
	24,992,483	39,394,546
Shareholders equity:		
Share capital (Note 12)	**55,988,817**	54,339,390
Convertible debentures (Note 11)	**1,673,408**	1,720,859
Deficit	**(45,090,767)**	(47,629,529)
Stock based compensation	**23,268**	
Cumulative translation adjustment	**(236,223)**	1,348,449
	12,358,503	9,779,169
Commitments and contingencies (Note 18)		
Subsequent events (Note 21)		
Reconciliation to United States generally accepted accounting principles (Note 22)		
	$ 37,350,986	$ 49,173,715

On behalf of the Board:

Geoffrey B. Genovese, Director	John H. Bailey, Director

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

Envoy Communications Group Inc.
Consolidated Statements of Operations
(Expressed in Canadian dollars)

For the years ended September 30	2003	2002	2001
Net revenue	**$42,427,243**	$ 59,121,090	$82,785,541
Operating expenses:			
Salaries and benefits	**28,038,911**	45,096,981	53,653,694
General and administrative (Note 14)	**5,973,664**	11,669,901	17,373,429
Occupancy costs	**3,276,497**	4,728,817	4,754,875
	37,289,072	61,495,699	75,781,998
Depreciation	**2,387,817**	2,858,641	2,866,679
Amortization of intangible asset (Note 9)	**24,197**	24,197	
Interest expense and financing costs (Note 10)	**2,707,687**	1,245,126	743,600
	42,408,773	65,623,663	79,392,277
Earnings (loss) before unusual items, gain on closure of subsidiaries, restructuring costs, income taxes, goodwill amortization and write-down	**18,470**	(6,502,573)	3,393,264
Unusual items (Note 16)		750,648	1,917,334
Gain on closure of subsidiaries (Notes 14 and 15)	**(2,499,604)**		
Restructuring costs (recovery) (Note 17)	**(267,212)**	10,857,534	
Earnings (loss) before income taxes, goodwill amortization and write-down	**2,785,286**	(18,110,755)	1,475,930
Income taxes (recovery) (Note 13)	**246,524**	(4,853,540)	1,359,731
Earnings (loss) before goodwill amortization and write-down	**2,538,762**	(13,257,215)	116,199
Goodwill amortization, net of income tax recovery of $nil (2002 $24,000; 2001 $24,000)		2,187,509	3,011,571
Write-down of goodwill (Note 8)		37,934,711	
Net earnings (loss)	**$ 2,538,762**	$(53,379,435)	$ (2,895,372)
Earnings (loss) per share (notes 2(i) and 12(d)):			
Basic	**$ 0.12**	$ (2.54)	$ (0.14)
Diluted	**0.09**	(2.54)	(0.14)
Earnings (loss) per share before goodwill amortization and write-down (notes 2(i) and 12(d)):			
Basic	**0.12**	(0.63)	0.01
Diluted	**0.09**	(0.6)	0.01

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

Envoy Communications Group Inc.
Consolidated Statements of Retained Earnings (Deficit)
(Expressed in Canadian dollars)

For the years ended September 30	2003	2002	2001
Retained earnings (deficit), beginning of year	**$ (47,629,529)**	$ 5,603,200	$ 8,403,367
Gain on redemption of shares (Note 12(b))		146,706	95,205
Net earnings (loss)	**2,538,762**	(53,379,435)	(2,895,372)
Retained earnings (deficit), end of year	**$ (45,090,767)**	$ (47,629,529)	$ 5,603,200

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

Envoy Communications Group Inc.
Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

For the years ended September 30	2003	2002	2001
Cash flows from operating activities:			
Net earnings (loss)	**$ 2,538,762**	$ (53,379,435)	$ (2,895,372)
Items not involving cash:			
Future income taxes (recovery)	**(275,201)**	(1,780,072)	(567,441)
Depreciation	**2,387,817**	2,858,641	2,866,679
Amortization of intangible asset	**24,197**	24,197	
Goodwill amortization		2,211,509	3,035,571
Write-down of goodwill		37,934,711	
Amortization of deferred financing charges	**108,996**	96,263	65,936
Write-down of deferred financing charges		750,648	
Convertible debentures accretion	**718,321**	133,870	
Stock based compensation	**23,268**		
Gain on disposal of subsidiaries	**(2,499,604)**		
Recognition of cumulative translation on closure of Hampel Stefanides (Note 14)	**(841,081)**		
Write-down of capital assets	**356,865**	3,481,105	
Other		52,500	
Net change in non-cash working capital balances:			
Restricted cash	**783,088**	(1,672,585)	297,962
Accounts receivable	**(457,592)**	6,757,260	7,389,275
Prepaid expenses	**(172,823)**	353,652	(174,654)
Accounts payable and accrued liabilities	**(283,423)**	(16,905,696)	12,440,922
Income taxes payable/recoverable	**2,871,137**	(2,606,457)	(1,145,133)
Deferred revenue	**(192,406)**	1,175,600	(758,380)
Amounts collected in excess of pass-through costs incurred	**232,784**	(175,514)	(777,930)
Other	**(9,422)**	(209,582)	159,003
Net cash provided by (used in) operating activities	**5,313,683**	(20,899,385)	19,936,438
Cash flows from financing activities:			
Long-term debt borrowings	**1,079,441**	1,580,459	8,137,183
Long-term debt repayments	**(4,835,314)**	(2,539,248)	(8,097,536)
Issuance of common shares	**109,084**		383,670
Issuance of convertible debentures	**2,000,000**	3,800,000	
Redemption of common shares		(628,083)	(1,295,475)
Reduction (increase) in restricted cash			394,625
Long-term portion of restructuring costs	**(454,868)**	792,275	
Other			190,143
Net cash provided by (used in) financing activities	**(2,101,657)**	3,005,403	(287,390)

The accompanying notes are an integral part of these financial statements

Envoy Communications Group Inc.
Consolidated Statements of Cash Flows (continued)
(Expressed in Canadian dollars)

For the years ended September 30	2003	2002	2001
Cash flows from investing activities:			
Acquisition of subsidiaries, net of cash acquired of $nil (2002 - $919,201; 2001 - $214,179)	**(104,137)**	(1,904,742)	(1,669,168)
Purchase of capital assets	**(1,132,189)**	(1,811,154)	(3,756,134)
Proceeds on sale of capital assets	**176,106**		
Net cash used in investing activities	**(1,060,220)**	(3,715,896)	(5,425,302)
Change in cash balance due to foreign exchange	**74,585**	297,978	452,645
Increase (decrease) in cash	**2,226,391**	(21,311,900)	14,676,391
Cash, beginning of year	**469,909**	21,781,809	7,105,418
Cash, end of year	**$ 2,696,300**	$ 469,909	$ 21,781,809
Supplemental cash flow information:			
Interest paid	**$ 1,977,822**	$ 643,926	$ 704,604
Income taxes paid	**46,800**	581,077	3,407,801
Supplemental disclosure of non-cash transactions:			
Conversion of debentures	**1,540,343**		
Shares issued for non-cash consideration		265,500	3,908,156
Capital assets acquired under capital leases		820,424	

The accompanying notes are an integral part of these financial statements

For the years ended September 30, 2003, 2002 and 2001

1. Nature of Business

The Company, continued under the Business Corporations Act (Ontario), has operations in the United States, the United Kingdom and Canada and provides marketing, consumer and retail branding services.

Basis of Presentation

(a) The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada, which vary in certain significant respects from generally accepted accounting principles in the United States. A description of the significant differences, as applicable to the Company, is included in note 22.

(b) Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for 2003.

2. Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, collectively known as Envoy Communications Group Inc. Intercompany balances and transactions are eliminated on consolidation.

Significant subsidiaries as at September 30, 2003 are as follows:

Company	**% of ownership**	**Jurisdiction of incorporation**
Communiqué Incentives Inc.	100	Ontario
Watt International Inc.	100	Ontario
Watt Gilchrist Limited	100	United Kingdom
John Street Inc.	70	Ontario

(b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

For the years ended September 30, 2003, 2002 and 2001

(c) Capital Assets

Capital assets are recorded at cost and are depreciated over their estimated useful lives as follows:

Asset	Basis	Rate
Audiovisual equipment	Straight line	2-5 years
Computer equipment and software	Declining balance	30%-50%
Furniture and equipment	Declining balance	20%
Leasehold improvements	Straight line	Over term of leases
Equipment under capital leases	Straight line	3-5 years

(d) Revenue Recognition

The Company presents as net revenue its net commission and fee income earned as compensation for its services. Further, the balance sheet reflects the following:

(i) deferred revenue representing only fees billed and collected in advance of such fees being earned; and

(ii) the reimbursable pass-through costs which are included in unbilled accounts receivable.

Net revenue represents the Company s compensation for its agency and non-agency services and is recognized only when collection of such net revenue is probable. Agency services are those that require the Company to incur external media and production costs on behalf of its clients and for which it is entitled to pass through the costs for reimbursement from its clients. The reimbursement of pass-through costs are not included in net revenue. The Company s agency and non-agency projects are short-term in nature.

Fees earned for non-agency services are recognized either upon the performance of the Company s services when the Company earns a per-diem fee, or in the case of a fixed fee, when the Company s services are substantially complete and accepted by the client. Fees earned but not yet billed are included in accounts receivable. Fees billed to clients in excess of fees recognized as net revenue are classified as deferred revenue.

When the Company s compensation for its agency services is based on commissions, net revenue is comprised of:
(i) commissions earned from media expenditures, which are recognized at the time the advertising appears or is broadcast, or in respect of on-line advertising, either rateably over the period of time the advertising appears or based on the actual impressions delivered at the contractual rate per impression, depending upon the terms of the arrangement; and (ii) commissions earned on expenditures for the production of advertisements, which are recognized upon the completion of the Company s services and acceptance by the client, being the time at which the Company has no further substantial obligations with respect thereto.

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

When the Company s compensation for its agency services is fee-based, net revenue is comprised of non-refundable monthly agency fees, which are recognized in the month earned.

Pass-through costs related to production are accrued and recorded in accounts receivable, as unbilled reimbursable costs, at the time the third party suppliers render their services. Pass-through costs related to media are accrued at the time the advertisement appears or is broadcast.

(e) Goodwill

Goodwill represents the price paid for acquisitions in excess of the fair market value of net tangible and intangible assets acquired. Effective October 1, 2002, the Company adopted the recommendations of the CICA Handbook Section 3062 Goodwill and Other Intangible Assets . These standards require that goodwill and other intangible assets determined to have indefinite lives are no longer amortized but tested for impairment based on the fair value of the Company s reporting units on adoption of the standard and at least annually thereafter. Transitional impairment tests for goodwill were completed as at October 1, 2002 and an annual impairment test completed on March 31, 2003 and, as a result no write-down was required. Prior to 2003, the Company amortized goodwill on a straight-line basis over periods ranging from 7 to 25 years and goodwill was considered to be impaired since the future anticipated undiscounted cash flows from the acquired businesses were less than the carrying value of goodwill. Goodwill arising on acquisitions completed after June 30, 2001 was not amortized.

(f) Foreign Currency Translation

The financial statements of the Company s foreign subsidiaries, all of which are self-sustaining operations, are translated using the current rate method, whereby the assets and liabilities of such foreign operations are translated at the exchange rate in effect at the balance sheet date. Revenue and expenses are translated at the average exchange rate for the year. Translation gains or losses are deferred and included as a separate component of shareholders equity.

In respect of the Company s and its subsidiaries foreign currency transactions, at the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in earnings in the current year.

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

(g) Income Taxes

The Company accounts for income taxes using the liability method. Under this method, future income taxes are recognized at the enacted or substantially enacted tax rate expected to be applicable at the date of reversal for all significant temporary differences between the tax and accounting bases of assets and liabilities and for certain tax carryforward items. Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the substantive enactment of the change.

(h) Stock-based Compensation

Effective October 1, 2002, the Company adopted the recommendations of the CICA Handbook Section 3870 Stock-based Compensation and Other Stock-based Payments . These standards require that direct awards of stock and liabilities based on the price of common stock be measured at fair value at each reporting date, with the change in fair value reported in the statement of operations, and encourages, but does not require, the use of the fair value method for all other types of employee stock-based compensation plans. The Company does not use the fair value method to account for employee stock-based compensation plans but discloses pro forma information for options granted after October 1, 2002 (see Note 12). The Company records no compensation expense when options are issued to employees or modified. Any consideration paid by employees on the exercise of options is credited to share capital.

(i) Earnings Per Share

The Company uses the provisions of CICA Handbook Section 3500, Earnings per Share. Basic earnings per share is computed using the weighted average number of common shares that are outstanding during the year. Diluted earnings per share is computed using the weighted average number of common and potential common shares outstanding during the year. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options using the treasury stock method and potential shares issuable upon exercise of convertible debt and warrants.

(j) Business Combinations

The Company uses the provisions of the CICA Handbook Section 1581, Business Combinations . All business combinations are accounted for using the purchase method of accounting. The value of shares issued in a business combination are measured using the average share price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced. Effective July 1, 2001, goodwill acquired in business combinations completed after June 30, 2001 was not amortized and is subject to impairment testing. Intangible assets that meet specific criteria are recognized and reported apart from goodwill.

For the years ended September 30, 2003, 2002 and 2001

3. Acquisition of subsidiaries

(a) Effective October 1, 2001, the Company acquired 100% of the outstanding shares of Commodore Conference Planners Inc. (Commodore), a conference and event marketing company. Under the terms of the acquisition, the initial purchase price consisted of $611,113 in cash consideration excluding acquisition costs. Additional consideration, to a maximum of $475,000 cash, may be paid over a two-year period if certain performance milestones are achieved for the 12-month periods ending September 30, 2002 and 2003. For the twelve months ended September 30, 2003, an earnout payment of $nil (2002 $193,000) was accrued.

The acquisition of Commodore has been accounted for using the purchase method of accounting. The fair value of the net assets acquired at October 1, 2001 and consideration accounted for to date was as follows:

Capital assets	$ 11,160
Non-compete agreement	72,590
Non-cash working capital	(517,544)
Net liabilities	(433,794)
Consideration, less cash acquired of $919,201, October 1, 2001	(171,187)
Additional cash consideration included in accounts payable, earn-out for 2002	193,000
Legal fees	11,000
Excess of purchase price over fair value of net assets acquired allocated to goodwill	$ 466,607

The amount assigned to the non-compete agreement is amortized over the term of the agreement. As a result of the adoption of new accounting standards for business combinations, the goodwill arising in connection with this acquisition is not amortized (note 2(i)(e)).

(b) Effective January 1, 2001, the Company acquired 100% of the outstanding shares of International Design Group, a Toronto-based international retail planning and design firm. Under the terms of the acquisition, the initial purchase price, which consisted of $1,090,000 in cash consideration and 61,728 common shares of the Company with a fair value of $284,332, was paid upon closing. Additional consideration may be paid over a three-year period if certain performance milestones are achieved for the 12-month periods ending December 31. The earn-out amounts earned will be satisfied by a maximum of $2,000,000 in cash and a maximum of 154,321 common shares of the Company. No amounts were owing by the Company in 2003 or 2002 under the earn-out agreements. The acquisition has been accounted for using the purchase method of accounting.

The fair value of the net assets acquired was $1,198,684, excluding cash acquired of $214,179. The net assets acquired consisted of working capital and capital assets. The resulting excess purchase price over the fair value of the net assets acquired of $336,382 was allocated to goodwill and was being amortized over 25 years.

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

4. Restricted cash

Restricted cash includes a trust account established for Communiqué Incentives Inc. for customer deposits of $1,047,997 (2002 $1,831,085).

5. Accounts receivable

	2003	2002
Trade receivables	**$ 6,512,040**	$11,921,393
Accrued revenue	**4,317,799**	5,881,363
Work in process	**2,270,988**	1,349,986
Unbilled pass-through costs		1,375,306
	$13,100,827	$20,528,048

6. Related party transactions

In October and November 2002 the Company sold the operations of Devlin Multimedia Inc. (Devlin) and Sage to certain executives of the respective subsidiaries (see Note 15).

During the year, relatives of the CEO loaned the Company $225,000 of which $150,000 was outstanding at year end. The loan bears interest at 10% per annum and is repayable on demand.

During the year, relatives of a director loaned the Company $75,000 which was repaid prior to year end. The loan bore an interest rate of 10% per annum, and was repayable on demand.

During the year, relatives of the CEO and a director were part of the group that loaned the Company $2.0 million of convertible debentures described in Note 11. In total, these relatives loaned the Company $1,850,000, of which $1,070,000 was outstanding at year end.

Related party transactions are recorded at the exchange amount, being the amount agreed to by the related parties.

During 2003, Envoy paid one of its directors $312,589 (2002 $265,936; 2001 $300,020) for legal services provided to Envoy.

For the years ended September 30, 2003, 2002 and 2001

7. Capital assets

2003	Cost	Accumulated depreciation	Net book value
Audiovisual equipment	$	$	$
Computer equipment and software	**9,813,701**	**7,513,574**	**2,300,127**
Furniture and equipment	**427,705**	**293,588**	**134,117**
Leasehold improvements	**4,014,240**	**1,489,757**	**2,524,483**
Equipment under capital leases	**1,741,118**	**838,528**	**902,590**
	$15,996,764	**$10,135,447**	**$5,861,317**

2002	Cost	Accumulated depreciation	Net book value
Audiovisual equipment	$ 780,918	$ 762,386	$ 18,532
Computer equipment and software	13,115,157	8,665,300	4,449,857
Furniture and equipment	1,427,777	1,151,402	276,375
Leasehold improvements	8,233,909	6,316,255	1,917,654
Equipment under capital leases	1,940,971	766,661	1,174,310
	$25,498,732	$17,662,004	$7,836,728

8. Goodwill

The changes in the carrying amount of goodwill for the year ended September 30, 2003 were as follows:

Goodwill, beginning of year	**$11,314,283**
Additions	**104,137**
Reduction charged to cumulative translation adjustment	**(892,635)**
Goodwill, end of year	**$10,525,785**

2002	Cost	Accumulated amortization	Net book value
Goodwill	$57,417,846	$46,103,563	$11,314,283

For the years ended September 30, 2003, 2002 and 2001

8. Goodwill (continued)

In 2002, the Company performed assessments of the carrying values of goodwill recorded in connection with its various businesses. The assessment was performed because a number of factors indicated that an impairment had arisen commencing in the period ending March 31, 2002. The main indicators of impairment were significant negative industry and economic trends impacting both current operating results and expected future growth rates and loss of significant clients. Based on these factors, the Company concluded that significant permanent impairment existed with respect to the Company s goodwill and other assets, which primarily related to the goodwill associated with the businesses of Sage, Promanad and Hampel Stefanides.

In quantifying the impairment charge, the Company compared the expected future undiscounted cash flows of each acquisition, to the respective carrying value of the assets of the business, including assigned goodwill. The cash flow periods used ranged between 5 and 25 years, consistent with the remaining goodwill amortization period.

As a result of the review, the Company determined that the carrying values of certain acquired businesses were not fully recoverable. Accordingly, the Company recorded two write-downs: $28,426,266 in the second quarter of 2002 and $9,508,445 in the fourth quarter of 2002 based on the amount by which the goodwill exceeded the expected future undiscounted cash flows of the respective operation.

9. Other assets

	2003	**2002**
Non-compete agreement, net of accumulated amortization of $48,394 (2002 - $24,197) (note 3(a))	**$24,197**	$ 48,394
Other	**39,271**	68,255
	$63,468	$116,649

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

10. Bank credit facility and other debt

	2003	2002
Bank credit facility (a)	$ 6,115,746	$ 9,838,192
Promissory note, 8% per annum, repayable in five monthly instalments commencing June 30, 2002 (b)		295,615
Loan payable to landlord, 3.5% per annum, due July 1, 2009, repayable in monthly instalments of $7,665 principal and interest	481,297	553,992
Loan payable to landlord, 0.925% per annum, due December 1, 2002, repayable in monthly instalments of $6,728 principal and interest		20,185
Loan payable to landlord, 10.0% per annum, due March 1, 2010, repayable in monthly instalments of $3,956 principal and interest	227,556	251,444
Loan payable to landlord, 10.0% per annum, due April 1, 2005, repayable in monthly instalments of $742 principal and interest	31,479	37,001
Loan payable to landlord, 8.0% per annum, due April 1, 2010, repayable in monthly instalments of $561 principal and interest	34,488	38,337
Capital lease, 12.3% over the lease period, repayable in quarterly instalments of £7,919 principal and interest, due November 2004	86,295	
Capital lease, 12.3% over the lease period, repayable in quarterly instalments of (2002 - $63,056 (£25,330)) principal and interest, due January 2003		64,123
Capital leases, 10.2% to 14% over the lease period, repayable in monthly instalments of $33,136 principal and interest, due between January 2005 and February 2005	566,788	820,424
Promissory note, 10% per annum, due on demand (note 6)	150,000	
Promissory note, 10% per annum, due on September 30, 2006 (c)	500,000	
Convertible debentures (note 11)	3,231,266	2,083,498
	11,424,915	14,002,811
Less current portion	6,857,953	10,589,114
	$ 4,566,962	$ 3,413,697

For the years ended September 30, 2003, 2002 and 2001

10. Bank credit facility and other debt (continued)

(a) In April 2003, the Company finalized the amendments to its banking arrangements and thereby normalized its credit facilities with its bankers. This new amendment gives the Company a demand operating line of $7,000,000. Interest rates are variable based on certain leverage ratios ranging from Prime plus 2.5% to 5.0% and at September 30, 2003 the effective interest rate was 8.0% (2002 8.5%). The demand operating facility is to be repaid and cancelled by April 30, 2004. Of the outstanding borrowings as at September 30, 2003, $nil (2002 Cdn. $3,178,691; US $2,002,704) is denominated in U.S. dollars. The facility is secured by a general security agreement against the Company and all of its subsidiaries.

As a condition to the credit facility amendment, the Company amended the terms of the existing debentures as described in Note 11.

As a condition to the amendment, the Company was required to raise $2,000,000 to reduce its bank debt. On April 24, 2003 the Company issued $2,000,000 convertible debentures as part of the refinancing plan. These debentures may be converted into common shares at a price of $0.15 each for a total of 13,333,333 common shares.

As a condition of the amendment, the Company issued to its bankers warrants to purchase 2,300,000 common shares of the Company. Costs associated with this new banking amendment have been charged to interest expense and financing costs.

Subsequent to year end, the Company has completed a new financing and has renegotiated its bank facility (see Note 21).

(b) During the third quarter of 2002, the Company negotiated new repayment terms for a promissory note originally due on June 30, 2002 in respect of the Gilchrist acquisition. Under the revised terms, the Gilchrist note is to be repaid in five monthly instalments commencing July 1, 2002 with interest on the principal balance charged at 8% per annum. The balance was paid in full during 2003.

(c) In September 2003, the holder of the promissory note agreed to postpone the maturity date from June 30, 2003 to September 30, 2006 and to reduce the rate of interest from 15% to 10% per annum. In consideration of the foregoing and subsequent to the year end the holder of the term note was issued a share purchase warrant to purchase, on or before April 24, 2008, 50,000 of the Company s common shares at an exercise price of $0.15 per share. The warrants were part of the warrants previously issued to Envoys bankers (see (a) above).

For the years ended September 30, 2003, 2002 and 2001

10. Bank credit facility and other debt (continued)

Principal repayments on long-term debt, excluding convertible debentures (note 11), are as follows:

2004	$6,857,953
2005	313,244
2006	629,037
2007	125,428
2008	132,493
Thereafter	135,494
	$8,193,649

Interest and financing costs were charged to expense during the year for the following:

	2003	2002	2001
Cash interest paid on credit facility, landlord loans and capital leases	$ 912,255	$ 634,407	$671,848
Financing fees on credit facility	311,053	179,386	71,752
Accrued financing fee charges on credit facility	179,685	200,000	
Cash interest paid on convertible debentures and amortization of debenture issue costs	484,851	59,130	
Accrued interest on debentures	101,522	38,333	
Accreted interest imputed on debentures	718,321	133,870	
Total interest and financing costs	$2,707,687	$1,245,126	$743,600

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

11. Convertible debentures

In April 2003, as part of the renegotiation of the existing debt facility, the Company amended the terms of the debentures issued on April 29, 2002 and September 12, 2002 as follows: the early repayment terms on the debentures have been deferred to April 24, 2005; the debentures are repayable in cash on maturity on April 24, 2008; both debentures are now convertible into common shares at a price of $0.15 each, for a total of 25,333,333 common shares; and, the warrants attached to the convertible debentures have been cancelled.

On April 24, 2003, the Company issued $2,000,000 in 10% convertible debentures as part of the refinancing plan, which mature on April 24, 2008. These debentures may be converted into common shares at a price of $0.15 each for a total of 13,333,333 common shares. Holders also have the right to require the Company to purchase all or a portion of their debentures on or after April 24, 2005 at the issue price plus accrued and unpaid interest.

The debentures are bifurcated into a debt component, representing a yield to maturity of 25.6% per annum over the five-year life, and an equity component with proceeds allocated $1,465,929 to long-term debt and $534,071 to shareholders equity. That portion of offering expenses, related to the debt component being $120,906 has been recorded as deferred financing fees which are included in prepaid expenses, and the remaining $44,049 applied to reduce the equity component.

During the year, convertible debentures with a face value of $1,410,000 were converted into 9,400,000 common shares of the Company. Subsequent to year end, all convertible debentures have been converted totalling 29,266,667 common shares.

On April 29, 2002, the Company issued $1,800,000 in 10% convertible debentures which mature on April 29, 2007 (amended to April 24, 2008 as discussed above). Prior to the amendments discussed above, the debentures were convertible until the maturity date into 2,500,000 units of the Company at a conversion price of $0.72 per unit. Each unit consisted of one common share in the capital of the Company and one purchase warrant of the Company. Each purchase warrant entitled the holder to purchase one common share (2,500,000 common shares in aggregate) within the earlier of (a) 12 months of the date of conversion of the debenture, and (b) the maturity date at a price of $0.90 per common share. Holders also had the right to require the Company to purchase all or a portion of their debentures on or after April 29, 2004 at the issue price plus accrued and unpaid interest. In addition, upon a change in control occurring on or before April 29, 2004, the Company will be required to offer to purchase the debentures at a purchase price equal to 101% of the issue price plus accrued and unpaid interest to the repurchase date. The debentures are secured by a charge over the Company s assets and undertakings, which charge will be subject only to security interests in favour of the Company s bankers, equipment leases and non-consensual liens. The net proceeds from the sale of the debentures were used for general corporate purposes.

The debentures are bifurcated into a debt component, representing a yield to maturity of 25.4% per annum over the five-year life, and an equity component with proceeds allocated as $1,017,770 to long-term debt and $782,230 to shareholders equity. That portion of offering expenses related to the debt component, being $60,587 has been recorded as deferred financing fees which are included in prepaid expenses, and the remaining $46,565 applied to reduce the equity component.

For the years ended September 30, 2003, 2002 and 2001

11. Convertible debentures (continued)

The principal amount of the debentures will increase as interest is compounded using an effective interest rate method over two years, being the earliest date at which they are redeemable at the option of the holder.

On September 12, 2002, the Company issued $2,000,000 in 10% convertible debentures which mature on September 12, 2007 (amended to April 24, 2008 as discussed above). Prior to the amendments discussed above, the debentures were convertible until the maturity date into 5,882,353 units of the Company at a conversion price of $0.34 per unit. Each unit consisted of one common share in the capital of the Company and one purchase warrant of the Company. Each purchase warrant entitled the holder to purchase one common share (5,882,353 common shares in aggregate) within the earlier of (a) twelve months of the date of conversion of the debenture, and (b) the maturity date at a price of $0.34 per common share. Holders also had the right to require the Company to purchase all or a portion of their debentures on or after September 12, 2004 at the issue price plus accrued and unpaid interest. In addition, upon a change in control occurring on or before September 12, 2004, the Company will be required to offer to purchase the debentures at a purchase price equal to 101% of the issue price plus accrued and unpaid interest to the repurchase date. The debentures are secured by a charge over the Company s assets and undertakings, which charge will be subject only to security interests in favour of the Company s bankers, equipment leases and non-consensual liens. The net proceeds from the sale of the debentures were used for general corporate purposes.

The debentures are bifurcated into a debt component, representing a yield to maturity of 31.5% per annum over the five-year life, and an equity component with proceeds allocated as $931,858 to long-term debt and $1,068,142 to shareholders equity. That portion of the offering expenses related to the debt component, being $72,365, has been recorded as deferred financing fees which are included in prepaid expenses, and the remaining $82,948 applied to reduce the equity component.

The principal amount of the debentures will increase as interest is compounded using an effective interest rate method over two years, being the earliest date at which they are redeemable at the option of the holder.

As at September 30, 2003, the aggregate debt component carrying values of all of the Company s convertible debentures is $3,231,266 (2002 - $2,083,498). Principal repayments, based on scheduled maturity dates, is $4,390,000 in 2008. However, this date may be accelerated to 2005, at the option of the holders of the debentures.

For the years ended September 30, 2003, 2002 and 2001

12. Share capital

(a) Authorized:

50,000,000 common shares without par value (2002 50,000,000; 2001 50,000,000)

Issued:

	2003		2002		2001	
	Number of shares	**Amount**	**Number of shares**	**Amount**	**Number of shares**	**Amount**
Balance, beginning of year	21,258,693	$54,339,390	21,192,719	$54,883,305	21,098,222	$54,597,762
Common shares issued pursuant to:						
Conversion of convertible debentures	9,400,000	1,540,343				
Stock options exercised	388,334	109,084			101,000	383,670
Acquisitions (note 3)			150,000	213,000	61,728	284,332
Repurchase of shares pursuant to share issuer bid			(299,400)	(774,789)	(535,000)	(1,390,680)
Shares issued to settle liability with landlord (note 17)			250,000	52,500		
			21,293,319	54,374,016	20,725,950	53,875,084
Shares to be issued in respect of contingent consideration			(34,626)	(34,626)	466,769	1,008,221
Balance, end of year	31,047,027	$55,988,817	21,258,693	$54,339,390	21,192,719	$54,883,305

For the years ended September 30, 2003, 2002 and 2001

12. Share capital (continued)

(b) Repurchase of shares

During 2002, pursuant to a normal course issuer bid, the Company repurchased and cancelled 299,400 common shares at an average price of $2.10 per common share for total cash consideration of $628,083. As a result of these purchases, $146,706 was recorded in retained earnings as a gain on redemption.

During 2001, pursuant to a normal course issuer bid, the Company repurchased and cancelled 535,000 common shares at an average price of $2.42 per common share for total consideration of $1,295,475. As a result of these repurchases, $95,205 was recorded as a gain on redemption of shares in retained earnings. Under the terms of the normal course issuer bid, the Company may repurchase and cancel up to 10% of the public float to July 26, 2002.

(c) Stock option plan

The Company has reserved 4,000,000 common shares under its stock option plan. Under the plan, the options are exercisable for one common share and the exercise price of the option must equal the market price of the underlying share at the grant date. The options have vesting periods ranging from the date of grant up to five years. Once vested, options are exercisable at any time until expiry. Expiry dates range between 2004 and 2008.

In 2002, the Company obtained approval to re-price options. All employees, excluding insiders and U.S. employees, were given the opportunity to cancel their existing stock options with an exercise price greater than $6 per share and replace them with new stock options. Options were cancelled on January 31, 2002 and new options to acquire 50% of the number of options cancelled were granted on August 2, 2002 at an exercise price of $3.05.

For the years ended September 30, 2003, 2002 and 2001

12. Share capital (continued)

Details of the options are as follows:

	Number of options	Weighted average exercise price per share
Options outstanding, September 30, 2000	2,340,500	$ 5.33
Options granted	780,000	5.30
Options exercised	(101,000)	3.80
Options cancelled	(340,000)	5.87
Options outstanding, September 30, 2001	2,679,500	5.31
Options granted	1,719,000	1.15
Options cancelled	(1,199,500)	5.37
Options outstanding, September 30, 2002	3,199,000	3.06
Options granted	1,820,000	0.26
Options exercised	(388,334)	0.28
Options cancelled	(2,889,250)	2.74
Options outstanding, September 30, 2003	1,741,416	1.27
Options exercisable, September 30, 2003	1,049,750	$ 1.95
Options exercisable, September 30, 2002	2,322,084	$ 3.35
Options exercisable, September 30, 2001	1,491,510	$ 5.07

The range of exercise prices for options outstanding and exercisable options at September 30, 2003 are as follows:

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable
$0.25	991,666	4.08	300,000
$0.40	20,000	4.77	20,000
$0.61	225,000	3.67	225,000
$3.05	394,750	3.86	394,750
$3.90	50,000	0.44	50,000
$6.20	15,000	0.86	15,000
$7.40	45,000	1.50	45,000
	1,741,416		1,049,750

For the years ended September 30, 2003, 2002 and 2001

12. Share capital (continued)

(d) Earnings (loss) from operations per share:

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

	2003	2002	2001
Numerator:			
Net earnings (loss) (i)	$ 2,538,762	$ (53,379,435)	$ (2,895,372)
Denominator:			
Denominator for basic net earnings (loss) per share - weighted average shares outstanding	21,674,064	20,998,397	21,160,616
Effect of dilutive potential common shares:			
Shares issuable pursuant to warrants	904,958		
Shares issuable under stock options	460,631		
Shares issuable under conversion of debentures	21,196,342		
Denominator for diluted net earnings (loss) per share	44,235,995	20,998,397	21,160,616

(i) For fully diluted earnings per share in 2003, the numerator is $3,843,456. This difference is due to the accounting for convertible debentures which requires them to be treated as if converted for purposes of fully diluted earnings per share.

Included in the difference is cash interest of $477,377, accreted interest of $718,321 and amortized debenture issue costs of $108,996.

For the years ended September 30, 2003, 2002 and 2001

12. Share capital (continued)

As the Company experienced a loss for the years ended September 30, 2002 and 2001, all potential common shares outstanding from dilutive securities are considered anti-dilutive and are excluded from the calculation of loss per share.

Details of potential dilutive securities are as follows:

	2003	2002	2001
Effect of dilutive potential common shares:			
Shares issuable pursuant to warrants		7,882,353	
Shares issuable under stock options		3,199,000	2,679,500
Shares to be issued in respect of contingent consideration			1,772,241
Shares issuable upon conversion of convertible debentures		8,382,353	

The Company records no compensation expense when options are issued to employees but provides pro forma information for options granted after October 1, 2002 as disclosed in the Summary of Significant Accounting Policies.

The estimated fair value of the options granted during fiscal 2003 was $175,203 (2002 $279,759) of which $23,268 (2002 $nil) was expensed in the financial statements. No other value associated with the stock options was recognized in the accounts of the Company.

The following assumptions were used in the calculation of this estimated fair value:

4 Risk free interest rate 4.0% (2002 4.0%)
4 Expected life 1.95 years (2002 1.36 years)
4 Expected volatility 83.35% (2002 76.0%)
4 Expected dividends $nil (2002 $nil)

Assuming that the Company would have expensed the full value of the stock options in their financial results, the following would be the pro forma net income and earnings per share:

	2003
Pro forma net income	$2,386,827
Pro forma earnings per share	
Basic	$ 0.11
Fully diluted	$ 0.08

For the years ended September 30, 2003, 2002 and 2001

13. Income taxes

Income tax expense (recovery) for the years ended September 30, 2003, 2002 and 2001 consists of:

	2003	2002	2001
Current	$102,696	$(3,073,468)	$1,927,172
Future	143,828	(1,780,072)	(567,441)
	$246,524	$(4,853,540)	$1,359,731

The income tax expense (recovery) attributable to income (loss) differs from the amounts computed by applying the Canadian statutory rates of 37.1% (2002 39.5%; 2001 42.5%) of pre-tax income (loss) as a result of the following:

	2003		2002		2001	
Income tax expense (recovery) at statutory rates	$1,033,341	37.1%	$(7,153,748)	(39.5)%	$ 627,270	42.5%
Increase (decrease) in income taxes resulting from:						
Adjustment to future tax assets for substantively enacted changes in tax laws and rates	(179,597)	(6.4)%	654,691	3.6%	100,000	6.8%
Expenses (revenues) deducted (included) in the accounts that have no corresponding deduction (included) for income taxes	(872,628)	(31.3)%	276,996	1.5%	665,323	45.1%
Impact of different tax rate on earnings of foreign subsidiaries	(307,945)	(11.1)%	(483,406)	(2.5)%	(185,524)	(12.6)%
Change in valuation allowance	963,9133	4.4%	2,407,144	13.3%		
Other	(390,560)	(13.8)%	(555,217)	(3.1)%	152,662	10.4%
	$ 246,524	8.9%	$(4,853,540)	(26.7)%	$1,359,731	92.2%

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13. Income taxes (continued)

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at September 30, 2003 and 2002 are presented below:

	2003	2002
Future tax assets:		
Capital assets	$1,124,221	$1,263,019
Share issuance costs	399,008	422,369
Non-capital losses expiring in 2010	4,853,936	3,890,104
Other	183,549	189,845
	6,560,715	5,765,337
Less valuation allowance	3,371,057	2,407,144
Net future tax assets	3,189,658	3,358,193
Future tax liabilities:		
Goodwill	19,258	43,965
Total net future tax assets	3,170,400	3,314,228
Less current portion	498,172	855,000
	$2,672,228	$2,459,228

At September 30, 2003, the Company has non-capital losses of approximately $12,700,000 available to reduce future years taxable income, which expire as follows:

2007	$ 55,000
2008	3,200,000
2009	6,010,000
2010	3,435,000
	$12,700,000

The Company has capital losses of approximately $14,000,000 for United States tax purposes available for carryforward up to 2008 to be applied against future capital gains.

No provision has been made in the financial statements with respect to any potential future income tax assets which may be associated with these capital losses.

For the years ended September 30, 2003, 2002 and 2001

14. Closure of Hampel Stefanides Inc. (Hampel)

On February 7, 2003, the Company decided to cease the operations of Hampel after conducting a review, in conjunction with the Company s banks, of the ongoing viability, future prospects, cash needs and local debt situation of Hampel. As the Company s banks held a first charge on the assets of Hampel, the net proceeds from the liquidation of those assets were applied in reduction of the Company s debt obligations to the banks. Consequently, there were not sufficient proceeds from the liquidation to make any payment to the unsecured creditors of Hampel. As the Company has no obligation to pay the creditors of Hampel, the consolidated accounts of the Company reflect a gain on the shut-down of Hampel.

Following the liquidation of the assets, the shares of Hampel were sold for a nominal consideration, and the purchaser assumed the liabilities. Based on the sale of the shares of Hampel, included in general and administrative expenses is the recognition of a cumulative translation gain of $841,081.

15. Closure of Subsidiaries

In the first quarter of fiscal 2003, the assets of our technology company Devlin Multimedia Inc. (Devlin) were sold, and the Company s other technology company, Sage Information Consultants Inc. (Sage), was shut down. The results of operations prior to these closures have been included in the results of operations for 2003.

The sale of assets to Devlin was completed on October 30, 2002 at a price equal to their net book value, and correspondingly no gain or loss on the disposal was recorded. Legal expenses related to the disposal were recorded to reduce the gain on disposal of subsidiaries, and income taxes related to the closure of the company have been provided in the consolidated provision.

Sage was closed effective November 11, 2002. All operations of the business were halted and the assets and liabilities of the company were realized over time. Envoy sold the rights to continue business with the customers of Sage to a company formed by certain management employees of Sage, and the proceeds of this agreement were used to offset some of the costs incurred to close the business. A loss of $114,684 has been recorded on the closure of Sage.

For the years ended September 30, 2003, 2002 and 2001

16. Unusual items

During 2002, as a result of changes in the bank loan arrangements, the Company was no longer allowed to fully utilize its line of credit and, accordingly, the remaining unamortized portion of deferred financing charges totalling $750,648 were written off.

During 2001, the Company announced that it was terminating its discussions in connection with the proposed acquisition of Leagas Delaney. Generally accepted accounting principles require that the $1,917,334 of costs incurred in connection with the proposed acquisition and the related equity financing be expensed in full as of the date of abandonment. Costs include legal, accounting, consulting and other out-of-pocket expenses incurred in the negotiation and preparation of legal documents and preparation of long-form prospectus materials prepared in connection with the abandoned acquisition.

17. Restructuring costs

In response to a general economic downturn impacting the Company s business, management implemented a restructuring plan during the first half of fiscal 2002 in order to bring costs more in line with expected revenue. The restructuring involved downsizing its workforce, exiting excess office space and writing off redundant capital assets. Accordingly, the Company recorded a restructuring expense of $10,857,534. The restructuring includes a reduction of staff, as well as the abandonment of leased office space in New York City. As part of the settlement with the landlord, the Company issued 250,000 common shares with a cost of $52,500.

Total restructuring costs accrued at September 30 are classified as:

	2003	2002
Accounts payable and accrued liabilities	$214,060	$1,702,345
Long-term portion of restructuring costs	337,407	792,275
	$551,467	$2,494,620

	Cash	Non-cash	Total provision (recovery) 2003	Accrual at September 30, 2003
Severance	$ (74,969)	$	$ (74,969)	$ 56,885
Lease exit costs	(192,243)		(192,243)	494,582
Write-down of capital assets				
	$(267,212)	$	$(267,212)	$ 551,467

For the years ended September 30, 2003, 2002 and 2001

17. Restructuring costs (continued)

	Cash	Non-cash	Total provision 2002	Accrual at September 30, 2002
Severance	$3,268,261	$	$ 3,268,261	$ 1,013,424
Lease exit costs	4,055,668	52,500	4,108,168	1,481,196
Write-down of capital assets		3,481,105	3,481,105	
	$7,323,929	$3,533,605	$10,857,534	$ 2,494,620

18. Commitments and contingencies

(a) The Company has entered into operating lease agreements for office premises and equipment with minimum annual lease payments over the next five years as follows:

2004	$1,903,967
2005	1,687,428
2006	1,537,137
2007	1,074,725
2008	1,067,732
Thereafter	1,290,636
	$8,561,625

Rent expense under operating leases for the year ended September 30, 2003 amounted to $2,645,288 (2002 $2,041,417; 2001 $1,980,592).

(b) The Company has letters of credit outstanding of U.S. $500,000 which expire on April 30, 2004.

(c) The shares held by the minority shareholders of John Street Inc., representing a 30% interest, are mandatorily redeemable by the Company at September 30, 2004 for cash consideration and as such represents a financial liability of the Company. No amount has been accrued in the financial statements as the purchase price will be determined and paid over a three-year period based on certain performance milestones.

(d) In the ordinary course of business, the Company and its subsidiaries have legal proceedings brought against them. Management does not expect the outcome of these proceedings, in aggregate, to have a material adverse effect on the Company s consolidated financial position or results of operations.

For the years ended September 30, 2003, 2002 and 2001

19. Financial instruments

The estimated fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. These estimates, although based on the relevant market information about the financial instrument, are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(a) The carrying values and estimated fair values of the Company s financial instruments are as follows:

(i) The carrying amounts of cash, restricted cash, accounts receivable, accounts payable and accrued liabilities and promissory note approximate their fair values due to the short-term nature of these instruments.

(ii) The fair value of the Company s bank credit facility approximates its carrying value as it bears an interest rate that is at the current market rate.

(iii) The fair values of the Company s long-term obligations and convertible debentures are estimated using discounted cash flow analysis which is based on the Company s current incremental borrowing rates for similar types of borrowing arrangements. The carrying values of the capital leases and convertible debentures are not significantly different from their fair values.

As at September 30, 2003, the carrying value of the loans payable to landlords was $774,820 (2002 $900,959) and their fair value was $674,653 (2002 $671,000).

(b) Risk management activities:

(i) Currency risk:

The Company is subject to currency risk through its activities in the United States and the United Kingdom. Unfavourable changes in the exchange rate may affect the operating results of the Company. The Company does not actively use derivative instruments to reduce its exposure to foreign currency risk. However, dependent on the nature, amount and timing of foreign currency receipts and payments, the Company may enter into foreign currency contracts to mitigate the associated risks. As at September 30, 2003, there were no foreign currency contracts outstanding.

For the years ended September 30, 2003, 2002 and 2001

19. Financial instruments (continued)

At September 30, 2003, the Company had U.S. $nil (2002 $2,002,704) (Cdn.$3,178,691) outstanding on the U.S. portion of the bank credit facility. Prior to June 30, 2002, the U.S. dollar borrowings were designated as a hedge against the Company s investment in its U.S. operations, managing exposure to foreign currency risk. Commencing July 1, 2002, the Company no longer hedged Watt s U.S. dollar receivables with foreign currency contracts and thus, the Company s U.S. dollar borrowings are now a hedge of such receivables.

(ii) Credit risk:

The Company manages its credit risk with respect to accounts receivable by acting as an agent for its customers, by dealing primarily with large creditworthy customers and by billing whenever possible in advance of rendering services. As at September 30, 2003, one customer represented 8% of accounts receivable (2002 one customer represented 11% of accounts receivable).

The Company is exposed to credit risk in the event of non-performance by counterparties in connection with its foreign currency contracts. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but mitigates this risk by dealing with financially sound counterparties only and, accordingly, does not anticipate loss for non-performance.

20. Segmented information

The Company provides integrated marketing communication services to its clients. While the Company has subsidiaries in Canada, the United States, the United Kingdom and Continental Europe, it operates as an international business and has no distinct reportable business segments.

The tables below set out the following information:

(a) The Company s external net revenue by geographic region based on the region in which the customer is located is as follows:

	2003	2002	2001
Net revenue:			
Canada	$ 6,966,653	$ 15,982,433	$ 21,826,277
United States	18,185,170	27,708,424	40,970,400
United Kingdom and Continental Europe	17,275,420	15,430,233	19,988,864
	$ 42,427,243	$ 59,121,090	$ 82,785,541

For the years ended September 30, 2003, 2002 and 2001

20. Segmented information (continued)

(b) The Company s identifiable assets for each geographic area in which it has operations are as follows:

	2003	2002
Capital assets:		
Canada	$3,631,876	$5,363,424
United States		261,566
United Kingdom and Continental Europe	2,229,441	2,211,738
	$5,861,317	$7,836,728

	2003	2002
Goodwill:		
Canada	$ 3,191,903	$ 3,087,766
United Kingdom and Continental Europe	7,333,882	8,226,517
	$10,525,785	$11,314,283

(c) The Company s external net revenue by type of service is as follows:

	2003	2002	2001
Net revenue:			
Marketing	$ 7,822,280	$12,428,558	$24,374,986
Consumer and retail branding	34,313,108	38,203,746	43,437,449
Technology	291,854	8,488,786	14,973,106
	$42,427,243	$59,121,090	$82,785,541

(d) In 2003, the Company had three customers, which represented 26%, 16% and 12% of net revenue respectively. In 2002, the Company had three customers which represented 19%, 12% and 12% of net revenue respectively. In 2001, the Company had two customers which represented 13.6% and 11.3% of net revenue, respectively.

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21. Subsequent events

On October 31, 2003, the Company borrowed the amount of $4,500,000, of which $4,000,000 was raised by way of secured debentures and $500,000 by way of unsecured term notes. The loans bear interest at the rate of 10% per annum, mature on October 31, 2006, and carry warrants entitling the lenders to purchase, on or before April 24, 2008, one Envoy common share for each $2.00 principal amount of the loan at a price of $0.15 per share. These warrants were part of the Warrants previously issued to Envoy s bankers as described in Note 10(a) and Note 10 (c), and released to Envoy as part of its commitment to the bankers to raise additional funds to further reduce its bank indebtedness. All of these warrants have been exercised subsequent to the year end. $3,800,000 of the loan proceeds were used to pay down the bank debt.

$100,000 of the $500,000 unsecured term notes were loaned by officers of the Company and a further $150,000 of the unsecured term notes were loaned by a relative of a director of the Company.

At a special meeting of shareholders the Company held on January 8, 2004, the shareholders approved an amendment to the Articles of the Company to increase its authorized share capital from 50 million common shares to 200 million common shares.

22. Reconciliation to United States generally accepted accounting principles

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) as applied in Canada. Set out below are the material adjustments to net earnings (loss) for the years ended September 30, 2003, 2002 and 2001 required to conform to US GAAP.

	2003	2002	2001
Net earnings (loss) based on Canadian GAAP	$ 2,538,762	$ (53,379,435)	$ (2,895,372)
Stock-based compensation expense (a)			(886,000)
Foreign currency contracts, net of income tax recovery of $35,703 (c)		49,303	(49,303)
Convertible debentures (d)	67,538	(46,100)	
Net earnings (loss) based on U.S. GAAP	$ 2,606,300	$ (53,376,232)	$ (3,830,675)
Net loss from continuing operations	$ (1,521,001)	$ (15,888,170)	$ (4,038,840)
Net earnings (loss) from discontinued operations (note 22(e))	$ 4,127,301	$ (37,488,062)	$ 208,165

For the years ended September 30, 2003, 2002 and 2001

22. Reconciliation to United States generally accepted accounting principles (continued)

The calculation of diluted earnings (loss) per share used income from continuing operations as the control number in determining whether potential common shares are dilutive or antidilutive.

	2003	2002	2001
Earnings (loss) per share:			
Basic	$ 0.12	$ (2.54)	$ (0.18)
Diluted	0.12	(2.54)	(0.18)
Loss per share from continuing operations:			
Basic	$ (0.07)	$ (0.76)	$ (0.19)
Diluted	(0.07)	(0.76)	(0.19)

The following adjustments are required in order to conform shareholders equity based on Canadian GAAP to shareholders equity based on U.S. GAAP:

	2003	2002
Shareholders equity based on Canadian GAAP	$12,358,503	$9,779,169
Convertible debentures (d)	(593,958)	(578,603)
Shareholders equity based on U.S. GAAP	$11,764,545	$9,200,566

Summary of accounting policy differences:

The areas of material difference between Canadian and U.S. GAAP and their impact on the consolidated financial statements of the Company are set out below:

(a) Stock-based compensation expense:

U.S. GAAP requires the Company to record compensation expense when modifications are made which extend the lives of options. During the year ended September 30, 2001, the Company extended the life of an individual s option award and has therefore recorded the intrinsic value of the option at the date of the extension as compensation expense.

(b) Stock-based compensation disclosures:

The Company measures compensation expense relating to employee stock option plans for U.S. GAAP purposes using the intrinsic value method specified by APB Opinion No. 25, which in the Company s circumstances would not be materially different from compensation expense as determined under Canadian GAAP, except as disclosed in note 22(a).

Had the Company determined compensation costs based on the fair value at the grant date of its stock options consistent with the method prescribed under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (SFAS 123), the Company s net earnings (loss) and earnings (loss) per share would have been reported as the pro forma amounts indicated below:

For the years ended September 30, 2003, 2002 and 2001

22. Reconciliation to United States generally accepted accounting principles (continued)

	2003	2002	2001
Net earnings (loss) in accordance with U.S. GAAP as reported	$2,606,300	$(53,376,232)	$(3,830,675)
Pro forma net earnings (loss)	2,246,121	(54,353,655)	(4,719,780)
Pro forma basic earnings (loss) per share	$ 0.10	$ (2.59)	$ (0.22)
Pro forma diluted earnings (loss) per share	0.10	(2.59)	(0.22)

Compensation cost is reflected over the expected lives of the options. The notional compensation expense associated with the Company s options is not deductible for Canadian income tax purposes. Accordingly, the full amount of compensation expense is reflected in the pro forma figures above, without any related tax recovery.

The weighted average estimated fair value at the date of the grant, as defined by SFAS 123, for options granted in fiscal 2003 was $0.12 per share (2002 $0.16; 2001 -$2.39).

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

	2003	2002	2001
Risk-free interest rate	4.00%	4.00%	4.70%
Dividend yield			
Volatility factor of the future expected market price of the Company s common shares	83%	76%	65%
Weighted average expected life of the options	1.95 years	1.36 years	2.33 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected price volatility. Because the Company s employee share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee share options.

For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period on a straight-line basis.

For the years ended September 30, 2003, 2002 and 2001

22. Reconciliation to United States generally accepted accounting principles (continued)

(c) Derivative financial instruments:

The Company enters into forward contracts to manage its exposure to fluctuations in foreign exchange rates. Effective October 1, 2000, the Company adopted the provisions of FASB Statement No. 133, Accounting For Derivatives and Hedging Activities. SFAS No. 133 requires that all derivatives be recognized as assets and liabilities on the balance sheet and measured at fair value. Hedge accounting is only applied to derivatives if the hedging relationship has been identified, and the Company has formally documented the designation of the hedging relationship and the method for assessing the effectiveness of the hedging relationship. Both at inception of the hedging relationship and throughout its term, the relationship must be effective in achieving offsetting changes in the cash flows of the hedged item.

Under SFAS No. 133 for derivatives designated and effective as hedges of future cash flows, changes in the fair value of the derivative are recognized in other comprehensive income, with no impact on net earnings until the hedged item is recognized in earnings. To the extent the hedge is ineffective, or not designated or documented as a hedge, the change in fair value of the hedge would be recognized in earnings each period. During 2001, the Company had not designated and documented its foreign exchange contracts as a hedge of future cash flows and, therefore, must record the change in fair value as a charge against earnings.

Under Canadian GAAP, no accounting recognition is given to the fair value of those forward contracts which are a hedge of future cash flows. As at September 30, 2001, the fair value of foreign exchange forward contracts, which were otherwise designated as a hedge of future cash flows for Canadian GAAP, totalled ($85,006). This amount represents an additional liability under U.S. GAAP, and this amount net of the related tax recovery is recorded as a charge to U.S. GAAP net earnings.

As at September 30, 2003 and 2002, there were no foreign currency contracts outstanding.

Envoy Communications Group Inc.
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22. Reconciliation to United States generally accepted accounting principles (continued)

(d) Convertible debentures:

During 2003, the Company issued $2,000,000 (2002 $3,800,000) in convertible debentures. The debentures are convertible at any time at the option of the holder into common shares and common share purchase warrants of the Company (note 11), and are redeemable in cash at the option of the holder two years after the issue date. Under Canadian GAAP, the debentures are bifurcated into a debt component and an equity component, based on relative fair values, which resulted in aggregate proceeds of $1,465,929 (2002 $1,949,628) allocated to long-term debt, and $534,071 (2002 $1,850,372) to shareholders equity, respectively.

Under Canadian GAAP, the discount resulting from allocating proceeds to the equity component must be recorded as an additional interest expense, using an effective yield method, over the minimum period to redemption. As a result of accreting the debentures, $718,321 (2002 $133,870) has been charged as interest expense for 2003. Under Canadian GAAP, issue costs are allocated between the debt and equity components which resulted in $44,048 (2002 $129,513) of the aggregate $314,955 (2002 $262,465) issue costs being applied to reduce the equity allocation.

Under U.S. GAAP, any excess of the fair value of the shares over the proceeds allocated to the common stock portion of the conversion option is considered a beneficial conversion feature. For the debentures issued during 2002, an aggregate beneficial conversion feature of $1,188,356 must be recorded as additional interest expense over the minimum period to the earliest redemption date which has been amended, in 2003, from April 29, 2004 and September 12, 2004 respectively to April 24, 2005 for both the debentures issued in 2002. As a result included in interest expense for the debentures during 2003 under U.S. GAAP would be $486,856 (2002 $168,541) associated with the beneficial conversion feature.

Under U.S. GAAP, costs associated with issuance of the debentures cannot be apportioned between the debt and equity components. Accordingly, at September 30, 2003 unamortized deferred financing fees under U.S. GAAP would be higher by $68,695 (2002 $118,084). If the Company had recorded the issue costs in accordance with U.S. GAAP, additional amortization of $163,927 (2002 $11,429) would have been charged to interest expense. Additionally, share capital would be lower by $130,343 (2002 $nil).

(e) Discontinued operations:

The businesses disposed of in the Gain on closure of subsidiaries, as described in Notes 14 and 15, are treated as discontinued operations under U.S. GAAP. This treatment requires that the results of operations of these businesses be removed from the normal operations of the Company, and be presented in summary form as earnings from operations, gain on disposal of, and income taxes from those discontinued businesses.

As a result of the accounting for the disposed businesses as discontinued operations under U.S. GAAP, the amounts reported as assets and liabilities on the balance sheet would be different from those reported under Canadian GAAP. The assets and liabilities of the discontinued operations are as follows:

Envoy Communications Group Inc.
Notes to Consolidated Financial Statements

For the years ended September 30, 2003, 2002 and 2001

22. Reconciliation to United States generally accepted accounting principles (continued)

(e) Discontinued operations: (continued)

	2003	2002
Current assets		$9,262,277
Long-term assets		1,105,466
Current liabilities		9,983,488

As a result of accounting for the disposed businesses as discontinued operations under U.S. GAAP, the amounts reported as revenues and expenses in the Statements of Operations of the Company would be different than those reported under Canadian GAAP. The revenues and expenses of the discontinued operations are as follows:

	2003	2002	2001
Net revenue	$3,386,913	$ 15,824,996	$34,683,009
Operating expenses	2,649,784	16,857,573	28,190,551
Depreciation	70,217	520,401	661,504
Interest expense and financing fees	199	727	40,983
Restructuring costs		5,691,023	
Unusual item			1,380,967
Income taxes (recovery)	(119,903)	(2,552,010)	1,999,098
Goodwill amortization		1,436,173	2,201,741
Write-down of goodwill		31,359,171	
Earnings (loss) from discontinued Operations (excluding gain)	$ 786,616	$(37,488,062)	$ 208,165
Pre-tax earnings (loss) from discontinued operations	$ 906,519	$(34,936,052)	$ (1,790,932)
Gain on discontinued operations	3,340,685		
Income taxes (recovery) from discontinued operations	(119,903)	(2,552,010)	1,999,098
Earnings (loss) from discontinued operations	$4,127,301	$(37,488,062)	$ 208,165

For the years ended September 30, 2003, 2002 and 2001

22. Reconciliation to United States generally accepted accounting principles (continued)

(f) Comprehensive income:

The Company s comprehensive income represents U.S. GAAP net earnings plus the change in the cumulative translation adjustment account in respect of foreign operations as follows:

	2003	2002	2001
Net earnings (loss) for the year in accordance with U.S. GAAP	$ 2,606,300	$ (53,376,232)	$ (3,830,675)
Change in cumulative translation adjustment account	(1,584,672)	515,569	1,147,208
	$ 1,021,628	$ (52,860,663)	$ (2,683,467)

(g) Reduction of capital:

In 1997, the share capital of the Company was reduced by $9,886,961 pursuant to a special resolution of its shareholders and was applied against the deficit. This reduction in capital is not permitted under U.S. GAAP. While the adjustment has no impact on shareholders equity, under U.S. GAAP, capital stock would be increased by $9,886,961 and retained earnings would be decreased by $9,886,961 as at September 30, 2003 and 2002.

(h) Other disclosures:

U.S. GAAP and the United States Securities and Exchange Commission require the Company to disclose the following items, for which disclosure is not required under Canadian GAAP:

(i) The allowance for doubtful accounts as at September 30, 2003 was $32,048 (2002 $226,037).

(ii) U.S. GAAP requires the disclosure of accrued liabilities. Accrued liabilities included in accounts payable and accrued liabilities as at September 30, 2003 were $3,524,013 (2002 $4,779,517). As at September 30, 2003, Envoy had accrued $1,326,700 (2002 $1,122,745) for the termination of certain leased premises of Hampel Stefanides.

At September 30, 2003 and 2002, there were no other accrued liabilities that exceeded 5% of current liabilities.

(iii) The Company has disclosed both net earnings before goodwill amortization and earnings per share before goodwill amortization, which are not permitted disclosures under U.S. GAAP.

For the years ended September 30, 2003, 2002 and 2001

(i) Restructuring charges:

Under U.S. GAAP restructuring charges would be included as operating expenses in the consolidated statement of operations and the long term portion of restructuring charges would be included in operating activities on the consolidated statement of cash flows.

(j) Goodwill amortization and goodwill write-downs:

Under U.S. GAAP goodwill amortization and goodwill write-downs would be included as operating expenses in the consolidated statement of operations and the income taxes relating to these items would not be netted against operating expenses.

(k) Gain on redemption of shares:

Under U.S. GAAP there would be no gain on the redemption of shares (Note 12 (b)).

(l) Recent accounting pronouncements:

(i) Effective October 1, 2003, the Company will be required to adopt the new Canadian Accounting Guideline, Hedging Relationships , that establishes standards for the documentation and effectiveness of hedging relationships that are substantially similar to the corresponding requirements in SFAS No. 133. The Company does not believe that the adoption of these standards will have a material impact on its consolidated financial statements.

For the years ended September 30, 2003, 2002 and 2001

(ii) In December 2002, the CICA issued Handbook Section 3063, Impairment of Long-Lived Assets , and revised Section 3475, Disposal of Long-Lived Assets and Discontinued Operations . These new rules supersede the write-down and disposal provisions of CICA Handbook Section 3061, Property, Plant and Equipment , as well as current Handbook Section 3475, Discontinued Operations . The new standards are based on SFAS 144. Under revised Handbook Section 3475, new standards are established for the recognition, measurement, presentation and disclosure of the disposal of long-lived assets as well as for the presentation and disclosure of discontinued operations. New Handbook Section 3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets held for use. Under the new standards, an impairment loss is recognized when the carrying amount of an asset held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. An impairment loss is measured as the amount by which the asset s carrying amount exceeds its fair value.

The new accounting recommendations contained in Handbook Section 3063 on the impairment of long-lived assets held for use should be applied for years beginning on or after April 1, 2003. The revised accounting recommendations contained in Handbook Section 3475 on disposal of long-lived assets and discontinued operations should be applied to disposal activities initiated by a company s commitment to a plan on or after May 1, 2003. The Company has not determined the impact of the adoption of these standards on its consolidated financial statements.

(iii) In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables.EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company does not believe that the adoption of these standards will have a material impact on its consolidated financial statements.

(iv) In December 2002, the FASB issued Statement 148, Accounting for Stock-Based Compensation, Transition and Disclosure. Statement 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Statement 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, Statement 148 requires disclosure of the pro forma effect in interim financial statements. The Company adopted the annual disclosure requirements of Statement 148, which are effective for fiscal years ending after December 15, 2002 and elected to continue to account for employee stock options under APB No. 25.

(v) In January 2003, the FASB issued FASB Interpretation No. 46, or FIN 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for fiscal year ended September 30, 2004. The Company does not believe that the adoption of these standards will have a material impact on its consolidated financial statements.

(vi) In May 2003, the FASB issued Statement 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. Statement 150 requires that certain financial instruments that are settled in cash, including certain types of mandatorily redeemable securities, be classified as liabilities rather than as equity or temporary equity. Statement 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period after June 15, 2003. The Company has not determined the impact of the adoption of these standards on its consolidated financial statements.

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—

Earnings on equity investments in joint ventures

(2,212

)

(2,475

)

Distributions from equity investments

3,021

2,824

Non-cash gain on re-measurement of equity investment

(8,410

)

—

Gain on deconsolidation of joint venture

—

(3,772

)

Gain on sale of trademarks, net

(1,268

)

(875

)

Loss on sale of NGX

—

79

Trademark impairment

77,721

521,653

Goodwill impairment

37,812

103,877

Settlement of note receivable related to formation of Buffalo joint venture

1,141

—

Mark to market adjustment on convertible note

(73,745

)

—

Gain on debt to equity conversions

(1,056

)

—

Gain on sale of Complex Media

(958

)

(2,728

)

(Gain) loss on extinguishment of debt

(4,473

)

20,939

Income on other equity investment

364

—

Deferred income tax benefit

(4,905

)

(31,721

)

Loss on foreign currency translation

453

2,755

Changes in operating assets and liabilities:

Accounts receivable

16,265

(4,596

)

Other assets – current

17,033

(9,541

)

Other assets

(2,785

)

2,543

Deferred revenue

2,778

(13

)

Accounts payable and accrued expenses

(14,944

)

(34,375

)

Other tax liabilities

(531

)

(4,165

)

Other liabilities

1,128

(297

)

Net cash provided by continuing operating activities

49,697

3,097

Net cash used in discontinued operating activities

—

(6,966

)

Net cash provided by (used in) operating activities

49,697

(3,869

)

Cash flows provided by (used in) investing activities:

Purchases of property and equipment

(776

)

(829

)

Acquisition of additional interest in Iconix MENA

—

(1,800

)

Acquisition of trademarks from Iconix Southeast Asia

(2,120

)

—

Acquisition of remaining interest in Iconix Canada

(7,053

)

(11,177

)

Acquisition of Badgley Mischka and Sharper Image trademarks in certain

international joint ventures

(1,289

)

—

Acquisition of additional interest in Iconix Australia, net of cash acquired

(649

)

Proceeds received from note due from American Greetings

—

1,250

6

Proceeds from sale of interest in Badgley Mischka in certain international joint ventures	2,500	—
Proceeds from sale of Galore Media	—	250
Proceeds from sale of Complex Media	958	2,728
Proceeds from sale of NGX	—	2,561
Proceeds from sale of interest in Badgley Mischka Canada		375
Proceeds from sale of interest in Sharper Image Canada		500
Proceeds from sale of discontinued operation, net of cash sold		336,675
Decrease in cash and cash equivalents from deconsolidation of joint venture		(1,853)
Proceeds from note receivable from formation of Buffalo joint venture	1,409	—
Additions to trademarks	(284)	(109)
Net cash (used in) provided by continuing investing activities	(7,304)	328,571
Net cash used in discontinued investing activities	—	(84)
Net cash (used in) provided by investing activities	(7,304)	328,487
Cash flows provided by (used in) financing activities:		
Prepaid financing costs	(5,423)	(7,145)
Proceeds from Variable Funding Notes, net of discount and fees		73,437
Proceeds from long-term debt, net of discount and fees	95,700	288,000
Payment of long-term debt	(145,655)	(583,157)
Repurchase of convertible notes	—	(58,810)
Payment of make-whole premium on repayment of long-term debt	—	(13,933)
Proceeds from sale of trademarks and related notes receivable from consolidated JVs	195	6,927
Distributions to non-controlling interests	(13,693)	(3,850)
Tax benefit related to amortization of convertible notes' discount	35	78
Cost of shares repurchased on vesting of restricted stock	(147)	(1,078)
Net cash used in continuing financing activities	(68,988)	(299,531)
Net cash used in discontinued financing activities	—	(23,873)
Net cash used in financing activities	(68,988)	(323,404)
Effect of exchange rate changes on cash and restricted cash	(466)	2,831
Net (decrease) increase in cash and cash equivalents, and restricted cash	(27,061)	4,045
Cash, cash equivalents, and restricted cash from continuing operations, beginning of period	114,693	314,383
Cash and cash equivalents from discontinued operations, beginning of period	—	12,297
Cash, cash equivalents, and restricted cash, beginning of period	114,693	326,680
Cash, cash equivalents, and restricted cash, end of period	87,632	330,725
Less: Cash and cash equivalents from discontinued operations, end of period	—	—
Cash, cash equivalents, and restricted cash of continuing operations, end of period	$87,632	$330,725

Supplemental disclosure of cash flow information:

Nine Months
Ended September

	30, 2018	2017
Cash paid during the period:		
Income taxes (net of refunds received)	$(6,413)	$34,836
Interest	$30,334	$51,657

See Notes to Unaudited Condensed Consolidated Financial Statements.

Iconix Brand Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

September 30, 2018

(dollars in thousands (unless otherwise noted) except per share data)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management of Iconix Brand Group, Inc. (the "Company," "we," "us," or "our"), all adjustments (consisting primarily of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2018 ("Current Quarter") and the nine months ended September 30, 2018 ("Current Nine Months") are not necessarily indicative of the results that may be expected for a full fiscal year. The interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

During the Current Nine Months, the Company adopted seven new accounting pronouncements. Refer to Note 20 for further details.

Certain reclassifications, which were immaterial, have been made to conform prior year data to the current presentation.

Assessment of Going Concern

These consolidated financial statements are prepared on a going concern basis that contemplates the realization of assets and discharge of liabilities in the normal course of business. Due to certain developments during the year ended December 31, 2017, including the decision by Target Corporation not to renew the existing Mossimo license agreement following its expiration in October 2018 and by Walmart, Inc. not to renew the existing Danskin Now license agreement following its expiration in January 2019, and the Company's revised projected future earnings, the Company had initially forecasted that it would unlikely be in compliance with certain of its financial debt covenants in 2018 and beyond and that it may otherwise face possible liquidity challenges in 2018 and beyond. As a result, the Company amended its Senior Secured Term Loan to provide relief under certain covenants and implemented a cost savings plan to improve liquidity.

Additionally, the Company considered Sears Holdings Corporation's bankruptcy filing on October 15, 2018 and determined that the bankruptcy filing does not currently expect it to have a material impact on the Company's ability to continue as a going concern. Refer to Note 4 and 22 for further details.

While conditions and events do exist that may raise substantial doubt about the Company's ability to continue as a going concern for the next twelve months, management believes as a result of implemented and planned cost savings, that its plans alleviate this substantial doubt, and therefore the management believes that it will continue as a going concern for the next twelve months.

For additional information, please refer to Note 1 of Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

2. Discontinued Operations

On May 9, 2017, the Company signed definitive agreements to sell its Entertainment segment for $349.1 million in cash, which included a customary working capital adjustment. The sale was completed on June 30, 2017. As a result of the sale, the Company has classified the results of its Entertainment segment as discontinued operations in its condensed consolidated statement of operations for the three months ended September 30, 2017 ("Prior Year Quarter") and the nine months ended September 30, 2017 ("Prior Year Nine Months").

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The following table presents the details of the Entertainment segment for the Prior Year Quarter and Prior Year Nine Months which were shown as income from discontinued operations, net of income taxes, in our unaudited condensed consolidated statement of operations:

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2018	2017	2018	2017
Licensing revenue	$—	$—	$—	$53,129
Selling, general and administrative expenses	—	—	—	34,542
Depreciation and amortization	—	—	—	303
Operating income	—	—	—	18,284
Other expenses (income):				
Interest expense	—	—	—	12,973
Interest income	—	—	—	(180)
Loss on extinguishment of debt	—	2,308	—	31,554
Foreign currency translation loss	—	—	—	169
Other expenses – net	—	2,308	—	44,516
Loss from operations of discontinued operations before income taxes	—	(2,308)	—	(26,232)
Gain on sale of Entertainment segment	—	(228)	—	104,099
Provision for income taxes	—	(406)	—	28,555
Net income from discontinued operations	—	(2,130)	—	49,312
Less: Net income attributable to non- controlling interest from discontinued operations	—	—	—	2,943
Income from discontinued operations, net of income taxes	$—	$(2,130)	$—	$46,369

The cash proceeds from the sale of the Company's Entertainment segment were utilized by the Company to make mandatory principal prepayments on both its Securitization Notes and 2016 Senior Secured Term Loan (each as defined below) (as well as a corresponding prepayment premium). As a result, and in accordance with ASC 205-20-45-6, for the Prior Year Quarter and Prior Year Nine Months, the Company allocated interest expense of $6.5 million (which includes $1.0 million of amortization of the original issue discount on the 2016 Senior Secured Term Loan) and $12.9 million (which includes $1.7 million of amortization of the original issue discount on the 2016 Senior Secured Term Loan, respectively, from continuing operations to discontinued operations. Given the completion of the sale on June 30, 2017, there were no corresponding allocations of interest expense for the Prior Year Quarter. For the Prior Year Quarter, given the mandatory principal prepayment of $152.2 million on the 2016 Senior Secured Notes paid in July 2017, the Company allocated the associated prepayment penalty of $0.3 million as well as the write-off of the pro-rata portion of deferred financing costs of $2.0 million related to the Securitization Notes from continuing operations to discontinued operations on the Company's condensed consolidated statement of operations. Additionally, for the Prior Year Nine Months, the Company allocated the prepayment premium of $15.2

million related to the 2016 Senior Secured Term Loan as well as the write-off of the pro-rata portion of deferred financing costs and original issue discount of $9.4 and $4.7 million, respectively, from continuing operations to discontinued operations on the Company's unaudited condensed consolidated statement of operations. Refer to Note 9 for further details.

During the Prior Year Quarter, the Company recorded an additional $0.2 million of transaction costs associated with the sale of the Entertainment segment which was allocated to discontinued operations and recorded within Gain on sale of Entertainment segment on the Company's condensed consolidated statement of operations which resulted in a reduction of the pre-tax gain to $104.1 million.

The following table presents cash flow of the Entertainment segment during the Prior Year Nine Months:

	Nine Months Ended September 30, 2018	2017
Net cash used in discontinued operating activities	$—	$(6,966)
Net cash used in discontinued investing activities	$—	$(84)
Net cash used in discontinued financing activities	$—	$(23,873)

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3. Revenue Recognition

Adoption of ASC Topic 606, “Revenue from Contracts with Customers”

On January 1, 2018, we adopted ASC Topic 606 – Revenue from Contracts with Customers (“Topic 606”), using the modified retrospective method applied to those license agreements which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605. Under Topic 605, the Company recognized minimum royalty revenue on a straight-line basis over the term of each contract year, as defined, in each license agreement and royalties exceeding the defined minimum amounts were recognized as income during the period corresponding to the licensee’s sales. Under Topic 606, the Company is recognizing the minimum royalty revenue on a straight-line basis over the entire contract term and royalties exceeding the defined minimum amounts are recognized only in the subsequent periods to when the minimum guarantee for the contract year has been achieved and when the later of the following events occur: (i) the subsequent sale occurs, or (ii) the performance obligation to which some or all of the sales-based royalty has been allocated has been satisfied (or partially satisfied), as is discussed below.

We recorded a net increase to opening retained earnings and the corresponding amount to non-controlling interest of $16.5 million and $1.2 million, respectively, net of tax, as of January 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact primarily related to our revenues associated with license agreements which have escalating guaranteed minimum royalties in the contract years of the license agreement term. The impact to revenues was an increase of approximately $2.4 million for the Current Quarter and an increase of $0.6 million for the Current Nine Months as a result of applying Topic 606.

Revenue Recognition

Licensing Revenue

The Company licenses its brands across a broad range of product categories, including fashion apparel, footwear, accessories, sportswear, home furnishings and décor, and beauty and fragrance. The Company seeks licensees with the ability to produce and sell quality products in their licensed categories and to meet and exceed minimum sales and royalty payment thresholds.

The Company maintains direct-to-retail and traditional wholesale licenses. Typically, in a direct-to-retail license, the Company grants exclusive rights to one of its brands to a national retailer for a broad range of product categories. Direct-to-retail licenses provide retailers with proprietary rights to national brands at favorable economics. In a traditional wholesale license, the Company grants the right to a specific brand to a single or small group of related product categories to a wholesale supplier, who is permitted to sell licensed products to multiple retailers within an approved distribution channel.

The Company’s license agreements typically require the licensee to pay the Company royalties based upon net sales with guaranteed minimum royalties in the event that net sales do not reach certain specified targets. The Company’s licenses also typically require the licensees to pay to the Company certain minimum amounts for the advertising and marketing of the respective licensed brands.

Licensing revenue is comprised of revenue related to the Company’s entry into various trade name license agreements that provide revenues based on minimum royalties and advertising/marketing fees and additional revenues based on a percentage of defined sales. Minimum royalty amounts are recognized as revenue on a straight-line basis over the full contract term. Minimum royalties that escalate on an annual basis over the contract term are recognized on a straight-line basis over the full contract term. Royalties exceeding the defined minimum amounts in a specific contract year (sales-based royalties), as defined in each license agreement, are recognized only in the subsequent periods to when the minimum guarantee for the contract year has been achieved and when the later of the following events occur: (i) the subsequent sale occurs, or (ii) the performance obligation to which some or all of the sales-based royalty has been allocated has been satisfied (or partially satisfied).

Within the Company's International segment, the Umbro business purchases replica soccer jerseys for resale to certain licensees. The Company generally does this as an accommodation to its licensees to consolidate ordering from the manufacturers. The revenue associated with such activity is included in licensing revenue and was approximately $0.2 million and $2.8 million in the Current Quarter and the Current Nine Months, respectively. The associated cost of goods sold is included in selling general and administrative expenses and was approximately $0.2 million and $2.7 million in the Current Quarter and Current Year Nine Months, respectively. There were less than $0.1 million of such sales and corresponding cost of goods sold in both the Prior Year Quarter and Prior Year Nine Months. Revenue for these sales are recognized upon the transfer of control of the promised product to the customer or licensee in an amount that reflects the consideration that we expect to receive in exchange for these products.

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The following table presents our revenues disaggregated by license type:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Licensing revenue by license type:				
Direct-to-retail license	$19,344	$27,640	$60,651	$96,438
Wholesale licenses	26,682	25,477	81,238	76,927
Other licenses[1]	198	48	3,095	170
	$46,224	$53,165	$144,984	$173,535

[1] Included in Other licenses for the Current Quarter and the Current Year Nine Months is $0.2 million and $2.8 million, respectively, of revenue associated with the Umbro business purchases discussed above as compared to less than $0.1 million for both the Prior Year Quarter and Prior Year Nine Months.

The following table represents our revenues disaggregated by geography:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Total licensing revenue by geographic region:				
United States	$29,430	$39,792	$96,532	$129,737
Other [1]	16,794	13,373	48,452	43,798
	$46,224	$53,165	$144,984	$173,535

[1] No single country represented 10% of the Company’s revenues in the periods presented.

Remaining Performance Obligation

We enter into long-term license agreements with our licensees across all operating segments. Revenues are recognized on a straight line basis consistent with the nature, timing and extent of our services, which primarily relate to the ongoing brand management and maintenance of the intellectual property. As of October 1, 2018, the Company and its joint ventures had a contractual right to receive over $425 million of aggregate minimum licensing revenue through the balance of all of their current licenses, excluding any renewals.

As of September 30, 2018, future minimum license revenue to be recognized is as follows: $29.6 million, $98.1 million, $71.5 million, $48.9 million, $42.1 million and $137.4 million for the remainder of FY 2018, FY 2019, FY 2020, FY 2021, FY 2022 and thereafter, respectively.

Contract Balances

Timing of revenue recognition may differ from the timing of invoicing to licensees. We record a receivable when amounts are contractually due or when revenue is recognized prior to invoicing. Deferred revenue is recorded when amounts are contractually due prior to satisfying the performance obligations of the contracts. For multi-year license agreements, as the performance obligation is providing the licensee with the right of access to the Company’s intellectual property for the contractual term, the Company uses a time-lapse measure of progress and straight lines the guaranteed minimum royalties over the contract term.

Contract Asset

We record contract assets when revenue is recognized in advance of cash payment being due from our licensees. Contract assets due within one year of the most recent balance sheet date are recorded within Other assets – current and long term contract assets are recorded within Other assets on the Company's condensed consolidated balance sheet. As of September 30, 2018, our contract assets – current and long term contract assets were $6.4 million and $12.9 million, respectively, which has been included within other assets – current and other assets, respectively, in the Company's condensed consolidated balance sheet.

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Deferred Revenue

We record deferred revenue when cash payment is received or due in advance of our performance, including amounts which are refundable. Advanced royalty payments are recognized ratably over the period indicated by the terms of the license and are reflected in the Company's consolidated balance sheet in deferred revenue at the time the payment is received. The increase in deferred revenues for the Current Nine Months is primarily driven by cash payments received or due in advance of satisfying our performance obligations, offset by $4.3 million of revenues recognized that were included in the deferred revenue balance at the beginning of the period.

4. Goodwill and Trademarks and Other Intangibles, net

Goodwill

Goodwill by reportable operating segment and in total, and changes in the carrying amounts, as of the dates indicated are as follows:

	Women's	Men's	Home	International	Consolidated
Net goodwill at December 31, 2017	$37,812	$ —	$ —	$ 26,070	$ 63,882
Impairment	(37,812)	—	—	—	(37,812)
Acquisition of 5% interest in Iconix Australia	—	—	—	29	29
Net goodwill at September 30, 2018	$—	$ —	$ —	$ 26,099	$ 26,099

The annual evaluation of the Company's goodwill, by segment, is typically performed as of October 1, the beginning of the Company's fourth fiscal quarter.

During the second quarter of 2018, based upon the results of step 1 of the goodwill impairment test in accordance with ASC 350 for the women's segment, the Company noted that the carrying value of the women's segment exceeded its fair value after first reflecting the impairment of the Mossimo trademark as discussed below. In accordance with step 2 of the goodwill impairment test, the Company recorded a non-cash impairment charge of $37.8 million in the second quarter of 2018, which is due to the projected decline in royalties associated with the license agreements for the Mossimo brand.

In July 2018, the Company purchased an additional 5% ownership interest in Iconix Australia from its joint venture partner. As a result of this transaction, the Company recorded goodwill of less than $0.1 million. Refer to Note 5 for further details.

Trademarks and Other Intangibles, net

Trademarks and other intangibles, net, consist of the following:

		September 30, 2018		December 31, 2017	
	Estimated Lives in Years	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization

Indefinite-lived trademarks	Indefinite	$397,579	$ —	$465,391	$ —
Definite-lived trademarks	10-15	8,958	8,948	8,958	8,917
Non-compete agreements	2-15	—	—	940	940
Licensing contracts	1-9	988	874	3,412	3,122
		$407,525	$ 9,822	$478,701	$ 12,979
Trademarks and other intangibles, net			$ 397,703		$ 465,722

The trademarks of Candie's, Bongo, Joe Boxer, Rampage, Mudd, London Fog, Mossimo, Ocean Pacific, Danskin, Rocawear, Cannon, Royal Velvet, Fieldcrest, Charisma, Starter, Waverly, Ecko, Zoo York, Ed Hardy, Umbro, Modern Amusement, Buffalo, Lee Cooper, Hydraulic and Pony have been determined to have an indefinite useful life. Each of these intangible assets are tested for impairment annually and as needed on an individual basis as separate single units of accounting representing domestic and various international assets, with any related impairment charge recorded to the income statement at the time of determining such impairment. The annual evaluation of the Company's indefinite-lived trademarks is typically performed as of October 1, the beginning of the Company's fourth fiscal quarter.

As of September 30, 2018, given the ongoing financial distress of Sears' Holding Corporation ("Sears") and its continuing liquidity challenges, the Company conducted an indefinite-lived intangible asset impairment test in accordance with ASC 350 for the Joe Boxer, Cannon and Bongo trademarks whose future revenues and earnings are either exclusively or heavily dependent on the existing license agreements with Sears. As part of its indefinite-lived intangible asset impairment test for the Joe Boxer, Cannon and Bongo trademarks, the Company developed a number of potential scenarios of the future forecasted cash flows of the Joe Boxer, Cannon and Bongo trademarks in the event of a potential bankruptcy filing by Sears and applied a probability of occurrence to each potential scenario. As a result, based on the indefinite-lived intangible asset impairment tests, the Company recorded a non-cash impairment charge of $4.4 million in the Current Quarter to reduce the Joe Boxer trademark to fair value. The fair value of the Bongo and Cannon trademarks remained above their current book value and thus no impairment charge was recorded. On October 15, 2018, Sears filed for Chapter 11 bankruptcy. The Company will continue to monitor the Sears bankruptcy proceeding. As new and additional information is learned about the Sears bankruptcy filing, the Company will update its forecasted future earnings for the Joe Boxer, Cannon and Bongo brands as is deemed necessary. At this time, the Company is uncertain of the outcome of the Sears bankruptcy filing and how it could affect the future revenues and cash flows of these brands as well as if any future indefinite-lived intangible asset impairment charge for these trademarks is expected. Refer to Note 22 for further details.

As of June 30, 2018, the Company revised its forecasted future earnings for the Mossimo brand and accordingly, conducted an indefinite-lived intangible asset impairment test in accordance with ASC 350. Consequently, the Company recorded a non-cash impairment charge of $73.3 million in the Current Nine Months in the women segment to reduce the Mossimo trademark to fair value.

In accordance with ASC 360, there were no impairment charges to the Company's definite-lived trademarks during the Current Nine Months or Prior Year Nine Months.

During the Current Nine Months, the Company completed the sale of the Badgley Mischka and Sharper Image intellectual property and related assets from the Iconix Southeast Asia, Iconix MENA, Iconix Europe and Iconix Australia joint ventures. Refer to Note 6 for further details.

During the Current Quarter, the Company purchased an additional 5% ownership interest in Iconix Australia which resulted in the Company consolidating the entity on its condensed consolidated balance sheet and the statement of operations for the Current Quarter. As a result of this transaction, the Company recorded $12.3 million of trademarks on its condensed consolidated balance sheet. Refer to Note 5 for further details.

Other amortizable intangibles primarily include non-compete agreements and contracts, which are amortized on a straight-line basis over their estimated useful lives of 1 to 15 years. Certain trademarks are amortized using estimated useful lives of 10 to 15 years with no residual values.

Amortization expense for intangible assets for the Current Quarter was less than $0.1 million as compared to amortization expense for intangible assets of approximately $0.2 million for the Prior Year Quarter. Amortization expense for intangible assets for the Current Nine Months was approximately $0.2 million as compared to amortization expense for intangible assets of $0.6 million for the Prior Year Nine Months.

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5. Joint Ventures and Investments

Joint Ventures

As of September 30, 2018, the following joint ventures are consolidated with the Company:

Entity Name	Date of Original Formation / Investment	Iconix's Ownership % as of September 30, 2018	Joint Venture Partner	Put / Call Options, as applicable
Lee Cooper China Limited[5]	June 2018	100%	POS Lee Cooper HK Co. Ltd.	—
Starter China Limited[4]	March 2018	100%	Photosynthesis Holdings Co. Ltd.	—
Danskin China Limited	October 2016	100%	Li-Ning (China) Sports Goods Co. Ltd.	—
Umbro China Limited	July 2016	95%	Hong Kong MH Umbro International Co. Ltd.	Call Options
US Pony Holdings, LLC	February 2015	75%	Anthony L&S Athletics, LLC	—
Iconix MENA Ltd.[1]	December 2014	55%	Global Brands Group Asia Limited	Put / Call Options
Iconix Israel, LLC[1]	November 2013	50%	MGS	—
Iconix Europe LLC[1]	December 2009	51%	Global Brands Group Asia Limited	Put / Call Options
Iconix Australia[6]	September 2013	55%	Pac Brands USA, Inc.	Put / Call Options
Hydraulic IP Holdings LLC[1]	December 2014	100%[3]	Top On International	—
Diamond Icon[1]	March 2013	51%	Albion Agencies Ltd.	
Buffalo brand joint venture[1]	February 2013	51%	Buffalo International	—
Icon Modern Amusement, LLC[1]	December 2012	51%	Dirty Bird Productions	—
Hardy Way, LLC	May 2009	85%	Donald Edward Hardy	—

(1) The Company determined, in accordance with ASC 810, based on the corporate structure, voting rights and contributions of the Company and its respective joint venture partner, the entity is a variable interest entity (VIE) and, as the Company has been determined to be the primary beneficiary, is subject to consolidation. The Company has consolidated this joint venture within its consolidated financial statements since inception. The liabilities of the VIE are not material and none of the VIE assets are encumbered by any obligation of the VIE or other entity.

(2) Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for material terms of the put and call options associated with certain of the Company's joint ventures.

(3) In April 2018, pursuant to a letter agreement entered into simultaneously with the Company's acquisition of a 51% equity interest in Hydraulic, the Company acquired the remaining 49% ownership interest from its joint venture partner for no cash consideration as a result of an affiliate of the joint venture partner not making its minimum guaranteed royalty payment obligations to the Company in accordance with the respective license agreement. This transaction resulted in the Company effectively increasing its ownership interest in Hydraulic to 100%. The Company will retain 100% ownership interest in Hydraulic unless the affiliate of such joint venture partner satisfies its outstanding payment obligations by making all payments of the minimum guaranteed royalties to the Company under the terminated license agreement.

(4) In March 2018, the Company entered into an agreement with Photosynthesis Holdings, Co. Ltd. ("PHL") to sell up to no less than a 50% interest and up to a total of 60% interest in its wholly-owned indirect subsidiary, Starter China Limited, a newly registered Hong Kong subsidiary of Iconix China ("Starter China"), and which will hold the Starter trademarks and related assets in respect of the Greater China territory. PHL's purchase of the initial 50% equity interest in Starter China is expected to occur over a three-year period commencing on January 15, 2020 for cash consideration of $20.0 million. The additional 10% equity interest (for a total equity interest of 60% interest) purchase right of PHL is expected to occur over a three-year period commencing January 16, 2022 for cash consideration equal to the greater of $2.7 million or 2.5 times the royalty received under the respective license agreement in the previous twelve months based on other terms and conditions specified in the share purchase agreement.

(5) In June 2018, the Company entered into an agreement with POS Lee Cooper HK Co. Ltd. ("PLC") to sell up to no less than a 50% interest and up to a total of 60% interest in its wholly-owned indirect subsidiary, Lee Cooper China Limited, a newly registered Hong Kong subsidiary of Iconix China ("Lee Cooper China"), and which will hold the Lee Cooper trademarks and related assets in respect of the Greater China territory. PLC's purchase of the initial 50% equity interest in Lee Cooper China is expected to occur over a four-year period commencing on October 15, 2020 for cash consideration of approximately $8.2 million. The additional 10% equity interest (for a total equity interest of 60% interest) purchase right of PLC is expected to occur over a two-year period commencing January 15, 2024 for cash consideration equal to the greater of $2.5 million or 2.5 times the royalty received under the respective license agreement in the previous twelve months based on other terms and conditions specified in the share purchase agreement.

(6) In July 2018, the Company entered into the Third Amended and Restated Shareholders Agreement ("the Amended Agreement") for Iconix Australia in which the Company purchased an additional 5% ownership interest in Iconix Australia from Brand Collective (USA), Inc. ("BrandCo") for $0.7 million in cash. As a result of this transaction, the Company's ownership interest in Iconix Australia effectively increased to 55% and reduced BrandCo's ownership interest in Iconix Australia to 45%. The Amended Agreement also resulted in a change in rights, duties and obligations of the Company and BrandCo in their capacity as joint venture partners in respects of the Iconix Australia joint venture. Additionally, as a result of this transaction and in accordance with ASC 810, based on the corporate structure, voting rights and contributions of the Company and BrandCo, Iconix Australia has been determined to be a VIE, and thus is subject to consolidation and included in the Company's condensed consolidated financial statements as of July 2018.

The estimated fair value of the assets acquired, less liabilities assumed, is allocated as follows:

Fair value of 50% interest in Iconix Australia	$	6,507	
Book value of Company equity investment prior to purchase of additional 5% interest		(1,904	)
Gain on re-measurement of initial equity investment		8,410	
	$	13,013	
Trademarks		12,349	
Cash		44	
Accounts receivable		360	
Intercompany receivables, net		368	
Accounts payable and accrued expenses		(85	)
Deferred revenue		(52	)
Goodwill		29	
	$	13,013	

The Iconix Australia trademarks have been determined by management to have an indefinite useful life and accordingly, no amortization is being recorded in the Company's condensed consolidated statement of operations. The goodwill and trademarks are subject to a test for impairment on an annual basis. Additionally, as a result of the acquisition, the Company recognized a $5.9 million non-controlling interest associated with BrandCo's 45% ownership interest in the Iconix Australia joint venture on the date of consolidation. Given the put option associated with the joint venture, the Company has recorded the non-controlling interest in Redeemable Non-controlling interest on the Company's condensed consolidated balance sheet.

For both the Current Quarter and Current Nine Months, post-acquisition, the Company recognized approximately $0.4 million, in revenue from such assets. In addition, the Company's selling, general and administrative expenses increased by less than $0.1 million for both the Current Quarter and Current Nine Months, and net income attributable to non-controlling interest increased by $0.2 million for both the Current Quarter and Current Nine Months as a result of consolidating Iconix Australia on the Company's condensed consolidated statement of operations.

Additionally, pursuant to the Amended Agreement, the specified put and call rights held by BrandCo and the Company, respectively, relating to BrandCo's owernship interest in the joint venture, were amended and restated as follows:

Two-Year Put/Call Option: At any time from December 20, 2020, BrandCo may deliver a put notice to the Company and the Company may deliver a call notice to BrandCo, in each case, for the Company's purchase of all units in the joint venture held by BrandCo. Upon the exercise of such put/call, the purchase price for BrandCo's units in the joint venture will be an amount equal to (i) the percentage interest represented by BrandCo's units, multiplied by (ii) 5, multiplied by (iii) RR, where RR is equal to:

A + (A x (100% + CAGR))

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A = trailing 12 months royalty revenue; and

CAGR = 36 month compound annual rate

As part of the formation of certain joint ventures, the Company entered into arrangements whereby the joint venture partner paid for its investment in the joint venture entity through payment of a portion of the purchase price in cash at closing and the remainder due over a pre-determined period of time.

As of September 30, 2018, the following amounts due from such joint venture partners remain recorded on the Company's consolidated balance sheet:

Entity	Joint Venture Partner	Amount	Recorded in
Iconix India joint venture	Reliance Brands Ltd.	$ 1,000	Other Assets - Current

Investments

Equity Method Investments

Entity Name	Date of Original Formation / Investment	Partner	Put / Call Options, as applicable[3]
Iconix India joint venture[1]	June 2012	Reliance Brands Ltd.	—
Iconix SE Asia, Ltd.[4]	October 2013	Global Brands Group Asia Limited	Put / Call Options
MG Icon[1]	March 2010	Purim LLC	—
Galore Media, Inc.[1][2]	April 2016	Various minority interest holders	—

(1) The Company determined, in accordance with ASC 810, based on the corporate structure, voting rights and contributions of the Company and its respective joint venture partner, that the joint venture is not a VIE and not subject to consolidation. The Company has recorded its investment under the equity method of accounting since inception.

(2) In September 2017, the Company entered into a stock repurchase agreement with Galore Media, Inc. ("Galore") whereby the Company sold, and Galore agreed to repurchase, the Company's 50,050 outstanding shares of Series A Preferred Stock of Galore for $0.5 million. Pursuant to the stock repurchase agreement, the Company received $0.3 million upon execution of the agreement and the remaining $0.2 million was received in December 2017. Additionally, pursuant to the stock repurchase agreement, the Company forfeited and surrendered the 46,067 shares of Series A Preferred Stock of Galore that were received in April 2016 upon the Company's exercise of the initial warrant. All remaining warrants to purchase additional shares of Series A Preferred Stock of Galore were also forfeited as part of the stock repurchase arrangement. This transaction resulted in the Company's ownership interest in Galore being reduced to zero.

(3) Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for material terms of the put and call options associated with the Company's joint venture.

(4) In the Prior Year Nine Months, the Company received the final purchase price installment payment due from its joint venture partner, in respect of such partner's interest in the joint venture, which resulted in the Company no longer having a de facto agency relationship with the Iconix SE Asia, Ltd. joint venture partner. In accordance with ASC 810, the receipt of the final purchase price installment payment was considered a reconsideration event and although the joint venture remains a VIE, the Company is no longer the primary beneficiary. As a result, the Company deconsolidated the entity from its condensed consolidated balance sheet as of June 30, 2017 and recognized a pre-tax gain on deconsolidation of $3.8 million in its condensed consolidated statement of operations for the Prior Year Nine Months. Subsequent to the deconsolidation of the joint venture, Iconix SE Asia, Ltd. is

being accounted as an equity-method investment with earnings from the investment being recorded in equity earnings from joint ventures in the Company's condensed consolidated statement of operations.

Additionally, through its ownership of Iconix China Holdings Limited, the Company has equity interests in the following private companies which are accounted for as equity method investments:

Brands Placed	Partner	Ownership by Iconix China	Value of Investment as of September 30, 2018	Value of Investment as of December 31, 2017
Candie's	Candies Shanghai Fashion Co. Ltd.	20%	$10,343	$ 10,539
Marc Ecko	Shanghai MuXiang Apparel & Accessory Co. Limited	15%	2,270	2,270
Material Girl	Ningo Material Girl Fashion Co. Ltd.	20%	2,129	2,217
Ecko Unltd	Ai Xi Enterprise (Shanghai) Co. Limited	20%	10,568	10,542
			$25,310	$ 25,568

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Other Equity Investments

Entity Name	Date of Original Formation / Investment
China Outfitters Holdings Ltd.[3]	September 2008
Marcy Media Holdings, LLC[1]	July 2013
Complex Media[1][2]	September 2013
iBrands International, LLC[1]	April 2014

(1) Historically, given that the Company does not have significant influence over the entity, its investment has been recorded under the cost method of accounting. During the three months ended March 31, 2018, the Company adopted ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. As a result of the adoption of the standard, given that these investments do not have readily determinable fair values and the Company does not have significant influence over the entity, the Company assesses these investments for potential impairment on a quarterly basis. As of September 30, 2018, there were no indicators of impairment for these investments.

(2) In July 2016, the Company received $35.3 million in connection with the sale of its interest in Complex Media. An additional $3.7 million was held in escrow to satisfy specified indemnification claims, with a portion of such escrow released twelve months following the closing of the transaction and the remainder released eighteen months following the closing of the transaction, subject to any such claims, at which time, the Company recorded the gain within its consolidated statement of operations. The Company recognized a gain of $10.2 million as a result of this transaction which has been recorded in Other Income on the Company's consolidated statement of operations during the third quarter of the year ended December 31, 2016. In July 2017, the Company received $2.7 million in cash of the total $3.7 million being held in escrow. As a result, the Company has recognized a gain of $2.7 million recorded within Other Income on the Company's condensed consolidated statement of operations in FY 2017. In January 2018, the Company received the remaining $1.0 million in cash being held in escrow. As a result, the Company has recognized a gain of $1.0 million recorded within Other Income on the Company's condensed consolidated statement of operations in the Current Nine Months.

(3) As part of the 2015 purchase of our joint venture partners' interest in Iconix China, the Company acquired available-for-sale securities in China Outfitters Holdings Ltd. The Company historically recorded the change in fair value through accumulated other comprehensive income on the Company's condensed consolidated balance sheet. In the three months ended March 31, 2018, the Company adopted ASU 2016-01 and accordingly, adjustments to the fair value of this entity will be recorded through other income on the Company's condensed consolidated statement of operations prospectively. As of January 1, 2018, the Company reclassified the $3.2 million cumulative loss in fair value of these available-for-sale securities which were historically recorded in accumulated other comprehensive loss to accumulated losses in accordance with ASU 2016-01. As of September 30, 2018, the fair value of this investment was approximately $1.1 million.

6. Gains on Sale of Trademarks, Net

The following table details transactions comprising gains on sale of trademarks, net in the condensed consolidated statement of operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest in Sharper Image trademark in Iconix Southeast Asia(1)	$ —	$ —	$ 236	$ —
Interest in Sharper Image trademark in Iconix Europe(1)	—	—	352	—
Interest in Sharper Image trademark in Iconix MENA(1)	—	—	250	—
Interest in Sharper Image trademark in Iconix Australia(1)	—	—	125	—
Interest in Sharper Image trademark in Iconix Canada(3)	—	500	—	500
Interest in Badgley Mischka trademark in Iconix Southeast Asia(2)	—	—	478	—
Interest in Badgley Mischka trademark in Iconix Europe(2)	—	—	(244)	—
Interest in Badgley Mischka	—	—	71	—

trademark in Iconix MENA[2]				
Interest in Badgley Mischka trademark in Iconix Canada[4]	—	375	—	375
Net gains on sale of trademarks	$ —	$ 875	$ 1,268	$ 875

[1] In December 2016, the Company sold its rights to the Sharper Image intellectual property and related assets to 360 Holdings, Inc. The Sharper Image intellectual property and related assets within other foreign territories, which was owned by certain of the Company's joint venture entities, required the Company to negotiate and finalize the sale of the intellectual property with its respective joint venture partners. As a result, in the Current Nine Months, the Company recognized an additional combined gain of approximately $1.0 million upon final execution of the agreement for the sale of the Sharper Image intellectual property and related assets which were previously owned by the Iconix Southeast Asia, Iconix Europe, Iconix MENA and Iconix Australia joint ventures.

[2] In February 2016, the Company sold its rights to the Badgley Mischka intellectual property and related assets to Titan Industries, Inc. in partnership with the founders, Mark Badgley and James Mischka, and the apparel license MJCLK LLC. The Badgley Mischka intellectual property and related assets within other foreign territories, which was owned by certain of the Company's joint venture entities, required the Company to negotiate and finalize the sale of the intellectual property with its respective joint venture partners. As a result, in the Current Nine Months, the Company recognized an additional combined net gain of approximately $0.3 million upon final execution of the agreement for the sale of the Badgley Mischka intellectual property and related assets which were previously owned by the Iconix Southeast Asia, Iconix Europe and Iconix MENA joint ventures.

[3] In September 2017, the Company sold its interest in the Sharper Image trademark in Canada for $0.5 million in cash. The Company recognized a gain of $0.5 million as a result of this transaction.

[4] In September 2017, the Company sold its interest in certain Badgley Mischka trademarks for shoes and handbags in Canada for $0.4 million in cash. The Company recognized a gain of $0.4 million as a result of this transaction.

7. Fair Value Measurements

ASC 820 “Fair Value Measurements” (“ASC 820”), establishes a framework for measuring fair value and requires expanded disclosures about fair value measurement. While ASC 820 does not require any new fair value measurements in its application to other accounting pronouncements, it does emphasize that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 established the following fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity’s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs):

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

Level 3: Unobservable inputs for which there is little or no market data and which requires the owner of the assets or liabilities to develop its own assumptions about how market participants would price these assets or liabilities

The valuation techniques that may be used to measure fair value are as follows:

(A) Market approach - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities

(B) Income approach - Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about those future amounts, including present value techniques, option-pricing models and excess earnings method

(C) Cost approach - Based on the amount that would currently be required to replace the service capacity of an asset (replacement cost)

To determine the fair value of certain financial instruments, the Company relies on Level 2 inputs generated by market transactions of similar instruments where available, and Level 3 inputs using an income approach when Level 1 and Level 2 inputs are not available. The Company’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of financial assets and financial liabilities and their placement within the fair value hierarchy.

Hedge Instruments

From time to time, the Company may purchase hedge instruments to mitigate income statement risk and cash flow risk of revenue and receivables. As of September 30, 2018, the Company had no hedge instruments.

Financial Instruments

As of September 30, 2018 and December 31, 2017, the fair values of cash, receivables and accounts payable approximated their carrying values due to the short-term nature of these instruments. The fair value of notes receivable and notes payable from and to our joint venture partners approximate their carrying values. The fair value of our other equity investments is not readily determinable, and it is not practical to obtain the information needed to determine the value. However, there has been no indication of an impairment of these other equity investments as of September 30, 2018 or December 31, 2017. The estimated fair values of other financial instruments subject to fair value disclosures, determined based on Level One inputs including broker quotes or quoted market prices or rates for the same or similar instruments and the related carrying amounts are as follows:

	September 30, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current portion[1]	$691,638	$685,810	$800,842	$747,818

[1] Carrying amounts include aggregate unamortized debt discount and debt issuance costs.

Additionally, the fair value of the other equity investments acquired as part of the 2015 purchase of our joint venture partners' interest in Iconix China was approximately $1.1 million as of September 30, 2018. Due to the adoption of ASU 2016-01, changes in fair value of this other equity investment will be prospectively recorded in the Company's condensed consolidated statement of operations in future periods.

Financial instruments expose the Company to counterparty credit risk for nonperformance and to market risk for changes in interest. The Company manages exposure to counterparty credit risk through specific minimum credit standards, diversification of counterparties and procedures to monitor the amount of credit exposure. The Company's financial instrument counterparties are investment or commercial banks with significant experience with such instruments as well as certain of our joint venture partners – see Note 5.

Non-Financial Assets and Liabilities

The Company accounts for non-recurring adjustments to the fair values of its non-financial assets and liabilities under ASC 820 using a market participant approach. The Company uses a discounted cash flow model with Level 3 inputs to measure the fair value of its non-financial assets and liabilities. The Company also adopted the provisions of ASC 820 as it relates to purchase accounting for its acquisitions. The Company has goodwill, which is tested for impairment at least annually, as required by ASC 350- "Intangibles- Goodwill and Other" ("ASC 350"). Further, in accordance with ASC 350, the Company's indefinite-lived trademarks are tested for impairment at least annually, on an individual basis as separate single units of accounting. Similarly, consistent with ASC 360- "Property, Plant and Equipment" ("ASC 360"), as it relates to accounting for the impairment or disposal of long-lived assets, the Company assesses whether or not there is impairment of the Company's definite-lived trademarks. The Company recorded impairment charges on the Mossimo and Joe Boxer indefinite-lived trademarks and women's segment goodwill during the Current Nine Months. The Company recorded impairment charges on certain indefinite-lived and definite-lived assets during the Prior Year Nine Months. Refer to Note 4 for further details.

8. Fair Value Option

During the Current Nine Months, the Company elected to account for its 5.75% Convertible Notes under the fair value option. The fair value carrying amount and the contractual principal outstanding balance of the 5.75% Convertible Notes accounted for under the fair value option as of September 30, 2018 is $55.9 million and $111.0 million, respectively. The change of $17.2 million and $73.7 million in the fair value of the 5.75% Convertible Notes accounted for under the fair value option are included in the Company's condensed consolidated statement of operations for the Current Quarter and Current Nine Months, respectively, within Other Income.

The primary reason for electing the fair value option is for simplification and cost-benefit considerations of accounting for the 5.75% Convertible Notes (the hybrid financial instrument) at fair value in its entirety versus bifurcation of the embedded derivatives. The 5.75% Convertible Notes contain bifurcatable embedded derivatives and do not require settlement by physical delivery of non-financial assets.

The significant inputs to the valuation of the 5.75% Convertible Notes at fair value are Level 1 inputs as they are based on the quoted prices of the notes in the active market.

9. Debt Arrangements

The Company's debt obligations consist of the following:

	September 30, 2018	December 31, 2017
Senior Secured Notes	$ 376,154	$ 408,174
1.50% Convertible Notes	—	233,898
Variable Funding Note, net of original issue discount	94,250	91,363
Senior Secured Term Loan, net of original issue discount	170,865	74,813
5.75% Convertible Notes[1]	55,878	—
Unamortized debt issuance costs	(5,509)	(7,406)
Total debt	691,638	800,842
Less current maturities	50,406	44,349
Total long-term debt	$ 641,232	$ 756,493

[1] On February 12, 2018, the Company entered into the Exchange Agreements and consummated the Note Exchange on February 22, 2018, pursuant to which the Company exchanged approximately $125.0 million aggregate principal amount of its 1.50% Convertible Notes for 5.75% Convertible Notes issued by the Company in an aggregate principal amount of approximately $125.0 million. See below for further details.

Senior Secured Notes and Variable Funding Note

On November 29, 2012, Icon Brand Holdings, Icon DE Intermediate Holdings LLC, Icon DE Holdings LLC and Icon NY Holdings LLC, each a limited-purpose, bankruptcy remote, wholly-owned direct or indirect subsidiary of the Company, (collectively, the "Co-Issuers") issued $600.0 million aggregate principal amount of 2012 Senior Secured Notes in an offering exempt from registration under the Securities Act.

Simultaneously with the issuance of the 2012 Senior Secured Notes, the Co-Issuers also entered into a revolving financing facility of Variable Funding Notes, which allows for the funding of up to $100 million of Variable Funding Notes and certain other credit instruments, including letters of credit. The Variable Funding Notes were issued under the Indenture and allow for drawings on a revolving basis. Drawings and certain additional terms related to the Variable Funding Notes are governed by the Variable Funding Note Purchase Agreement, among the Co-Issuers, Iconix, as manager, certain conduit investors, financial institutions and funding agents, and Barclays Bank PLC, as provider of letters of credit, as swing line lender and as administrative agent. The Variable Funding Notes will be governed, in part, by the Variable Funding Note Purchase Agreement and by certain generally applicable terms contained in the Indenture. Interest on the Variable Funding Notes will be payable at per annum rates equal to the CP Rate, Base Rate or Eurodollar Rate, as defined in the Variable Funding Note Purchase Agreement.

On June 21, 2013, the Co-Issuers issued $275.0 million aggregate principal amount of 2013 Senior Secured Notes in an offering exempt from registration under the Securities Act.

The Senior Secured Notes and the Variable Funding Notes are referred to collectively as the "Securitization Notes." The Securitization Notes were issued in securitization transactions pursuant to which the Securitized Assets, were transferred to and are currently held by the Co-Issuers. The Securitized Assets do not include revenue generating assets of (x) the Iconix subsidiaries that own the Ecko Unltd trademarks, the Mark Ecko trademarks, the Artful Dodger trademarks, the Umbro trademarks, and the Lee Cooper trademarks, (y) the Iconix subsidiaries that own Iconix's other brands outside of the United States and Canada or (z) the joint ventures in which Iconix and certain of its subsidiaries have investments and which own the Modern Amusement trademarks, the Buffalo trademarks, the Pony trademarks, and the Hydraulic trademarks.

The Securitization Notes were issued under the Securitization Notes Indenture among the Co-Issuers and Citibank, N.A., as Trustee and securities intermediary. The Securitization Notes Indenture allows the Co-Issuers to issue additional series of notes in the future subject to certain conditions.

In February 2015, the Company received $100.0 million proceeds from the Variable Funding Notes. There is a commitment fee on the unused portion of the Variable Funding Notes facility of 0.5% per annum. Following the anticipated repayment date in January 2020, additional interest will accrue on the Variable Funding Notes equal to 5% per annum. The Variable Funding Notes and other credit instruments issued under the Variable Funding Note Purchase Agreement are secured by the collateral described below.

On August 18, 2017, the Company entered into an amendment to the Securitization Notes Supplemental Indenture to, among other things, (i) extend the anticipated repayment date for the Variable Funding Notes from January 2018 to January 2020, (ii) decrease the L/C Commitment and the Swingline Commitment (as such terms are defined in the amendment) available under the Variable Funding Notes to $0 as of the closing date, (iii) replace Barclays Bank PLC with Guggenheim Securities Credit Partners, LLC, as provider of letters of credit, as swingline lender and as administrative agent under the purchase agreement and (iv) provide that, upon the disposition of intellectual property assets by the Co-Issuers as permitted by the Securitization Notes Base Indenture, (x) the holders of the Variable Funding Notes will receive a mandatory prepayment, pro rata based on the amount of Variable Funding Notes held by such holder, and (y) the maximum commitment will be permanently reduced by the amount of the mandatory prepayment.

At the issuance of the Securitization Notes, the Company was required to make principal payments of interest on a quarterly basis while the Securitization Notes are outstanding. To the extent funds were available, principal payments in the amount of $10.5 million and $4.8 million were required to be made on the 2012 Senior Secured Notes and 2013 Senior Secured Notes, respectively, on a quarterly basis. The amount of quarterly principal payments changed in subsequent periods due to the prepayments made on the Securitization Notes. See below for further discussion.

The legal final maturity date of the Senior Secured Notes is in January of 2043, but it is anticipated that, unless earlier prepaid to the extent permitted under the Securitization Notes Indenture, the Senior Secured Notes will be repaid in January of 2020. If the Co-Issuers have not repaid or refinanced the Senior Secured Notes prior to the anticipated repayment date, additional interest will accrue on the Senior Secured Notes at a rate equal to the greater of (A) 5% per annum and (B) a per annum interest rate equal to the excess, if any, by which the sum of (i) the yield to maturity (adjusted to a quarterly bond-equivalent basis), on the anticipated repayment date of the United States treasury security having a term closest to 10 years plus (ii) 5% plus (iii) with respect to the 2012 Senior Secured Notes, 3.4%, or with respect to the 2013 Senior Secured Notes, 3.14%, exceeds the original interest rate. The Senior Secured Notes rank pari passu with the Variable Funding Notes.

Pursuant to the Securitization Notes Indenture, the Securitization Notes are the joint and several obligations of the Co-Issuers only. The Securitization Notes are secured under the Indenture by a security interest in substantially all of the assets of the Co-Issuers (the “Collateral”), which includes, among other things, (i) intellectual property assets, including the U.S. and Canadian registered and applied for trademarks for the following brands and other related IP assets: Candie’s, Bongo, Joe Boxer (excluding Canadian trademarks, none of which are owned by Iconix), Rampage, Mudd, London Fog (other than the trademark for outerwear products sold in the United States), Mossimo, Ocean Pacific and OP, Danskin and Danskin Now, Rocawear, Starter, Waverly, Fieldcrest, Royal Velvet, Cannon, and Charisma; (ii) the rights (including the rights to receive payments) and obligations under all license agreements for use of those trademarks; (iii) the following equity interests in the following joint ventures: an 85% interest in Hardy Way LLC which owns the Ed Hardy brand, a 50% interest in MG Icon LLC which owns the Material Girl and Truth or Dare brands, and a 100% interest in ZY Holdings LLC which owns the Zoo York brand; and (iv) certain cash accounts established under the Securitization Notes Indenture.

If the Company contributes an Additional IP Holder to Icon Brand Holdings LLC or Icon DE Intermediate Holdings LLC, that Additional IP Holder will enter into a guarantee and collateral agreement in a form provided for in the Securitization Notes Base Indenture pursuant to which such Additional IP Holder will guarantee the obligations of the Co-Issuers in respect of any Securitization Notes issued under the Securitization Notes Indenture and the other related documents and pledge substantially all of its assets to secure those guarantee obligations pursuant to a guarantee and collateral agreement.

Neither the Company nor any subsidiary of the Company, other than the Securitization Entities, will guarantee or in any way be liable for the obligations of the Co-Issuers under the Securitization Notes Indenture or the Securitization Notes.

The Securitization Notes are subject to a series of covenants and restrictions customary for transactions of this type, including (i) that the Co-Issuers maintain specified reserve accounts to be used to make required payments in respect of the Securitization Notes, (ii) provisions relating to optional and mandatory prepayments, including mandatory prepayments in the event of a change of control (as defined in the Securitization Notes Supplemental Indentures) and the related payment of specified amounts, including specified make-whole payments in the case of the Senior Secured Notes under certain circumstances, (iii) certain indemnification payments in the event, among other things, the transfers of the assets pledged as collateral for the Securitization Notes are in stated ways defective or ineffective and (iv) covenants relating to recordkeeping, access to information and similar matters. As of September 30, 2018, the Company is in compliance with all covenants under the Securitization Notes.

The Company’s Securitization Notes include a test that measures the amount of principal and interest required to be paid on the Co-Issuers’ debt to the approximate cash flow available to pay such principal and interest; the test is referred to as the debt service coverage ratio (“DSCR”). As a result of the decline in royalty collections received by the Co-Issuers during the twelve months ended June 30, 2018, the DSCR fell below 1.45x as of June 30, 2018. Beginning July 1, 2018, the Co-Issuers were required to allocate 25% of residual royalty collections (i.e. collections less debt service, management, servicing, administrative and other fees) to a restricted reserve account administered by the securitization program’s trustee, which will result in cash remaining inside the securitization program. The DSCR fell below 1.35x as of September 30, 2018 and as a result, beginning October 1, 2018, the Co-Issuers are required to allocate 50% of residual royalty collections (i.e. collections less debt service, management, servicing, administrative and other fees) to a restricted reserve account administered by the securitization program’s trustee, which will result in cash remaining inside the securitization program and not being distributed to the Company. The cash required to be maintained inside the securitization program may be released to the Company if the DSCR is at least 1.45x for two consecutive quarters.

The Securitization Notes are also subject to customary rapid amortization events provided for in the Securitization Notes Indenture, including events tied to (i) the failure to maintain a stated DSCR, (ii) certain manager termination events, (iii) the occurrence of an event of default and (iv) the failure to repay or refinance the Securitization Notes on the anticipated repayment date. If a rapid amortization event were to occur, Icon DE Intermediate Holdings LLC and Icon Brand Holdings LLC would be restricted from declaring or paying distributions on any of its limited liability company interests.

The Company used approximately $150.4 million of the proceeds received from the issuance of the 2012 Senior Secured Notes to repay amounts outstanding under its revolving credit facility (see below) and approximately $20.9 million to pay the costs associated with the 2012 Senior Secured Notes financing transaction. In addition, approximately $218.3 million of the proceeds from the 2012 Senior Secured Notes were used for the Company's purchase of the Umbro brand. The Company used approximately $7.2 million of the proceeds received from the issuance of the 2013 Senior Secured Notes to pay the costs associated with the 2013 Senior Secured Notes securitized financing transaction.

In June 2014, the Company sold the "sharperimage.com" domain name and the exclusive right to use the Sharper Image trademark in connection with the operation of a branded website and catalog distribution in specified jurisdictions, in which the Senior Secured Notes had a security interest pursuant to the Indenture. As a result of this permitted disposition, the Company paid an additional $1.6 million in principal in July 2014.

In January 2017, in connection with the sale of the Sharper Image intellectual property and related assets, the Company made a mandatory principal prepayment on its Senior Secured Notes of $36.7 million. The Company wrote off a pro-rata portion of the Senior Secured Notes' deferred financing costs of $0.5 million. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $0.5 million which has been recorded on the Company's consolidated statement of operations. Additionally, the quarterly principal payments on the 2012 Senior Secured notes and 2013 Senior Secured Notes were reduced to $9.9 million and $4.5 million, respectively.

In July 2017, in connection with the sale of the businesses underlying the Entertainment segment, the Company made a mandatory principal prepayment on its Senior Secured Notes of $152.2 million. The Company wrote off a pro-rata portion of the Senior Secured Notes' deferred financing costs of $2.0 million as well as paid a prepayment penalty of $0.3 million. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $2.3 million which has been allocated to discontinued operations on the Company's consolidated statement of operations in FY 2017. Additionally, the quarterly principal payments on the 2012 Senior Secured Notes and 2013 Senior Secured Notes were reduced to $7.3 million and $3.4 million, respectively.

As of September 30, 2018 and December 31, 2017, the total outstanding principal balance of the Securitization Notes was $476.2 million and $508.2 million, respectively, of which $42.7 million is included in the current portion of long-term debt on the consolidated balance sheet for both periods. As of September 30, 2018 and December 31, 2017, $20.3 million and $29.9 million, respectively, is included in restricted cash on the consolidated balance sheet and represents short-term restricted cash consisting of collections on behalf of the Securitized Assets, restricted to the payment of principal, interest and other fees on a quarterly basis under the Senior Secured Notes.

For the Current Quarter and the Prior Year Quarter, cash interest expense relating to the Securitization Notes was approximately $5.6 million and $6.2 million, respectively. For the Current Nine Months and the Prior Year Nine Months, cash interest expense relating to the Senior Secured Note was approximately $16.8 million and $21.3 million, respectively.

Senior Secured Term Loan

On August 2, 2017, the Company entered into the Senior Secured Term Loan, among IBG Borrower, the Company's wholly-owned direct subsidiary, as borrower, the Company and certain wholly-owned subsidiaries of IBG Borrower, as Guarantors, Cortland, as administrative agent and collateral agent and the lenders party thereto from time to time, including Deutsche Bank AG, New York Branch which was a privately negotiated transaction. Pursuant to the Senior Secured Term Loan, the lenders provided to IBG Borrower the Senior Secured Term Loan, scheduled to mature on August 2, 2022 in an aggregate principal amount of $300 million and bearing interest at LIBOR plus an applicable margin of 7% per annum.

Pursuant to the terms of the Senior Secured Term Loan, the net proceeds of the Senior Secured Term Loan were to be used to repay the Company's 1.50% Convertible Notes on or before their maturity (with any remaining funds going toward general corporate purposes).

On the Closing Date the net cash proceeds of the Senior Secured Term Loan were deposited into an escrow account. Effective as of the Closing Date, the funds in the escrow account were subject to release to IBG Borrower from time to time, subject to the satisfaction of customary conditions precedent upon each withdrawal, to finance repurchases of, or at the maturity date thereof to repay in full, the 1.50% Convertible Notes. The Company had the ability to make these repurchases in the open market or privately negotiated transactions, depending on prevailing market conditions and other factors.

Borrowings under the Senior Secured Term Loan were to amortize quarterly at 0.5% of principal, commencing on September 30, 2017. IBG Borrower was obligated to make mandatory prepayments annually from excess cash flow and periodically from net proceeds of certain asset dispositions and from net proceeds of certain indebtedness, if incurred (in each case, subject to certain exceptions and limitations provided for in the Senior Secured Term Loan).

IBG Borrower’s obligations under the Senior Secured Term Loan are guaranteed jointly and severally by the Company and the other Guarantors pursuant to a separate facility guaranty. IBG Borrower’s and the Guarantors’ obligations under the Senior Secured Term Loan are secured by first priority liens on and security interests in substantially all assets of IBG Borrower, the Company and the other Guarantors and a pledge of substantially all equity interests of the Company’s subsidiaries (subject to certain limits including with respect to foreign subsidiaries) owned by the Company, IBG Borrower or any other Guarantor. However, the security interests will not cover certain intellectual property and licenses owned, directly or indirectly by the Company’s subsidiary Iconix Luxembourg Holdings SÀRL or those subject to the Company’s securitization facility. In addition, the pledges exclude certain equity interests of Marcy Media Holdings, LLC, and the subsidiaries of Iconix China Holdings Limited and any interest in the proceeds related to the Company’s previously announced sale of its equity interest in Complex Media, Inc.

In connection with the Senior Secured Term Loan, IBG Borrower, the Company and the other Guarantors made customary representations and warranties and have agreed to adhere to certain customary affirmative covenants. Additionally, the Senior Secured Term Loan mandates that IBG Borrower, the Company and the other Guarantors enter into account control agreements on certain deposit accounts, maintain and allow appraisals of their intellectual property, perform under the terms of certain licenses and other agreements scheduled in the Senior Secured Term Loan and report significant changes to or terminations of licenses generating guaranteed minimum royalties of more than $0.5 million. Prior to the First Amendment (as discussed below), IBG Borrower was required to satisfy a minimum asset coverage ratio of 1.25:1.00 and maintain a leverage ratio of no greater than 4.50:1.00.

Amendments to Senior Secured Term Loan

First Amendment

On October 27, 2017, the Company entered into the First Amendment to the Senior Secured Term Loan pursuant to which, among other things, the remaining escrow balance of approximately $231 million (after taking into account approximately $59.2 million that was used to buy back 1.50% Convertible Notes in open market purchases in the third quarter of 2017) was returned to the lenders.

The First Amendment also provided for, among other things, (a) a reduction in the existing $300 million term loan, (b) a new senior secured delayed draw term loan facility in the aggregate amount of up to $165.7 million, consisting of (i) a $25 million First Delayed Draw Term Loan to be drawn on or prior to March 15, 2018, which was drawn on October 27, 2017 and (ii) a $140.7 million Second Delayed Draw Term Loan to be drawn on March 14, 2018 for the purpose of repaying the 1.50% Convertible Notes; (c) an increase of the Total Leverage Ratio permitted under the Senior Secured Term Loan from 4.50:1.00 to 5.75:1.00; (d) a reduction in the debt service coverage ratio multiplier in the Company’s asset coverage ratio under the Senior Secured Term Loan; (e) an increase in the existing amortization rate from 2 percent per annum to 10 percent per annum commencing July 2019; and (f) amendments to the mandatory prepayment provisions to (i) permit the Company not to prepay borrowings under the Senior Secured Term Loan from the first $100 million of net proceeds resulting from Permitted Capital Raising Transactions (as defined in the Senior Secured Term Loan) effected prior to March 15, 2018, and (ii) eliminate the requirement that the Company pay a Prepayment Premium (as defined in the Senior Secured Term Loan) on any payments or prepayments made prior to December 31, 2018. Indebtedness issued under the Delayed Draw Term Loan Facility was issued with original issue discount.

Conditions to the availability of the Second Delayed Draw Term Loan included (i) the Company raising additional funds through various sources (and/or achieving a reduction in the outstanding principal amount of the 2018 Notes) in an aggregate amount of at least $100 million which will be utilized to repay the 2018 Notes and provide at least $25 million of additional cash to enhance liquidity and be used for general corporate purposes, (ii) the Company being in financial covenant compliance, on a pro forma basis as of the time of the requested borrowing and on a projected basis for the succeeding 12 months, and (iii) there not existing a default or event of default as of the time of the borrowing.

Second Amendment

Given that the Company was unable to timely file its quarterly financial statements for the quarter ended September 30, 2017 with the SEC by November 14, 2017 and became in default under the terms of the Senior Secured Term Loan, as amended by the First Amendment, on November 24, 2017, the Company entered into the Second Amendment to the Senior Secured Term Loan. Pursuant to the Second Amendment, among other things, the lenders under the Senior Secured Term Loan agreed, subject to the Company’s compliance with the requirements set forth in the Second Amendment, to waive until December 22, 2017, the potential defaults and events of default arising under the Senior Secured Term Loan (a) from the failure to furnish to the Administrative Agent for the Senior Secured Term

Loan (i) the financial statements, reports and other documents as required under Section 6.01(b) of the Senior Secured Term Loan with respect to the fiscal quarter of the Company ended September 30, 2017 and (ii) the related deliverables required under Sections 6.02(b), 6.02(c) and 6.02(e) of the Senior Secured Term Loan or (b) relating to certain other affirmative covenants that may have been abrogated by such failure to make such timely deliveries.

In connection with the Second Amendment, Deutsche Bank was granted additional pricing flex in the form of price protection upon syndication of the Senior Secured Term Loan ("Flex") and ticking fees on the unfunded portion of the loan. The Second Amendment allows, among other things, for cash payments on account of the Flex and ticking fees to be paid from the proceeds of the First Delayed Draw Term Loan, which was previously fully funded in accordance with the terms of the Senior Secured Term Loan. After giving effect to the additional Flex provided in the Second Amendment, the Company estimates that it could be responsible for payments on account of Flex in an aggregate total amount of up to $12.0 million. As of September 30, 2018, the Company has paid a total of approximately $5.0 million in Flex which is being amortized over the remaining life of the debt facility utilizing the effective interest rate method with the amortization expense being recorded in interest expense on the Company's condensed consolidated statement of operations.

The Senior Secured Term Loan, as amended, contains customary negative covenants and events of default. The Senior Secured Term Loan limits the ability of IBG Borrower, the Company and the other Guarantors, with respect to themselves, their subsidiaries and certain joint ventures, from, among other things, incurring and prepaying certain indebtedness, granting liens on certain assets, consummating certain types of acquisitions, making fundamental changes (including mergers and consolidations), engaging in substantially different lines of business than those in which they are currently engaged, making restricted payments and amending or terminating certain licenses scheduled in the Senior Secured Term Loan. Such restrictions, failure to comply with which may result in an event of default under the terms of the Senior Secured Term Loan, are subject to certain customary and specifically negotiated exceptions, as set forth in the Senior Secured Term Loan.

If an event of default occurs, in addition to the Interest Rate increasing by an additional 3% per annum, Cortland shall, at the request of lenders holding more than 50% of the then-outstanding principal of the Senior Secured Term Loan, declare payable all unpaid principal and accrued interest and take action to enforce payment in favor of the lenders. An event of default includes, among other events: a change of control by which a person or group becomes the beneficial owner of 35% of the voting stock of the Company or IBG Borrower; the failure to extend of the Series 2012-1 Class A-1 Senior Notes Renewal Date (as defined in the Senior Secured Term Loan); the failure of any of Icon Brand Holdings LLC, Icon NY Holdings LLC, Icon DE Intermediate Holdings LLC, Icon DE Holdings LLC and their respective subsidiaries (the “Securitization Entities”) to perform certain covenants; and the entry into amendments to the securitization facility that would be materially adverse to the lenders or Cortland without consent. Subject to the terms of the Senior Secured Term Loan, both voluntary and certain mandatory prepayments will trigger a premium of 5% of the aggregate principal amount during the first year of the loan and a premium of 3% of the aggregate principal amount during the second year of the loan, with no premiums payable in subsequent periods.

As a result of the First Amendment, on October 27, 2017, the Company repaid $231.0 million which represented $240.7 million of outstanding principal balance. As this transaction was accounted for as a debt modification in accordance ASC 470-50-40, and based on the Company’s accounting policy for debt modifications, the Company wrote-off a pro-rata portion of the original issue discount and deferred financing costs of $9.3 million and $5.4 million, respectively, which were both recorded to interest expense on the Company’s consolidated statement of operations for FY 2017. As a result of this transaction, the Company’s outstanding principal balance of the Senior Secured Term Loan was reduced to $57.8 million at that time and the Company recorded a gain on modification of debt of $8.8 million (which is net of $0.8 million of additional deferred financing costs associated with the First Amendment) which has been recorded in interest expense on the Company’s consolidated statement of operations for FY 2017.

On November 2, 2017, the Company drew down the full amount of $25.0 million on the First Delayed Draw Term Loan of which the Company received $24.0 million in cash as this amount was net of the $1.0 million of original issue discount.

As a result of the Second Amendment, the Company incurred $0.2 million of additional deferred financing costs. In accordance with ASC 470-50-40, the Company accounted for this amendment as a debt modification and has recorded the additional deferred financing costs against the gain on modification of debt on the Company’s consolidated statement of operations for FY 2017.

On December 7, 2017, the Company paid approximately $5.0 million of Flex of which the Company has recorded this amount against the outstanding principal balance of Senior Secured Term Loan on the Company’s consolidated balance sheet and is being amortized over the remaining term of loan.

Third Amendment

On February 12, 2018, the Company, through IBG Borrower, entered into the Third Amendment to the Senior Secured Term Loan. The Third Amendment provides for, among other things, amendments to certain restrictive covenants and other terms set forth in the Senior Secured Term Loan, as amended, to permit (i) IBG Borrower to enter into the 5.75% Notes Indenture (as described above) and a related intercreditor agreement that was executed and (ii) the Note Exchange. In connection with the Third Amendment, Deutsche Bank was granted additional pricing flex in the form of price protection upon syndication of the loan (“Third Amendment Flex”). After giving effect to the additional Third Amendment Flex, the Company estimates that it could be responsible for payments on account of the Third Amendment Flex in an aggregate total amount of up to $6.1 million.

Fourth Amendment

The Company, through IBG Borrower, entered into the Fourth Amendment to the Senior Secured Term Loan as of March 12, 2018. The Fourth Amendment provides, among other things, that the funding date for the Second Delayed Draw Term Loan is March 14, 2018 instead of March 15, 2018. Accordingly, the conditions to the availability of the Second Delayed Draw Term Loan (described above) were satisfied as of March 14, 2018 due, in part, to the transactions contemplated by the Note Exchange, and the Company was able to draw on the Second Delayed Draw Term Loan. On March 14, 2018, the Company drew down $110 million under the Second Delayed Draw Term Loan and used those proceeds, along with cash on hand, to make a payment to the trustee under the indenture governing the 1.50% Convertible Notes to repay the remaining 1.50% Convertible Notes at maturity on March 15, 2018.

As of September 30, 2018 and December 31, 2017, the outstanding principal balance of the Senior Secured Term Loan is $170.9 million (which is net of $19.5 million of original issue discount) and $74.8 million (which is net of $8.0 million of original issue discount) of which $7.7 million and $1.7 million is recorded in current portion of long term debt on the Company's consolidated balance sheet, respectively.

The Company recorded cash interest expense of approximately $4.5 million relating to the Senior Secured Term Loan during the Current Quarter as compared to $4.0 million for the Prior Year Quarter. The Company recorded cash interest expense (including a commitment fee of approximately $1.2 million) of approximately $12.5 million relating to the Senior Secured Term Loan during the Current Nine Months as compared to $4.0 million for the Prior Year Nine Months, respectively.

The Company recorded an expense for the amortization of original issue discount and deferred financing fees of approximately $1.3 million relating to the Senior Secured Term Loan, included in interest expense on the unaudited condensed consolidated statement of operations, during the Current Quarter as compared to $0.5 million for the Prior Year Quarter. The Company recorded an expense for the amortization of original issue discount and deferred financing fees of approximately $3.0 million relating to the Senior Secured Term Loan, included in interest expense on the unaudited condensed consolidated statement of operations, during the Current Nine Months as compared to $0.5 million for the Prior Year Nine Months.

5.75% Convertible Notes

On February 12, 2018, the Company entered into the Exchange Agreements which was an offering exempt from registration under the Securities Act. On February 22, 2018, the Company consummated the Note Exchange, pursuant to which the Company exchanged approximately $125 million aggregate principal amount of 1.50% Convertible Notes for 5.75% Convertible Notes issued by the Company in an aggregate principal amount of approximately $125 million.

Consummation of the Note Exchange satisfied one of the principal conditions to the availability of the Second Delayed Draw Term Loan under the Senior Secured Term Loan that the Company achieve a reduction in the outstanding principal amount of the 1.50% Convertible Notes of at least $100.0 million. In addition, the Company satisfied the remaining conditions to the availability of the Second Delayed Draw Term Loan, which included (i) the Company being in financial covenant compliance, on a pro forma basis as of the time of the requested borrowing and on a projected basis for the succeeding 12 months based on projections reasonably acceptable to the lenders, and (ii) there not existing a default or event of default under the Senior Secured Term Loan as of the time of the borrowing. On March 14, 2018, the Company drew down $110 million under the Second Delayed Draw Term Loan and used those proceeds, along with cash on hand, to make a payment to the trustee under the indenture governing the 1.50% Convertible Notes in an amount to repay the remaining 1.50% Convertible Notes at maturity on March 15, 2018.

Interest on the 5.75% Convertible Notes may be paid in cash, shares of the Company’s common stock, or a combination of both, at the Company’s election. If the Company elects to pay all or a portion of an interest payment in shares of common stock, the number of shares of common stock payable will be equal to the applicable interest payment divided by the average of the 10 individual volume-weighted average prices for the 10-trading day period ending on and including the trading day immediately preceding the relevant interest payment date.

The 5.75% Convertible Notes are (i) secured by a second lien on the same assets that secure the obligations of IBG Borrower under the Senior Secured Term Loan and (ii) guaranteed by IBG Borrower and same guarantors as those under the Senior Secured Term Loan, other than the Company.

Subject to certain conditions and limitations, the Company may cause all or part of the 5.75% Convertible Notes to be automatically converted.

Holders converting their 5.75% Convertible Notes (including in connection with a mandatory conversion) shall also be entitled to receive a payment from the Company equal to the Conversion Make-Whole Payment if such conversion occurs after a regular record date and on or before the next succeeding interest payment date, through and including the maturity date (determined as if such conversion did not occur).

If the Company elects to pay all or a portion of a Conversion Make-Whole Payment in shares of common stock, the number of shares of common stock payable will be equal to the applicable Conversion Make-Whole Payment divided by the average of the 10 individual volume-weighted average prices for the 10-trading day period immediately preceding the applicable conversion date.

Subject to certain limitations pursuant to the Senior Secured Term Loan, from and after the one-year anniversary of the closing of the Note Exchange, the Company may redeem for cash all or part of the 5.75% Convertible Notes at any time by providing at least 30 days' prior written notice to holders of the 5.75% Convertible Notes.

If the Company undergoes a fundamental change (which would occur if the Company experiences a change of control or is delisted from NASDAQ) prior to maturity, each holder will have the right, at its option, to require the Company to repurchase for cash all or a portion of such holder's 5.75% Convertible Notes at a fundamental change purchase price equal to 100% of the principal amount of the 5.75% Convertible Notes to be repurchased, together with interest accrued and unpaid to, but excluding, the fundamental change purchase date.

The Company is subject to certain restrictive covenants pursuant to the 5.75% Convertible Note Indenture, including limitations on (i) liens, (ii) indebtedness, (iii) asset sales, (iv) restricted payments and investments, (v) prepayments of indebtedness and (vi) transactions with affiliates.

On various dates subsequent to the Exchange on February 22, 2018 and through March 16, 2018, certain noteholders converted an aggregate outstanding principal balance of $8.8 million of their 5.75% Convertible Notes in to approximately 4.5 million shares of the Company's common stock. Pursuant to the note agreement, the Company was required to make a conversion make-whole payment which was also settled in the issuance of approximately 1.9 million shares of the Company's common stock. As a result of this transaction, the conversion of the outstanding principal balance of $8.8 million of its 5.75% Convertible Notes represented a reduction of $9.6 million in the fair value of the 5.75% Convertible Notes and $0.8 million was recorded for the difference in the fair value of the debt and the fair value of the common stock issued has been recorded within Other Income in the Company's condensed consolidated statement of operations for the first quarter of 2018.

Additionally, in April 2018 and June 2018, certain noteholders converted an aggregate outstanding principal balance of $5.2 million of their 5.75% Convertible Notes in to approximately 2.7 million shares of the Company's common stock. Pursuant to the note agreement, the Company was required to make a conversion make-whole payment which was also settled in the issuance of approximately 2.0 million shares of the Company's common stock. As a result of this transaction, the conversion of the outstanding principal balance of $5.2 million of its 5.75% Convertible Notes represented a reduction of $4.2 million in the fair value of the 5.75% Convertible Notes and $0.2 million was recorded for the difference in the fair value of the debt and the fair value of the common stock issued has been recorded within Other Income in the Company's condensed consolidated statement of operations for the Current Nine Months.

The Company has elected to account for the 5.75% Convertible Notes based on the Fair Value Option accounting as outlined in ASC 825. Refer to Note 8 for further details. As of September 30, 2018, while the debt balance recorded at fair value on the Company's condensed consolidated balance sheet is $55.9 million, the actual outstanding principal balance of the 5.75% Convertible Notes is $111.0 million.

The Company recorded interest expense of approximately $1.6 million relating to the 5.75% Convertible Notes during the Current Quarter as compared to none for the Prior Year Quarter. The Company recorded interest expense of approximately $3.9 million relating to the 5.75% Convertible Notes during the Current Nine Months as compared to none for the Prior Year Nine Months. The Company paid its first interest payment which was due on August 15, 2018 in shares of the Company's common stock which resulted in the issuance of approximately 6.3 million shares.

1.50% Convertible Notes

On March 18, 2013, the Company completed the issuance of $400.0 million principal amount of the Company's 1.50% Convertible Notes in a private offering to certain institutional investors which was exempt from registration under the Securities Act. The net proceeds received by the Company from the offering, excluding the net cost of hedges and sale of warrants (described below) and including transaction fees, were approximately $390.6 million.

During FY 2016, the Company repurchased $104.9 million par value of the 1.50% Convertible Notes with a combination of $36.7 million in cash (including interest and trading fees) and the issuance of approximately 7.4 million shares of the Company's common stock. The Company accounted for this transaction in accordance with ASC 470-20 resulting in the recognition of a $9.6 million gain which is included in gain on extinguishment of debt, net in the Company's consolidated statement of income for FY 2016, and a reacquisition of approximately $1.2 million of the embedded conversion option recorded within additional paid in capital on the Company's consolidated balance sheet.

During FY 2017, the Company repurchased $58.9 million par value of the 1.50% Convertible Notes for $59.3 million in cash (including interest and trading fees). The Company accounted for this transaction in accordance with ASC 470-20 resulting in the recognition of a $1.5 million loss which was included in loss on extinguishment of debt in the Company's consolidated statement of operations during FY 2017.

On February 22, 2018, the Company exchanged $125 million of aggregate principal amount of 1.50% Convertible Notes for $125 million of aggregate principal amount of 5.75% Convertible Notes, and on March 15, 2018 (the maturity date), the Company repaid the remaining outstanding principal balance of $111.2 million of the 1.50% Convertible Notes, with the proceeds of the Second Delayed Draw Term Loan of $110 million plus cash on hand, effectively extinguishing the 1.50% Convertible Notes by its terms. The exchange of the 1.50% Convertible Notes for the 5.75% Convertible Notes was accounted for as a debt extinguishment in accordance with ASC 470 and resulted in the Company recording a gain on extinguishment of debt of $4.5 million, which is recorded in the Company's condensed consolidated statement of operations for the Current Nine Months.

For the Current Quarter, the Company recorded no non-cash interest expense (given the extinguishment of the debt as is discussed above) as compared to $3.5 million for the Prior Year Quarter, representing the difference between the stated interest rate on the 1.50% Convertible Notes and the rate for a similar instrument that does not have a conversion feature. For the Current Nine Months and the Prior Year Nine Months, the Company recorded additional non-cash interest expense of approximately $1.9 million and $10.8 million, respectively, representing the difference between the stated interest rate on the 1.50% Convertible Notes and the rate for a similar instrument that does not have a conversion feature.

For the Current Quarter, the Company recorded no cash interest expense relating to the 1.50% Convertible Notes (given the extinguishment of the debt as is discussed above) as compared to approximately $1.1 million in the Prior Year Quarter. For the Current Nine Months and the Prior Year Nine Months, the Company recorded cash interest expense relating to the 1.50% Convertible Notes of approximately $0.6 million and $3.3 million, respectively.

2016 Senior Secured Term Loan

On March 7, 2016, the Company entered into a credit agreement (the "Credit Agreement"), among IBG Borrower LLC, the Company's wholly-owned direct subsidiary, as borrower ("IBG Borrower"), the Company and certain wholly-owned subsidiaries of IBG Borrower, as guarantors (the "Guarantors"), Cortland Capital Market Services LLC, as administrative agent and collateral agent ("Cortland") and the lenders party thereto from time to time (the "Lenders"), including CF ICX LLC and Fortress Credit Co LLC ("Fortress") which was a privately negotiated transaction. Pursuant to the Credit Agreement, the Lenders are providing to IBG Borrower a 2016 Senior Secured Term Loan (the "2016 Senior Secured Term Loan"), scheduled to mature on March 7, 2021, in an aggregate principal amount of $300 million and bearing interest at LIBOR (with a floor of 1.50%) plus an applicable margin of 10% per annum.

The net cash proceeds of the 2016 Senior Secured Term Loan, which were approximately $264.2 million (after deducting financing, investment banking and legal fees), were, pursuant to the terms of the Credit Agreement, deposited by the Lenders into an escrow account on April 4, 2016. IBG Borrower deposited into the escrow account certain additional funds, so that the total amount of cash on deposit in the escrow account was sufficient to pay all outstanding obligations, plus accrued interest, under the Company's 2.50% Convertible Notes due June 2016. In accordance with the terms of the 2016 Senior Secured Term Loan, the funds in the escrow account were used to repay the 2.50% Convertible Notes (see above discussion on repayment of the 2.50% Convertible Notes) on or before their maturity, with any remaining funds going toward general corporate purposes permitted under the terms of the Credit Agreement.

In December 2016, as a result of the sale of the Sharper Image intellectual property and related assets and in accordance with the Credit Agreement, the Company was required to make a mandatory principal prepayment of $28.7 million and a corresponding prepayment premium of $4.3 million. The Company wrote off a pro-rata portion of the 2016 Senior Secured Term Loan's original issue discount and deferred financing costs of $2.1 million and $1.0 million, respectively. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $7.4 million which has been recorded on the Company's consolidated statement of operations in FY 2016.

In January 2017, the Company made a voluntary prepayment and an additional mandatory prepayment of $23.0 million and $23.5 million, respectively, as well as a corresponding prepayment premium of $3.4 million and $3.4 million, respectively. As the Company was contractually obligated to pay the prepayment premium prior to December 31, 2016, the Company recorded the aggregate $6.8 million of prepayment premium in accrued expenses on the Company's consolidated balance sheet as of December 31, 2016, with a corresponding amount recorded in loss on extinguishment of debt on the Company's consolidated statement of operations for FY 2016. For each of the voluntary prepayment of $23.0 million and the mandatory prepayment of $23.5 million, the Company wrote off a pro-rata portion of the 2016 Senior Secured Term Loan's original issue discount and deferred financing costs of $1.7 million and $0.8 million, respectively, which resulted in an aggregate loss on extinguishment of debt of $5.0 million recorded in the Company's consolidated statement of operations in FY 2017.

On June 30, 2017, in connection with the sale of the Entertainment segment, the Company made a mandatory prepayment of $140.0 million with a corresponding prepayment premium of $15.2 million of the 2016 Senior Secured Term Loan, of which the prepayment premium was allocated to discontinued operations in the Company's consolidated statement of operations. As part of this mandatory prepayment, the Company wrote-off a pro-rata portion of the original issue discount and deferred financing costs of $9.4 million and $4.7 million, respectively, which was also allocated to discontinued operations in the Company's consolidated statement of operations in FY 2017. Additionally, on June 30, 2017, the Company made a voluntary prepayment of $66.0 million with a corresponding prepayment premium of $7.2 million of which the prepayment premium was recorded in loss on extinguishment of debt within continuing operations on the Company's consolidated statement of operations in FY 2017. Accordingly, the Company wrote off the remaining portion of the original issue discount and deferred financing costs of $4.4 million and $2.3 million, respectively, which was recorded in loss on extinguishment of debt in the Company's consolidated statement of operations in FY 2017. As a result of these prepayments, the Company's outstanding principal balance of the 2016 Senior Secured Term Loan was zero as of June 30, 2017 and the facility has since been terminated.

Given the principal balance of the loan was reduced to zero as of June 30, 2017, the Company recorded no cash interest during the Current Quarter and Prior Year Quarter and recorded no interest during the Current Nine Months as compared to $12.4 million in the Prior Year Nine Months.

Debt Maturities

As of September 30, 2018, the Company's debt maturities on a calendar year basis are as follows:

	Total	October 1 through December 31, 2018	2019	2020	2021	2022	Thereafter
Senior Secured Notes	$376,154	$ 10,673	$42,693	$42,693	$42,693	$42,693	$194,709
Variable Funding Notes(1)	$94,250	—	—	94,250	—	—	—
Senior Secured Term Loan(2)	$170,865	964	11,570	19,284	19,284	119,763	—
5.75% Convertible Notes(3)	$55,878	—	—	—	—	—	55,878
Total	$697,147	$ 11,637	$54,263	$156,227	$61,977	$162,456	$250,587

(1) Reflects the net debt carrying amount, effected by the outstanding balance of the original issue discount, in the unaudited condensed consolidated balance sheet as of September 30, 2018. The actual principal outstanding balance of the Variable Funding Notes is $100.0 million as of September 30, 2018.

(2) Reflects the net debt carrying amount, effected by the outstanding balance of the original issue discount, in the unaudited condensed consolidated balance sheet as of June 30, 2018. The actual principal outstanding balance of the Senior Secured Term Loan is $190.4 million as of September 30, 2018.

(3) Reflects the debt carrying amount which is accounted for under the Fair Value Option in the unaudited condensed consolidated balance sheet as of September 30, 2018. The actual principal outstanding balance of the 5.75% Convertible Notes is $111.0 million as of September 30, 2018.

10. Stockholders' Equity

2009 Equity Incentive Plan

On August 13, 2009, the Company's stockholders approved the Company's 2009 Equity Incentive Plan ("2009 Plan"). The 2009 Plan authorizes the granting of common stock options or other stock-based awards covering up to 3.0 million shares of the Company's common stock. All employees, directors, consultants and advisors of the Company, including those of the Company's subsidiaries, are eligible to be granted non-qualified stock options and other stock-based awards (as defined) under the 2009 Plan, and employees are also eligible to be granted incentive stock options (as defined) under the 2009 Plan. No new awards may be granted under the Plan after August 13, 2019.

On August 15, 2012, the Company's stockholders approved the Company's Amended and Restated 2009 Plan ("Amended and Restated 2009 Plan"), which, among other items and matters, increased the shares available under the 2009 Plan by an additional 4.0 million shares to a total of 7.0 million shares issuable under the Amended and Restated 2009 Plan, and extended the 2009 Plan termination date through August 15, 2022.

2015 Executive Incentive Plan

On December 4, 2015, the Company's stockholders approved the Company's 2015 Executive Incentive Plan ("2015 Plan"). Under the 2015 Plan, the Company's officers and other key employees designated by the Compensation Committee are eligible to receive awards of cash, common stock or stock units issuable under the Amended and Restated 2009 Plan, or any other combination thereof. Awards under the 2015 Plan are based on the achievement of certain pre-determined, non-discretionary performance goals established by the Compensation Committee and are further subject, among other things, the 2015 Plan participant's continuous employment with the Company until the applicable payment date.

2016 Omnibus Incentive Plan

On November 4, 2016, the Company's stockholders approved the Company's 2016 Omnibus Incentive Plan ("2016 Plan"). The 2016 Plan replaced and superseded the Amended and Restated 2009 Plan. Under the 2016 Plan, all employees, directors, officers, consultants and advisors of the Company, including those of the Company's subsidiaries, are eligible to be granted common stock, options or other stock-based awards. At inception, there were 2.4 million shares of the Company's common stock available for issuance under the 2016 Plan. The 2016 Plan was amended at the 2017 Annual Meeting of Stockholders to increase the number of shares available under the plan by 1.9 million shares.

Shares Reserved for Issuance

As of September 30, 2018, there were approximately 3.4 million common shares available for issuance under the 2016 Plan. On May 7, 2018, the Company filed a Form S-8 to register the 1.9 million shares available for issuance under the 2016 Plan that were approved at the 2017 Annual Meeting of Stockholders.

Amendment of Certification of Incorporation

At the Special Meeting of Stockholders of the Company held on April 26, 2018, the Company's stockholders entitled to vote at the meeting voted to approve the amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of its common stock, $.001 par value per share, from 150 million to 260 million.

Stock Options and Warrants

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company’s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

There was no compensation expense related to stock option grants or warrant grants during the Current Nine Months or Prior Year Nine Months as all prior awards have been fully expensed. Additionally, no stock options or warrants were granted during the Current Nine Months or Prior Year Nine Months.

As of September 30, 2018, there was a total of 20,000 stock options outstanding and exercisable at a weighted average exercise price of $12.29. As of September 30, 2018, there was a total of 20,000 warrants outstanding and exercisable at a weighted average exercise price of $6.64. During the Current Nine Months, there were no canceled, exercised or expired/forfeited stock options or warrants.

The weighted average contractual term (in years) of options outstanding and exercisable and warrants outstanding and exercisable as of September 30, 2018 was 0.75 and 0.01, respectively.

All warrants issued in connection with acquisitions are recorded at fair market value using the Black Scholes model and are recorded as part of purchase accounting. Certain warrants are exercised using the cashless method.

Restricted stock

Compensation cost for restricted stock is measured as the excess, if any, of the quoted market price of the Company's stock at the date the common stock is issued over the amount the employee must pay to acquire the stock (which is generally zero). The compensation cost, net of projected forfeitures, is recognized over the period between the issue date and the date any restrictions lapse, with compensation cost for grants with a graded vesting schedule recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards. The restrictions do not affect voting and dividend rights.

The following table summarize information about unvested restricted stock transactions:

	Shares	Weighted Average Grant Date Fair Value
Non-vested, January 1, 2018	1,308,084	$ 25.29
Granted	50,000	0.75
Vested	(581,372)	7.12
Forfeited/Canceled	116,395	7.48
Non-vested, September 30, 2018	893,107	$ 33.43

The Company has awarded time-based restricted shares of common stock to certain employees. The awards have restriction periods tied to employment and vest over a maximum period of approximately 3 years. The cost of the time-based restricted stock awards, which is the fair market value on the date of grant net of estimated forfeitures, is expensed ratably over the vesting period.

The Company has awarded performance-based restricted shares of common stock to certain employees. The awards have restriction periods tied to certain performance measures. The cost of the performance-based restricted stock awards, which is the fair market value on the date of grant net of estimated forfeitures, is expensed when the likelihood of those shares being earned is deemed probable.

Compensation expense related to restricted stock grants (inclusive of the restricted stock grants awarded as part of the long-term incentive plans discussed below) for the Current Quarter and Prior Year Quarter was approximately $0.2 million and $0.6 million, respectively.

Compensation expense related to restricted stock grants (inclusive of the restricted stock grants awarded as part of the long-term incentive plans discussed below) for the Current Nine Months and Prior Year Nine Months was approximately $1.9 million and $2.9 million, respectively.

An additional amount of $0.7 million of expense of compensation expense related to restricted stock grants (inclusive of the restricted stock grants awarded as part of the long-term incentive plans discussed below) is expected to be expensed evenly over a period of approximately eighteen months.

For both the Current Quarter and Prior Year Quarter, the Company repurchased shares valued at less than $0.1 million of its common stock in connection with net share settlement of restricted stock grants and option exercises. For the Current Nine Months and the Prior Year Nine Months, the Company repurchased shares valued at approximately $0.1 million and approximately $1.1 million, respectively, of its common stock in connection with net share settlement of restricted stock grants and option exercises.

Retention Stock

On January 7, 2016, the Company awarded to certain employees a retention stock grant of approximately 1.3 million shares in the aggregate with a then current value of approximately $7.5 million. The awards cliff vest in three years based on the Company's total shareholder return measured against a peer group, as described in the Company's Form 10-K/A filed on April 29, 2016. The measurement period began on the grant date and the beginning measurement amount was calculated based on the 20 day average closing stock price leading up to the grant date. The measurement period ends on December 31, 2018 and the ending measurement amount is based on the 20 day average closing stock price leading up to December 31, 2018. The award will vest on a scaled pay out based on the Company's total shareholder return versus the peer group.

In accordance with ASC 718, the Company valued these shares utilizing a Monte Carlo simulation as the awards are based on market conditions.

The grant date fair value of the awards issued on January 7, 2016 was $4.25 and was based on the following range of assumptions for the Company and the peer group:

	January 7. 2016	
Valuation Assumptions:		
Beginning average stock price (20 trading days prior to January 7, 2016)	$4.85 - $63.41	
Valuation date stock price (closing values on January 7, 2016)	$4.53 - $59.08	
Risk free interest rate	1.21	%
Expected dividend yield used when simulating the total shareholder return	0.00	%
Expected dividend yield used when simulating the Company's stock price	0.00	%
Stock price volatility (based on historical stock price over the last 2.98 years)	21.09% - 72.17%	
Correlation coefficients	0.04 - 0.47	

Mr. Haugh, the Company's former Chief Executive Officer, was issued an Employment Inducement Award pursuant to his employment agreement. The terms of the Employment Inducement Award are similar to the retention stock awards provided to all other employees as described above. The grant date fair value of Mr. Haugh's award issued on February 23, 2016 was $5.75 and was based on the following range of assumptions for the Company and the peer group:

	February 23. 2016	
Valuation Assumptions:		
Beginning average stock price (20 trading days prior to February 23, 2016)	\$4.86 - \$66.71	
Valuation date stock price (closing values on February 23, 2016)	\$5.52 - \$69.92	
Risk free interest rate	0.90	%
Expected dividend yield used when simulating the total shareholder return	0.00	%
Expected dividend yield used when simulating the Company's stock price	0.00	%
Stock price volatility (based on historical stock price over the last 3.00 years)	24.23% - 74.33%	
Correlation coefficients	0.06 - 0.50	

As of June 15, 2018, Mr. Haugh, the Company’s former Chief Executive Officer and President, was no longer an employee of the Company or member of the Company’s board of directors. As of Mr. Haugh’s termination date, given that the retention stock awards were not earning out, the vesting of shares associated with Mr. Haugh’s awards resulted in zero shares issuable.

Compensation expense related to the retention stock awards was approximately \$0.2 million for both the Current Quarter and Prior Year Quarter. Compensation expense related to the retention stock awards was approximately \$0.7 million for both the Current Nine Months and Prior Year Nine Months.

An additional amount of $0.2 million of expense of compensation expense related to retention stock awards is expected to be expensed evenly over the remainder of FY 2018.

Long-Term Incentive Compensation

On March 31, 2016, the Company approved a new plan for long-term incentive compensation (the “2016 LTIP”) for key employees and granted equity awards under the 2016 LTIP in the aggregate amount of 707,028 shares at a weighted average share price of $7.31 with a then current value of approximately $5.2 million. For each grantee other than Mr. Haugh, the Company’s former Chief Executive Officer, 33% of the award was in the form of restricted stock units (“RSUs”) and 67% of the award was in the form of target level performance stock units (“PSUs”). Mr. Haugh’s award under the 2016 LTIP consisted of 25% RSUs and 75% PSUs. The RSUs for each grantee vest in three equal installments annually over a three-year period. Other than for Mr. Haugh, the PSUs cliff vest over three years based on the achievement of an aggregate adjusted operating income performance target established by the Compensation Committee. Subject to his continued employment, one-third of Mr. Haugh’s PSUs were to be converted to time-based awards on December 31, 2016, December 31, 2017 and December 31, 2018, based on the achievement of aggregate adjusted operating income performance targets established by the Compensation Committee, and such time-based awards shall vest and be settled on December 31, 2018. As noted above, as of Mr. Haugh’s termination date, approximately 0.2 million shares of this award vested, but will be issued on December 31, 2018 and the Company accelerated approximately $0.3 million of stock compensation expense for these awards. Additionally, given Mr. Haugh’s termination date, the one-third awards that would have converted to time-based awards on December 31, 2018 were forfeited and the Company reversed approximately $0.6 million of stock compensation expense for this tranche. For the Current Quarter and the Current Nine Months, less than 0.1 million shares and approximately 0.1 million shares, respectively, were forfeited in respect of the 2016 LTIP. The weighted average remaining contractual term (in years) of the PSUs is less than one year.

On March 7, 2017, the Company approved a new plan for long-term incentive compensation (the “2017 LTIP”) for certain employees and granted equity awards under the 2017 LTIP in the aggregate amount of 871,011 shares at a weighted average share price of $7.52 with a then current value of $6.6 million. For each grantee, 33% of the award was in the form of RSUs and 67% of the award was in the form of target level PSUs. The material terms of the PSUs and RSUs are substantially similar to those set forth in the 2016 LTIP. Specifically, the RSUs vest one third annually on each of March 30, 2018, March 30, 2019 and March 30, 2020. The PSUs vest based on performance metrics approved by the Compensation Committee, which, for the performance period commencing January 1, 2017 and ending on December 31, 2019, are based on the Company’s achievement of an aggregate adjusted operating income performance target as set forth in the applicable award agreements, and continued employment through December 31, 2019. For the Current Quarter and Current Nine Months, less than 0.1 million shares and approximately 0.2 million, respectively, were forfeited in respect of the 2017 LTIP. The weighted average remaining contractual term (in years) of the PSUs is two years.

On March 15, 2018, the Company approved a new plan for long-term incentive compensation (the “2018 LTIP”) for certain employees which consisted of (i) equity awards in the aggregate amount of 2,241,828 shares at a weighted average share price of $1.38 with a then current value of $3.1 million and (ii) cash awards in the aggregate amount of approximately $3.1 million. For each grantee, 50% of the award was in the form of PSUs and 50% of such award was in the form of cash (the “Cash Grant”). The Cash Grants comprising the 2018 LTIP vest in 48 equal semi-monthly installments on the 15th and last days of each month, beginning March 31, 2018 and ending March 15, 2020, subject in each case to continued employment through the applicable vesting date. Each installment is paid within 15 days of the applicable vesting date. Upon the end of an employee’s employment with the Company, any remaining unpaid portion of the Cash Grant is forfeited. The PSUs vest based on performance metrics approved by the Compensation Committee over three separate performance periods, commencing on January 1 of each of 2018, 2019 and 2020 and ending on December 31 of each of 2018, 2019 and 2020, which, for each such performance period, are based on the

Company's achievement of an aggregated adjusted operating income performance target to be set by the Compensation Committee prior to March 30 of each applicable performance period, and continued employment through the settlement date. For the Current Quarter and Current Nine Months, there were less than 0.1 million shares and approximately 0.9 shares, respectively, forfeited in respect of the 2018 LTIP. The weighted average remaining contractual term (in years) of the PSUs is three years.

Compensation benefit was recognized related to the PSUs granted as part of the long-term incentive plans of $2.1 million and $1.7 million in the Current Quarter and Prior Year Quarter, respectively. Compensation benefit was recognized related to the PSUs issued as part of the long-term incentive plans of $2.8 million in the Current Nine Months as compared to compensation expense of $0.6 million in the Prior Year Nine Months. The compensation benefit recognized during the Current Quarter and Current Nine Months is as a result of the Company revising its future forecasted earnings associated with the Sears bankruptcy filing which in accordance with ASC 718, required the Company to reverse compensation expense recognized in prior periods as the PSUs were no longer projected to earn-out on the vesting date for the 2017 LTIP as well as a reduction in the projected earn-out on the vesting date for the 2016 LTIP. Refer to Note 22 for further details.

An additional amount of $0.1 million of expense of compensation expense related to the PSUs granted as part of 2016 LTIP is expected to be expensed evenly over the remainder of FY 2018.

11. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects, in periods in which they have a dilutive effect, the effect of restricted stock-based awards, common shares issuable upon exercise of stock options and warrants and shares underlying convertible notes potentially issuable upon conversion. The difference between basic and diluted weighted-average common shares results from the assumption that all dilutive stock options outstanding were exercised, and all convertible notes have been converted into common stock.

For the Current Quarter, of the total potentially dilutive shares related to restricted stock-based awards, stock options and warrants, all or approximately 0.2 million shares were anti-dilutive, as compared to approximately 0.4 million shares that were anti-dilutive for the Prior Year Quarter.

For the Current Quarter, approximately 0.1 million of the performance related restricted stock-based awards issued to the Company's named executive officers were anti-dilutive as compared to approximately 0.2 million of the performance related restricted stock-based awards issued to the Company's named executive officers were anti-dilutive in the Prior Year Quarter.

For both the Prior Year Quarter and Prior Year Nine Months, warrants issued in connection with the Company's 1.50% Convertible Notes financing were anti-dilutive and therefore were not included in this calculation. Note there were no warrants associated with the Company's 1.50% Convertible Notes for the Current Quarter or the Current Nine Months as the outstanding principal balance was repaid on March 15, 2018 (the maturity date).

A reconciliation of weighted average shares used in calculating basic and diluted earnings per share follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
(in thousands)	2018	2017	2018	2017
Basic	71,844	57,189	64,577	57,081
Effect of convertible notes subject to conversion	104,066	—	58,519	—
Effect of exercise of stock options	—	—	—	—
Effect of assumed vesting of dilutive shares	—	—	—	—
Diluted	175,910	57,189	123,096	57,081

As a result of the Company being in a net loss position during the Current Nine Months, dilution from the exercise of vesting of restricted stock has been excluded in the diluted earnings per share calculation.

In accordance with ASC 480, the Company considers its redeemable non-controlling interest in its computation of both basic and diluted earnings per share. In addition, in accordance with ASC 260, the Company considers its 5.75% Convertible Notes in its computation of diluted earnings per share. For the Current Quarter, Prior Year Quarter, Current Nine Months, and Prior Year Nine Months, adjustments to the Company's redeemable non-controlling interest and effects of potential conversion on the 5.75% Convertible Notes had impacts on the Company's earnings per share calculations as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
For earnings (loss) per share - basic:				
Net income (loss) from continuing operations attributable to Iconix Brand Group, Inc.	$20,224	$(550,571)	$(31,446)	$(559,707)
Accretion of redeemable non-controlling interest	(5,744)	(547)	(8,652)	(1,641)
Net income (loss) attributable to Iconix Brand Group, Inc. after accretion of redeemable non- controlling interest for basic earnings (loss) per share	14,480	(551,118)	(40,098)	(561,348)
Net income (loss) from discontinued operations attributable to Iconix Brand Group, Inc.	—	(2,130)	—	46,369
Net income (loss) attributable to Iconix Brand Group, Inc. for basic earnings (loss) per share	$14,480	$(553,248)	$(40,098)	$(514,979)
For earnings (loss) per share - diluted:				
Net income (loss) from continuing operations attributable to Iconix Brand Group, Inc.	$20,224	$(550,571)	$(31,446)	$(559,707)
Effect of potential conversion of 5.75% Convertible Notes	(15,641)	—	(59,066)	—
Accretion of redeemable non-controlling interest	(5,744)	(547)	(8,652)	(1,641)
Net loss attributable to Iconix Brand Group, Inc. after the effect of potential conversion of 5.75% Convertible Notes and accretion of redeemable non- controlling interest for diluted earnings (loss) per share	$(1,161)	$(551,118)	$(99,164)	$(561,348)
Net income (loss) from discontinued operations attributable to Iconix Brand Group, Inc.	—	(2,130)	—	46,369
Net loss attributable to Iconix Brand	$(1,161)	$(553,248)	$(99,164)	$(514,979)

Group, Inc. for diluted earnings (loss) per share

Earnings (loss) per share - basic:				
Continuing operations	$0.20	$(9.64)	$(0.62)	$(9.83)
Discontinued operations	$—	$(0.04)	$—	$0.81
Earnings (loss) per share - basic	$0.20	$(9.67)	$(0.62)	$(9.02)
Earnings (loss) per share - diluted:				
Continuing operations	$(0.01)	$(9.64)	$(0.81)	$(9.83)
Discontinued operations	$—	$(0.04)	$—	$0.81
Earnings (loss) per share - diluted	$(0.01)	$(9.67)	$(0.81)	$(9.02)

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Weighted average number of common shares outstanding:				
Basic	71,844	57,189	64,577	57,081
Diluted	175,910	57,189	123,096	57,081

12. Contingencies

On May 1, 2017, 3TAC, LLC, referred to as 3TAC, a former licensee of the Company, and West Loop South, LLC, referred to as West Loop (3TAC and West Loop collectively referred to as Plaintiffs), filed a second amended complaint against the Company, its affiliate, IP Holdings Unltd., LLC, referred to as IPHU, and the Company's former CEO, Neil Cole (the Company, IPHU, and Cole are collectively referred to as the Iconix Parties), in the action captioned 3TAC, LLC and West Loop South, LLC v. Iconix Brand Group, Inc.,IP Holdings Unltd, LLC and Neil Cole, Case No. 16-cv-08795-GBD-RWL in the United States District Court for the Southern District of New York. Plaintiffs asserted claims for breach of contract, tortious interference with contract and business relations, unjust enrichment, trade libel, unfair competition and prima facie tort relating to the Iconix Parties' alleged breach of a Global License Agreement, as amended, between 3TAC and IPHU concerning intellectual property rights in and to the Marc Ecko brands, the Iconix Parties' alleged interference with 3TAC's performance thereunder, and the Iconix Parties' alleged interference with a related sublicense between 3TAC and West Loop. On October 27, 2017, Judge Katherine B. Forrest granted the Iconix Parties' motion to dismiss Plaintiffs' unjust enrichment, trade libel, unfair competition and prima facie tort claims. Plaintiffs filed a Third Amended Complaint on June 11, 2018, in which no new claims were asserted, and the only additional allegations are related to the allegedly "inconsistent" exclusive license of New Rise Brand Holdings, LLC. Plaintiffs seek damages of at least $22 million for their remaining claims as well as punitive damages, attorneys' fees and costs. The Iconix Parties are vigorously defending against the remaining claims. At this time, the Company is unable to estimate the ultimate outcome of this matter.

On November 1, 2017, Seth Gerszberg and EGRHC, LLC, collectively referred to as Plaintiffs, (EGRHC, LLC suing in its capacity as a successor-in-interest to Suchman, LLC, referred to as Suchman, a company wholly-owned by Gerszberg that entered into a joint venture with the Company pursuant to which they formed IP Holdings Unltd., LLC, referred to as IPHU), filed an action captioned Gerszberg and EGRHC, LLC v. Iconix Brand Group, Inc., IP Holdings Unltd, LLC and Neil Cole, Case No. 17-cv-08421-GBD-RWL in the United States District Court for the Southern District of New York. Plaintiffs asserted claims against the Company, IPHU, and Neil Cole (collectively referred to as the Iconix Parties) for breach of IPHU's Operating Agreement and related breaches of fiduciary duties, breach of an agreement pursuant to which the Company bought out Suchman's interest in IPHU and fraudulent inducement and unjust enrichment regarding that buyout agreement; and also asserted claims for fraudulent inducement regarding the fourth amendment of the Global License Agreement between 3TAC, LLC and IPHU concerning the intellectual property rights in and to the Marc Ecko brands. On May 7, 2018, Judge Katherine B. Forrest dismissed the breach of fiduciary duty, breach of the IPHU Operating Agreement, and unjust enrichment claims, based largely upon a release provision in the buyout agreement. Further, the court narrowed the remaining claims in the following manner: limiting the fraudulent inducement claim to the fourth amendment to the Global License Agreement (ruling that the fraudulent inducement claim as to the buyout agreement was released), and limiting the breach of the buyout agreement claim to the government investigation representation. Plaintiffs seek more than $100 million in damages, including compensatory and punitive damages, disgorgement and restitution. The Iconix Parties are vigorously defending against the remaining claims asserted by Plaintiffs. At this time, the Company is unable to estimate the ultimate outcome of this matter.

In April 2016, New Rise Brands Holdings, LLC, referred to as New Rise, a former licensee of the Ecko Unlimited trademark, and Sichuan New Rise Import & Export Co. Ltd., referred to as Sichuan, the guarantor under New Rise's license agreement, commenced an action captioned New Rise Brands Holdings, LLC and Sichuan New Rise Import & Export Co. Ltd v. IP Holdings Unltd, LLC, et al., Index No. 652278/2016 in the New York State Supreme Court, New York County against the Company’s subsidiary, IP Holdings Unltd, LLC, referred to as IP Holdings, seeking damages of at least $15 million, plus punitive damages of $50 million, counsel fees and costs. Among other claims, New Rise and Sichuan allege improper termination of New Rise’s license agreement, fraud and misappropriation. On September 21, 2018, New Rise and Sichuan served an expert report claiming damages ranging from $15.6 million to $44.2 million. IP Holdings is vigorously defending against the claims and has asserted counterclaims against New Rise and Sichuan. At this time, the Company is unable to estimate the ultimate outcome of this matter.

Two shareholder derivative complaints captioned James v. Cuneo et al, Docket No. 1:16-cv-02212 and Ruthazer v. Cuneo et al, Docket No. 1:16-cv-04208 have been consolidated in the United States District Court for the Southern District of New York, and three shareholder derivative complaints captioned De Filippis v. Cuneo et al. Index No. 650711/2016, Gold v. Cole et al, Index No. 53724/2016 and Rosenfeld v. Cuneo et al., Index No. 510427/2016 have been consolidated in the Supreme Court of the State of New York, New York County. The complaints name the Company as a nominal defendant and assert claims for breach of fiduciary duty, insider trading and unjust enrichment against certain of the Company's current and former directors and officers arising out of the Company's restatement of financial reports and certain employee departures. At this time, the Company is unable to estimate the ultimate outcome of these matters.

The Company continues to cooperate in the previously disclosed SEC investigation.

Three securities class actions have been consolidated in the United States District Court for the Southern District of New York, under the caption In re Iconix Brand Group, Inc., et al., Docket No. 1:15-cv-4860, against the Company and certain former officers and one current officer (the “Class Action”). The plaintiffs in the Class Action purport to represent a class of purchasers of the Company’s securities from February 22, 2012 to November 5, 2015, inclusive, and claim that the Company and individual defendants violated sections 10(b) and 20(a) of the Exchange Act, by making allegedly false and misleading statements regarding certain aspects of the Company’s business operations and prospects. On October 25, 2017, the Court granted the motion to dismiss the consolidated amended complaint filed by the Company and the individual defendants with leave to amend. On November 14, 2017, the plaintiffs filed a second consolidated amended complaint. On February 2, 2018, the defendants moved to dismiss the second consolidated amended complaint. The Company and the individual defendants intend to vigorously defend against the claims. At this time, the Company is unable to estimate the ultimate outcome of these matters.

From time to time, the Company is also made a party to litigation incurred in the normal course of business. In addition, in connection with litigation commenced against licensees for non-payment of royalties, certain licensees have asserted unsubstantiated counterclaims against the Company. While any litigation has an element of uncertainty, the Company believes that the final outcome of any of these routine matters will not, individually or in the aggregate, have a material effect on the Company’s financial position or future liquidity.

13. Related Party Transactions

For the Prior Year Nine Months, the Company paid less than $0.1 million to Galore Media, Inc. in relation to certain marketing services to promote the Company’s brands and for the rights to certain warrants of Galore Media, Inc. as compared to none during the Current Year Nine Months. The Company owned a minority interest in Galore Media, Inc. The Company sold its interest in Galore Media during FY 2017. Management believes that all transactions were made on terms and conditions no less favorable than those available in the marketplace from unrelated parties.

The Company has entered into certain license agreements in which the core licensee is also one of our joint venture partners. In the case of Sports Direct International plc ("Sports Direct"), the Company maintains license agreements with Sports Direct, but in addition, during the Current Quarter, the Company entered into a cooperation agreement with Sports Direct that allowed Sports Direct to appoint two members to the Company's Board of Directors. For the Current Quarter, Current Nine Months, Prior Year Quarter and Prior Year Nine Months, the Company recognized the following royalty revenue amounts:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Joint Venture Partner				
Global Brands Group Asia Limited [1]	$ 2,587	$ 6,472	$ 14,353	$ 14,168
Buffalo International ULC[2]	—	—	—	690
Rise Partners, LLC / Top On International Group Limited	242	—	725	695
M.G.S. Sports Trading Limited	139	188	475	405
Pac Brands USA, Inc.	47	74	171	197
Albion Equity Partners LLC / GL Damek	776	448	1,993	1,366
Anthony L&S	—	98	617	98
MHMC	732	450	2,195	1,350
Sports Direct International plc	275	—	275	—
	$ 4,798	$ 7,730	$ 20,804	$ 18,969

[1] Global Brands Group Asia Limited also served as agent to Peanuts Worldwide in respect of the Greater China Territory for Peanuts brands. As of June 30, 2017, due to the completion of the sale of the Entertainment segment, Global Brands Group Asia Limited is no longer a related party in its capacity as agent of Peanuts Worldwide. For the Prior Year Quarter and Prior Year Nine Months, Global Brands Group Asia Limited earned fees of approximately $0 million and less than $1.6 million, respectively, in its capacity as agent to Peanuts Worldwide, which have been recorded within discontinued operations in the Company's condensed consolidated statement of operations.

[2] Prior to FY 2017, Buffalo International ULC maintained the Buffalo license agreement. However, starting in February 2017, Buffalo International ULC effectively assigned the Buffalo license agreement to GBG. The license revenue from the Buffalo license agreement represents approximately $2.3 million and $6.0 million of the total license revenue for GBG shown in the table above for the Current Quarter and Prior Year Quarter, respectively. The license revenue from the Buffalo license agreement represents approximately $13.4 million and $12.7 million of the total license revenue for GBG shown in the table above for the Current Nine Months and Prior Year Nine Months, respectively.

14. Income Taxes

The Company computes its expected annual effective income tax rate in accordance with ASC 740 and makes changes on a quarterly basis, as necessary, based on certain factors such as changes in forecasted annual pre-tax income; changes to actual or forecasted permanent book to tax differences; impacts from tax audits with state, federal or foreign tax authorities; impacts from tax law changes; or change in judgment as to the realizability of deferred tax assets. The Company identifies items which are unusual and non-recurring in nature and treats these as discrete events. The tax effect of discrete items is recorded in the quarter in which the discrete events occur. Due to the volatility of these factors, the Company's consolidated effective income tax rate can change significantly on a quarterly basis.

With the exception of the Buffalo brand joint venture, Iconix Middle East joint venture, Diamond Icon joint venture and Umbro China joint venture, the Company is not responsible for the income taxes related to the non-controlling interest’s share of the joint venture’s earnings. Therefore, the tax liability associated with the non-controlling interest share of the joint venture’s earnings is not reported in the Company’s income tax expense, despite the joint venture’s entire income being consolidated in the Company’s reported income before income tax expense. As such, the joint venture’s earnings have the effect of lowering our effective tax rate. This effect is more pronounced in periods in which joint venture earnings are higher relative to our other earnings. Since the Buffalo brand joint venture is a taxable entity in Canada, the Iconix Middle East joint venture and Diamond Icon joint venture are taxable entities in the United Kingdom and the Umbro China joint venture is a taxable entity in Hong Kong, the Company is required to report its tax liability, including taxes attributable to the non-controlling interest, in its income statement. All other consolidated joint ventures are partnerships and treated as pass-through entities not subject to taxation in their local tax jurisdiction, and therefore the Company includes only the tax attributable to its proportionate share of income from the joint venture in income tax expense.

The Company conducts business globally and, as a result, the Company or one or more of its subsidiaries files income tax returns in the U.S., various state and local, and foreign jurisdictions. The Company, joined by its domestic subsidiaries, files a consolidated income tax return for Federal income tax purposes. In the normal course of business, the Company is subject to examination in such domestic and foreign jurisdictions. During the fourth quarter of 2016, the Internal Revenue Service initiated an audit of the 2014 federal income tax return which is still ongoing. The Company recognized no interest expense related to uncertain tax positions in both the Current Quarter and Prior Year Quarter. The Company recognized no interest expense related to uncertain tax positions in the Current Nine Months as compared to approximately $0.9 million during the Prior Year Nine Months. The Company recognizes accrued interest and penalties related to uncertain tax positions in income tax expense.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income in the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based on these items and the three consecutive years of pretax losses (resulting from impairment), management has determined that enough uncertainty exists relative to the realization of the deferred income tax asset balances to warrant the application of a full valuation allowance for all taxing jurisdictions starting as of September 30, 2017, other than for Canadian operations. In addition, the Company continues to have deferred tax liabilities related to indefinite lived intangibles on the condensed consolidated balance sheet a portion of which cannot be considered to be a source of taxable income to offset deferred tax assets.

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act. The new law, which is also commonly referred to as “U.S. tax reform”, significantly changed U.S. corporate income tax laws. The primary impact on the Company was associated with the effect of reducing the U.S. corporate income tax rate from 35% to 21% starting in 2018. As a result, the Company estimated a net benefit of $67 million which was recorded during the fourth quarter of 2017. Other provisions of the law took effect January 1, 2018, including, but not limited to, creating a territorial tax system, eliminating or limiting the deduction of certain expenses including interest expense, and requiring a tax on earnings generated by foreign subsidiaries that are in excess of a specified return.

As of September 30, 2018, the Company continues to evaluate its accounting for the tax effects of the enactment of the law. The Company made a reasonable estimate and recorded in the fourth quarter of 2017 (i) a net income tax provision of $34 million resulting from the remeasurement of the Company’s net deferred income tax assets and liabilities and uncertain tax liabilities based on the new reduced U.S. corporate income tax rate, and (ii) an income tax benefit of $101 million from the remeasurement of the Company’s valuation allowance for the impact of the law on certain tax attributes. In other cases, the Company has not been able to make a reasonable estimate and continues to account for those items based on its existing accounting under GAAP and the provisions of the tax laws that were in effect prior to enactment. Once the Company finalizes its analysis, it will be able to conclude on further adjustments, if any, to be recorded to these provisional amounts. Any such change will be reported as a component of income taxes in the period in which such adjustments are determined but in no case later than the fourth quarter of 2018.

The Company’s consolidated effective tax rate from continuing operations for the Current Quarter was 4.5% which resulted in a $1.0 million income tax expense as compared to the consolidated effective tax rate from continuing operations for the Prior Year Quarter of 4.9% which resulted in a $29.6 million income tax benefit. The decrease in the effective tax rate for the Current Quarter as compared to the Prior Year Quarter is primarily a result of the benefit recognized from the trademark impairment charge of approximately $4.4 million which was significantly reduced due to a valuation allowance against the deferred tax asset.

The Company’s consolidated effective tax rate from continuing operations for the Current Nine Months was 0.6% which resulted in a $0.1 million income tax benefit compared to the consolidated effective tax rate from continuing operations for the Prior Year Nine Months of 4.8% which resulted in a $29.2 million income tax benefit on a pretax loss of $613 million. The decrease in the effective tax rate in the Current Nine Months as compared to the Prior Year Nine Months is primarily a result of the benefits recognized in the Prior Year Nine Months from the trademark and goodwill impairment charges which was reduced by a valuation allowance against the impairment charges. Also, during the Prior Year Nine Months, the Company expensed approximately $2.0 million as a discrete item related to a change in estimate associated with certain state and local income tax audits.

During the second fiscal quarter of 2018, the Company elected to treat its Luxembourg top tier subsidiary (“Luxco”) as a disregarded entity for US tax purposes. All the operations under LuxCo were previously treated as disregarded for US tax purposes. As of the election date, all the foreign operations under LuxCo will be treated as a branch for US tax purposes and subject to US taxation. As such, the Company will no longer have any earnings in foreign subsidiaries that are not currently subject to taxation for US purposes. Before the election, the Company was indefinitely reinvested in all earnings in its foreign subsidiaries.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations; however, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

We have net operating loss (“NOL”) carryforwards for federal and state income tax purposes which, generally, can be used to reduce future taxable income. Our use of our NOL carryforwards is limited under Section 382 of the Internal Revenue Code, as we have had a change in ownership of more than 50% of our capital stock over a three-year period as measured under Section 382 of the Internal Revenue Code. These complex changes of ownership rules generally focus on ownership changes involving shareholders owning directly or indirectly 5% or more of our stock, including certain public “groups” of shareholders as set forth under Section 382 of the Internal Revenue Code, including those arising from new stock issuances and other equity transactions. Some of these NOL carryforwards will expire if they are not used within certain periods. At this time, we consider it more likely than not that we will not have sufficient taxable income in the future that will allow us to realize these NOL carryforwards.

15. Accumulated Other Comprehensive Income

The following table sets forth the activity in accumulated other comprehensive income for the Current Nine Months and Prior Year Nine Months:

	Foreign currency translation adjustments	Unrealized losses of available for sale securities	Total
Balance at December 31, 2017	$ (48,103)	$ (3,177)	$(51,280)
Changes before reclassifications	(3,509)	—	(3,509)
Cumulative adjustment for adoption of ASU 2016-01	—	3,177	3,177
Current period other comprehensive income	(3,509)	3,177	(332)
Balance at September 30, 2018	$ (51,612)	$ —	$(51,612)

	Foreign currency translation adjustments	Unrealized losses of available for sale securities	Total
Balance at December 31, 2016	$ (67,735)	$ (2,693)	$(70,428)
Changes before reclassifications	20,900	(625)	20,275
Current period other comprehensive income	20,900	(625)	20,275
Balance at September 30, 2017	$ (46,835)	$ (3,318)	$(50,153)

16. Segment and Geographic Data

The Company identifies its operating segments for which separate financial information is available and for which segment results are evaluated regularly by the Chief Executive Officer, the Company's chief operating decision maker, in deciding how to allocate resources and in assessing performance. The Company has disclosed the following operating segments: men's, women's, home, and international. Since the Company does not track, manage and analyze its assets by segments, no disclosure of segmented assets is reported.

Additionally, the Company previously owned and operated an Entertainment segment which is included in the Company's condensed consolidated statement of operations as a discontinued operation for the Prior Year Quarter and Prior Year Nine Months. See Note 2 in Notes to Consolidated Financial Statements for further details.

The geographic regions consist of the United States and Other (which principally represent Latin America and Europe). Revenues attributable to each region are based on the location in which licensees are located and where they principally do business.

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Reportable data for the Company’s operating segments is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Licensing revenue:				
Women's	$15,201	$21,043	$48,670	$76,820
Men's	7,282	11,393	27,752	31,568
Home	7,060	7,515	20,533	22,676
International	16,681	13,214	48,029	42,471
	$46,224	$53,165	$144,984	$173,535
Operating income (loss):				
Women's	$3,234	$(281,889)	$(77,832)	$(232,259)
Men's	1,855	(132,183)	8,393	(141,442)
Home	3,555	(91,203)	15,887	(77,717)
International	9,188	(82,505)	23,757	(67,021)
Corporate	(5,726)	(8,078)	(37,149)	(27,930)
	$12,106	$(595,858)	$(66,944)	$(546,369)

17. Other Assets- Current and Long-Term

Other Assets - Current

	September 30, 2018	December 31, 2017
Other assets- current consisted of the following:		
Notes receivables on sale of trademarks [1]	$ 2,755	$ 3,097
Note receivable in connection with acquisition of interest in Buffalo brand	—	2,515
Due from DHX Media, Ltd.[2]	—	1,175
Contract asset - current	6,405	—
Prepaid advertising	2,500	2,453
Prepaid expenses	2,409	4,621
Deferred charges	15	—
US federal tax receivables	15,854	29,662
Prepaid taxes	5,011	2,347
Prepaid insurance	321	1,428
Due from related parties	3,894	3,843
Other current assets	528	709
Other current assets	$ 39,692	$ 51,850

(1) Certain amounts due from our joint venture partners are presented net of redeemable non-controlling interest and non-controlling interest in the condensed consolidated balance sheet. Refer to Note 5 for further details.

(2) This amount represents the remaining amount due from DHX as a result of amounts reimbursable to the Company of $1.2 million associated with the transitional service agreement between DHX and the Company and other expenses which were incurred by the Company subsequent to the completion of the sale of the Entertainment segment on June 30, 2017. Refer to Note 2 for further details.

Other Assets – Long Term

	September 30, 2018	December 31, 2017
Other noncurrent assets consisted of the following:		
Contract asset - long term	$ 12,904	$ —
Prepaid Interest	5,649	5,601
Deposits	528	616
Other noncurrent assets	22	51
Other noncurrent assets	$ 19,103	$ 6,268

18. Other Liabilities – Current

As of September 30, 2018 and December 31, 2017, other current liabilities of $9.4 million and $13.6 million, respectively, related to $9.4 million and $9.2 million, respectively, due to certain joint ventures that are not consolidated with the Company and $0 million and $4.4 million, respectively, owed to Buffalo International for distributions associated with the Buffalo joint venture.

19. Foreign Currency Translation

The functional currency of Iconix Luxembourg and Red Diamond Holdings, which are wholly owned subsidiaries of the Company located in Luxembourg, is the Euro. However, the companies have certain dollar denominated assets, in particular cash and notes receivable, that are maintained in U.S. Dollars, which are required to be revalued each quarter. Due to fluctuations in currency in the Current Quarter and the Prior Year Quarter, the Company recorded a $0.3 million currency translation loss and a $1.1 million currency translation gain, respectively, that is included in the condensed consolidated statement of operations. Due to fluctuations in currency in the Current Nine Months and the Prior Year Nine Months, the Company recorded a $0.5 million currency translation loss and a $2.8 million currency translation loss, respectively, that is included in the condensed consolidated statement of operations.

Comprehensive income includes certain gains and losses that, under U.S. GAAP, are excluded from net income as such amounts are recorded directly as an adjustment to stockholders' equity. The Company's comprehensive income is primarily comprised of net income and foreign currency translation gain or loss. During the Current Quarter and the Prior Year Quarter, the Company recognized as a component of its comprehensive income, a foreign currency translation loss of $0.7 million and foreign currency translation gain of $6.4 million, respectively, due to changes in foreign exchange rates during the Current Quarter and the Prior Year Quarter, respectively. During the Current Nine Months and the Prior Year Nine Months, the Company recognized as a component of its comprehensive income, a foreign currency translation loss of $3.5 million and a foreign currency translation gain of $20.9 million, respectively, due to changes in foreign exchange rates during the Current Nine Months and the Prior Year Nine Months.

20. Accounting Pronouncements

Recent Accounting Pronouncements

In May 2014, FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606),” which is the new comprehensive revenue recognition standard that will supersede all existing revenue recognition guidance under U.S. GAAP. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to a customer in an amount that reflects the consideration to which such company expects to be entitled in exchange for those goods or services. The Company adopted the new standard in the first quarter of FY 2018. Refer to Note 3 for further details.

In January 2016, FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities”, includes amendments on recognition, measurement, presentation, and disclosure of financial instruments. It requires an entity to (1) measure equity investments at fair value through net income, with certain exceptions; (2) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (3) present financial assets and financial liabilities by measurement category and form of financial asset; (4) calculate the fair value of financial instruments for disclosure purposes based on an exit price; and (5) assess a valuation allowance on deferred tax assets related to unrealized losses on available-for-sale debt securities in connection with other deferred tax assets. The ASU provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The ASU also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Certain provisions of the ASU are eligible for early adoption. The Company adopted the new standard in the first quarter of FY 2018 which resulted in the Company reclassing the cumulative loss in fair value of our available-for-sale securities of $3.2 million from accumulated other comprehensive loss to accumulated losses as of January 1, 2018 in the Company’s condensed consolidated balance sheet. Change in the fair value of the available-for-sale securities will be recorded within the Company’s condensed consolidated statement of operations in future periods. Additionally, the Company’s previously cost method investments are now being categorized as other equity investments and continue to be recorded on the Company’s condensed consolidated balance sheet at cost and assessed for potential impairment on a quarterly basis. Refer to Note 5 and Note 7 for further details.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company’s leases are considered operating leases and are not capitalized under ASC 840. Under ASC 842, the majority of these leases will qualify for capitalization and will result in the recognition of lease assets and lease liabilities once the new standard is adopted. The Company is in the process of reviewing lease contracts to determine the impact of adopting ASC 2016-02.

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments”, which clarifies how certain cash receipts and cash payments are presented in the statement of cash flows. The amendment addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The Company adopted the new standard in the first quarter of FY 2018 which did not have a material impact to our financial statements.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740) – Intra-Entity Transfers of Assets Other Than Inventory”, which was issued as part of the FASB’s simplification initiative and, intends to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Under this ASU, an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The Company adopted the new standard in the first quarter of FY 2018 which did not have a material impact to our financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows: Restricted Cash.” The primary purpose of this ASU is to reduce the diversity in practice that exists in the classification and presentation of changes in restricted cash on the statement of cash flows. This ASU will require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted the new standard in the first quarter of FY 2018.

In January 2017, the FASB issued ASU No. 2017-01,"Business Combinations (Topic 805) - Clarifying the Definition of a Business", to clarify the definition of a business, which is fundamental in the determination of whether transactions should be accounted for as acquisition (or disposals) of assets or businesses. The guidance is generally expected to result in fewer transactions qualifying as business combinations. The Company adopted the new standard in the first quarter of FY 2018 which did not have a material impact to our financial statements.

In February 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment", which simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test and eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. The ASU is effective for public business entities for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. This ASU should be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We will adopt this accounting guidance in future periods.

In May 2017, the FASB issued ASU 2017-09, "Compensation – Stock Compensation (Topic 718)", which provides clarity and reduces both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation – Stock Compensation, to a change to the terms or conditions of a share-based payment award. The ASU is effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company adopted the new standard in the first quarter of FY 2018 which did not have a material impact to our financial statements.

21. Other Matters

During the Current Quarter and the Prior Year Quarter, the Company included in its selling, general and administrative expenses approximately $1.8 million and $2.4 million, respectively, of charges related to professional fees associated with the continuing correspondence with the Staff of the SEC, the SEC investigation and the class action and derivative litigations. During the Current Nine Months and the Prior Year Nine Months, the Company included in its selling, general and administrative expenses approximately $7.2 million and $7.1 million, respectively, of charges related to professional fees associated with the continuing correspondence with the Staff of the SEC, the SEC investigation and the class action and derivative litigations.

As of June 15, 2018, Mr. Haugh, the Company's former Chief Executive Officer and President, was no longer an employee of the Company or member of the Company's board of directors. Included in the charges related to professional fees discussed above is $2.1 million recorded in the Current Nine Months associated with his severance and other benefits.

22. Subsequent Events

On October 15, 2018, Sears Holding Corporation ("Sears") filed for Chapter 11 bankruptcy. The Company maintains license agreements with Sears for its Joe Boxer, Bongo and Cannon trademarks. At this time, the Company is uncertain of the outcome of the Sears bankruptcy filing and how it could affect the future revenues and cash flows of these brands as well as if any future indefinite-lived intangible asset impairment charge for these trademarks is expected. As new and additional information is learned about the Sears bankruptcy filing, the Company will update its forecasted future earnings for the Joe Boxer, Cannon and Bongo trademarks in the fourth quarter of FY 2018 as is deemed necessary. Refer to Note 4 for further details. As a result of the bankruptcy filing, the Company recorded a bad debt reserve of $8.2 million which represents the outstanding accounts receivable balance due from Sears as of September 30, 2018 of which $3.9 million was recognized as revenue during the Current Quarter.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Summary. Iconix Brand Group is a brand management company and owner of a diversified portfolio of approximately 30 global consumer brands across women's, men's, home and international industry segments. Additionally, the Company previously owned and operated an Entertainment segment which is included in the Company's unaudited condensed consolidated statement of operations as a discontinued operation for the first quarter of FY 2017. Refer to Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements for further details. The Company's business strategy is to maximize the value of its brands primarily through strategic licenses and joint venture partnerships around the world, as well as to grow the portfolio of brands through strategic acquisitions.

As of September 30, 2018, the Company's brand portfolio includes Candie's®, Bongo ®, Joe Boxer ®, Rampage ®, Mudd ®, London Fog ®, Mossimo ®, Ocean Pacific/OP ®, Danskin /Danskin Now ®, Rocawear ® /Roc Nation ®, Artful Dodger ®, Cannon ®, Royal Velvet ®, Fieldcrest ®, Charisma ®, Starter ®, Waverly ®, Ecko Unltd ® /Mark Ecko Cut & Sew ®, Zoo York ®, Umbro ® and Lee Cooper ®; and interests in Material Girl ®, Ed Hardy ®, Truth or Dare ®, Modern Amusement ®, Buffalo ®, Hydraulic ® and Pony ®.

The Company principally looks to monetize the Intellectual Property (herein referred to as "IP") related to its brands throughout the world and in all relevant categories by licensing directly with leading retailers (herein referred to as "direct to retail" or "DTR"), through a consortia of wholesale licensees, through joint ventures in specific territories and via other activity such as corporate sponsorships and content as well as the sale of IP for specific categories or territories. Products bearing the Company's brands are sold across a variety of distribution channels. The licensees are generally responsible for designing, manufacturing and distributing the licensed products. The Company supports its brands with marketing, advertising and promotional campaigns designed to increase brand awareness. Additionally, the Company provides its licensees with coordinated trend direction to enhance product appeal and help build and maintain brand integrity.

Globally, the Company has over 50 DTR licenses and more than 400 total licenses. Licensees are selected based upon the Company's belief that such licensees will be able to produce and sell quality products in the categories and distribution channels of their specific expertise and that they are capable of exceeding minimum sales targets and royalties that the Company generally requires for each brand. This licensing strategy is designed to permit the Company to operate its licensing business, leverage its core competencies of marketing and brand management with minimal working capital, and generally without inventory, production or distribution costs or risks, and maintain high margins. The vast majority of the Company's licensing agreements include minimum guaranteed royalty revenue which provides the Company with greater visibility into future cash flows. As of October 1, 2018, the Company had over $425 million of aggregate guaranteed royalty revenue over the terms of the Company's existing contracts excluding renewals.

The Company's OP DTR license agreement at Walmart was not renewed upon expiration in June 2017. The Company's Starter DTR license agreement at Walmart was not renewed upon expiration in December 2017. In October 2017, the Company also announced that Starter is now available on Amazon exclusively to Amazon Prime members. Additionally, the Company has learned that its Danskin Now license agreement with Walmart will not be renewed upon its expiration in January 2019 and royalty revenue for the Danskin Now brand at Walmart is estimated to decline approximately $15.5 million in 2018. The Company's Mossimo DTR license agreement at Target will not be renewed upon expiration in October 2018 and royalty revenue for the Mossimo brand at Target is estimated to decline approximately $10.0 million in 2018. The Company's Material Girl license agreement with Macy's will not be renewed upon its expiration in January 2020. The Company's Royal Velvet license agreement with JC Penney will not be renewed upon its expiration in January 2019. The Company is actively seeking to place OP, Danskin, Mossimo, Material Girl and Royal Velvet with new or existing licensees. At this time, the Company is uncertain how the terms and conditions of any potential replacement licensing arrangements could affect its future revenues and cash flows.

On December 22, 2017 the United States enacted the Tax Cuts and Jobs Act. The new law, which is also commonly referred to as “U.S. tax reform”, significantly changes U.S. corporate income tax laws by, among other changes, imposing a one-time mandatory tax on previously deferred earnings of foreign subsidiaries, reducing the U.S. corporate income tax rate from 35% to 21% starting on January 1, 2018, creating a territorial tax system which generally eliminates U.S. federal income taxes on dividends from foreign subsidiaries, eliminating or limiting the deduction of certain expenses including interest expense, and requiring a minimum tax on earnings generated by foreign subsidiaries, which could have a significant impact on our effective tax rate, cash tax expenses and/or deferred income tax balances.

A key initiative in the Company’s global brand expansion plans has been the formation of international joint ventures. The strategy in forming international joint ventures is to partner with best-in-class, local partners to bring the Company’s brands to market more quickly and efficiently, generating greater short- and long-term value from its IP, than the Company believes is possible if it were to build-out wholly-owned operations ourselves across a multitude of regional or local offices. Since September 2008, the Company has established the following international joint ventures: Iconix China, Iconix Latin America, Iconix Europe, Iconix India, Iconix Canada, Iconix Australia, Iconix Southeast Asia, Iconix Israel, Iconix Middle East, Umbro China, Danskin China and Starter China.

The Company also plans to continue to build and maintain its brand portfolio by acquiring additional brands directly or through joint ventures. In assessing potential acquisitions or investments, the Company primarily evaluates the strength of the target brand as well as the expected viability and sustainability of future royalty streams. The Company believes that this focused approach allows it to effectively screen a wide pool of consumer brand candidates and other asset light businesses, strategically evaluate acquisition targets and complete due diligence for potential acquisitions efficiently.

The Company's primary goal of maximizing the value of its IP also includes, in certain instances, the sale to third parties of a brand's trademark in specific territories or categories. As such, the Company evaluates potential offers to acquire some or all of a brand's IP by comparing whether the offer is more valuable than the Company's estimate of the current and potential revenue streams to be earned via the Company's traditional licensing model. Further, as part of the Company's evaluation process, it also considers whether or not the buyer's future development of the brand may help to expand the brand's overall recognition and global revenue potential.

The Company identifies its operating segments according to how business activities are managed and evaluated and, for which separate financial information is available and utilized on a regular basis by the Chief Executive Officer in deciding how to allocate resources and in assessing performance.

Therefore, the Company has disclosed these reportable segments for the periods shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Licensing revenue:				
Women's	$15,201	$21,043	$48,670	$76,820
Men's	7,282	11,393	27,752	31,568
Home	7,060	7,515	20,533	22,676
International	16,681	13,214	48,029	42,471
	$46,224	$53,165	$144,984	$173,535
Operating income (loss):				
Women's	$3,234	$(281,889)	$(77,832)	$(232,259)
Men's	1,855	(132,183)	8,393	(141,442)
Home	3,555	(91,203)	15,887	(77,717)
International	9,188	(82,505)	23,757	(67,021)
Corporate	(5,726)	(8,078)	(37,149)	(27,930)
	$12,106	$(595,858)	$(66,944)	$(546,369)

Results of Operations

Current Quarter compared to Prior Year Quarter

Licensing Revenue. Total revenue for the Current Quarter was $46.2 million, a 13% decrease as compared to $53.2 million for the Prior Year Quarter. Total licensing revenue was positively impacted by approximately $0.4 million due to the consolidation of the Australia joint venture. Excluding the Australia joint venture, licensing revenue was down 14%. The women's segment decreased 28% from $21.0 million in the Prior Year Quarter to $15.2 million in the

Current Quarter primarily due to a decrease in licensing revenue from our Danskin and Ocean Pacific brands as the brands transition from their historical DTR relationships. The men's segment decreased 36% from $11.4 million in the Prior Year Quarter to $7.3 million in the Current Quarter due to a decrease in licensing revenue from our Buffalo and Starter brands. The home segment decreased 6% from $7.5 million in the Prior Year Quarter to $7.1 million in the Current Quarter mainly due to weakness in our Waverly brand. The international segment increased 26% from $13.2 million in the Prior Year Quarter to $16.7 million in the Current Quarter, mainly due to strength in China, Europe, India and MENA.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses ("SG&A") were $30.2 million for the Current Quarter as compared to $21.5 million for the Prior Year Quarter, an increase of $8.7 million or 40%. SG&A in the Current Quarter included an $8.2 million accounts receivable reserve for the impact of the Sears bankruptcy. Excluding the reserve for Sears, SG&A for the Current Quarter was $22.0 million which is an increase of 2% over the Prior Year Quarter. SG&A from the women's segment increased 234% from $2.4 million in the Prior Year Quarter to $7.9 million in the Current Quarter mainly due to a $5.4 million increase in accounts receivables reserves and write-offs due to the Sears bankruptcy. Excluding Sears, SG&A in the women's segment decreased 2%. SG&A from the men's segment increased 106% from $2.6 million in the Prior Year Quarter to $5.4 million in the Current Quarter primarily due to a $1.9 million increase in advertising mostly in our Starter, Umbro and Buffalo brands. SG&A from the home segment increased 318% from $0.8 million in the Prior Year Quarter to $3.5 million in the Current Quarter mainly due to a $2.4 million increase in accounts receivables reserves and write-offs due to the Sears bankruptcy. Excluding Sears, SG&A in the home segment increased 12% mostly due to an increase in advertising. SG&A from the international segment increased 13% from $7.1 million in the Prior Year Quarter to $8.0 million in the Current Quarter mainly due to a $1.0 million increase in advertising costs. Corporate SG&A decreased 38% from $8.6 million in the Prior Year Quarter to $5.3 million primarily due to a decrease of $3.6 million in compensation costs. This mostly related to a decrease in performance based compensation as a result of the Sears bankruptcy.

Loss on Termination of Licenses. Loss on termination of licenses was zero for the Current Quarter, compared to $2.8 million in the Prior Year Quarter. The charge in the Prior Year Quarter was mostly related to the Rocawear brand tied to specific litigation.

Depreciation and Amortization. Depreciation and amortization was $0.5 million for the Current Quarter, compared to $0.6 million in the Prior Year Quarter, mostly as a result of a decrease in amortization costs in the Current Quarter.

Equity earnings on joint ventures. Equity earnings on joint ventures was $1.0 million for the Current Quarter, compared to $0.5 million for the Prior Year Quarter. The Prior Year Quarter included a loss of $0.6 million from our investments in China.

Gain on Sale of Trademarks. Gain on Sale of Trademarks was zero for the Current Quarter, compared to $0.9 million in the Prior Year Quarter. The gain in the Prior Year Quarter was related to the sale of the Badgley Mischka and Sharper Image brands in Canada.

Trademark & Goodwill Impairment. Trademark & Goodwill Impairment loss for the Current Quarter was $4.4 million as compared to a loss of approximately $625.5 million in the Prior Year Quarter. The Trademark Impairment for the Current Quarter related to Joe Boxer while the Trademark Impairment for the Prior Year Quarter was approximately $521.7 million primarily related to a write-down in the women's segment and men's segment. The Goodwill Impairment for the Prior Year Quarter was $103.9 million primarily related to a write-down in our women's segment and men's segment. The trademark impairment charge in the Current Quarter was primarily due to the ongoing financial distress of Sears and its continued liquidity challenges. The trademark and goodwill impairment charges in the Prior Year Quarter are primarily due to declines in net sales in certain brands within the segments and an inability to secure additional license agreements with guaranteed minimum royalties in future periods for the brands.

Operating Income (loss). Total operating income for the Current Quarter was $12.1 million an increase of $608.0 million as compared to a loss of approximately $595.9 million in the Prior Year Quarter. Excluding trademark and goodwill impairment, total operating income was $16.5 million for the Current Quarter or 36% of total revenue as compared to total operating income of $29.7 million in the Prior Year Quarter or 56% of total revenue. Operating income from the women's segment was $3.2 million in the Current Quarter compared to a loss of $281.9 million Prior

Year Quarter. Excluding trademark & goodwill impairment and the loss on the termination of licenses, women's operating income in the Current Quarter was $7.6 million as compared to $19.0 million in the Prior Year Quarter. Operating income from the men's operating segment was $1.9 million in the Current Quarter compared to a loss of $132.2 million in the Prior Year Quarter. Excluding trademark & goodwill impairment and the loss on the termination of licenses, men's operating income in the Prior Year Quarter was $8.6 million. Operating income from the home segment was $3.6 million in the Current Quarter compared to a loss of $91.2 million in the Prior Year Quarter. Excluding trademark & goodwill impairment, home operating income in the Prior Year Quarter was $6.7 million. Operating income from the international segment was $9.2 million in the Current Quarter compared to a loss of $82.5 million in the Prior Year Quarter. Excluding trademark & goodwill impairment, international operating income in the Prior Year Quarter was $6.2 million. Corporate operating loss was $5.7 million in the Current Quarter compared to operating loss of $8.1 million in the Prior Year Quarter.

Other Expenses (income)-Net. Other expenses (income)- net was approximately income of $10.6 million for the Current Quarter as compared to an expense of $14.6 million for the Prior Year Quarter, a decrease of $25.2 million. The decrease was primarily related to (i) a gain of $17.2 million in the Current Quarter related to the mark-to-market adjustment from the Company's 5.75% Convertible Notes based on the Company's accounting treatment which requires the fair value of the debt at the end of each period and (ii) a gain in the Current Quarter of $8.4 million due to the consolidation of the Australia joint venture.

Provision for Income Taxes. The effective income tax rate for the Current Quarter is approximately 4.5% resulting in a $1.0 million income tax, as compared to an effective income tax rate of 4.9% in the Prior Year Quarter which resulted in a $29.6 million income tax benefit. The decrease in the effective tax rate for the Current Quarter as compared to the Prior Year Quarter is primarily a result of the benefit recognized from the trademark impairment charge of approximately $4.4 million which was significantly reduced due to a valuation allowance against the deferred tax asset.

Net Income (Loss) from Continuing Operations. Our net income from continuing operations was approximately $21.7 million in the Current Quarter, compared to a net loss of approximately $580.8 million in the Prior Year Quarter, as a result of the factors discussed above.

Discontinued Operations. In the three months ended March 31, 2017, our Board of Directors approved a plan to sell the businesses underlying the Entertainment segment. As a result, we have classified the results of our Entertainment segment as discontinued operations in our condensed consolidated statement of operations for all periods presented. On May 9, 2017, we signed a definitive agreement to sell these businesses and completed the sale on June 30, 2017. See Note 2 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q (this “Quarterly Report”).

Current Nine Months compared to Prior Year Nine Months

Licensing Revenue. Total revenue for the Current Nine Months was $145.0 million, a 16% decrease as compared to $173.5 million for the Prior Year Nine Months. Total licensing revenue was negatively impacted by approximately $2.0 million due to the deconsolidation of the SE Asia joint venture and was positively impacted by $0.4 million due to the consolidation of the Australia joint venture. The women’s segment decreased 37% from $76.8 million in the Prior Year Nine Months to $48.7 million in the Current Nine Months primarily due to a decrease in licensing revenue from our Mossimo, Danskin and Ocean Pacific brands as the brands transition from their historical DTR relationships. The men’s segment decreased 12% from $31.6 million in the Prior Year Nine Months to $27.8 million in the Current Nine Months mainly due to a decrease is our Starter brand somewhat offset by an increase in our Umbro brand. The home segment decreased 9% from $22.7 million in the Prior Year Nine Months to $20.5 million in the Current Nine Months mainly due to weakness in our Waverly brand. The international segment increased 13% from $42.5 million in the Prior Year Nine Months to $48.0 million in the Current Nine Months, mainly due to $2.8 million of replica jersey sales from our Diamond Icon joint venture. The Company generally does this as an accommodation to its licensees to consolidate ordering from the manufacturers. Refer to Note 3 of Unaudited Condensed Consolidated Financial Statements for details. Excluding this increase in licensing revenue for Diamond Icon and the impact of deconsolidating the SE Asia joint venture and consolidation of the Australia joint venture, Licensing Revenue from our international segment increased 11% due to strength in our business in China, Europe and India.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses (“SG&A”) were $92.4 million for the Current Nine Months as compared to $73.7 million for the Prior Year Nine Months, an increase of $18.7 million or 25%. SG&A in the Current Nine Months included an $8.2 million accounts receivable reserve for the impact of the Sears bankruptcy. Excluding the reserve for Sears, SG&A for the Current Nine Months was $84.3 million which is an increase of 14% over the Prior Year Quarter. SG&A from the women’s segment increased 61% from $7.5 million in the Prior Year Nine Months to $12.2 million in the Current Nine Months due to a $3.8 million increase in accounts receivables reserves and write-offs due to the Sears bankruptcy. Excluding Sears, SG&A in the women's segment decreased 13%. SG&A from the men's segment increased 22% from $11.1 million in the Prior Year Nine Months to $13.6 million in the Current Nine Months primarily due to a $1.9 million increase in advertising costs mostly related to the Starter, Umbro and Buffalo brands. SG&A from the home segment increased 85% from $2.5 million in the Prior Year Nine Months to $4.6 million in the Current Nine Months mainly due to a $1.8 million increase in accounts receivables reserves and write-offs due to the Sears bankruptcy. Excluding Sears, SG&A in the home segment decreased 17%. SG&A from the international segment increased 19% from $21.0 million in the Prior Year Nine Months to $24.9 million in the Current Nine Months mainly due to a $2.6 million increase in cost of goods sold due to replica jersey sales by our Diamond Icon joint venture. Refer to Note 3 of Unaudited Condensed Consolidated Financial Statements for details. Corporate SG&A increased 18% from $31.5 million in the Prior Year Nine Months to $37.1 million in the Current Nine Months primarily due to a $7.8 million increase in professional fees, mostly related to costs associated with the 5.75% convertible note.

Loss on Termination of Licenses. Loss on termination of licenses was $5.7 million for the Current Nine Months, compared to $26.0 million in the Prior Year Nine Months. The charge in the Current Nine Months was related to a litigation settlement with a previous licensee for the Rocawear brand while the Prior Year Quarter related to the transition of a new license for the Umbro brand.

Depreciation and Amortization. Depreciation and amortization was $1.8 million for the Current Nine Months, compared to $1.8 million in the Prior Year Nine Months.

Equity Earnings on Joint Ventures. Equity earnings on joint ventures was $2.2 million for the Current Nine Months, compared to $2.5 million for the Prior Year Nine Months. The decrease was mainly due to the consolidation of the Australia joint venture.

Gain on Deconsolidation of Joint Venture. Gain on deconsolidation of joint venture was zero for the Current Nine Months, compared to $3.8 million for the Prior Year Nine Months due to the deconsolidation of Southeast Asia joint venture.

Gain on Sale of Trademarks. Gain on Sale of Trademarks was $1.3 million for the Current Nine Months, compared to $0.9 million in the Prior Year Nine Months. The gain in the Current Nine Months was related to the completion of the sale of the Sharper Image and Badgley Mischka trademarks in certain of the Company's international joint ventures.

Trademark & Goodwill Impairment. Trademark & Goodwill Impairment loss for the Current Nine Months was approximately $115.5 million as compared to $625.5 in the Prior Year Nine Months. The Trademark Impairment in the Current Nine Months was $77.7 million, comprised of approximately $73.3 million related to a write-down in the Mossimo trademark and $4.4 million related to a write-down in the Joe Boxer trademark while the Trademark Impairment in the Prior Year Nine Months was approximately $521.7 million primarily related to a write-down in the women's segment and men's segment. The Goodwill Impairment in the Current Nine Months was $37.8 million related to a write-down in our women's segment as a result of the impairment of the Mossimo trademark while the Goodwill Impairment in the Prior Year Nine Months was $103.9 million. The trademark and goodwill impairment charges in the Current Nine Months are primarily related to a write-down in the Mossimo trademark as a result of the Company's revisions to its forecasted future earnings for the Mossimo brand. The trademark and goodwill impairment charges in the Prior Year Quarter are primarily related to a write-down in our women's segment and men's segment primarily due to declines in net sales in certain brands within the segments and an inability to secure additional license agreements with guaranteed minimum royalties in future periods for these brands.

Operating Income (loss). Total operating loss for the Current Nine Months was $66.9 million, compared to a loss of approximately $546.4 million in the Prior Year Nine Months. Excluding trademark and goodwill impairment and the loss on termination of licenses, total operating income was $54.2 million for the Current Nine Months or 37% of total revenue as compared to the total operating income of the Prior Year Nine Months of $105.1 million or 61% of total revenue. Operating loss from the women's segment was $77.8 million in the Current Nine Months compared to a loss of $232.3 million in the Prior Year Nine Months. Excluding trademark and goodwill impairment and the loss of termination of licenses, operating income from the women's segment was $37.7 million in the Current Nine Months as compared to income of $71.2 million in the Prior Year Nine Months. Operating income from the men's operating segment was $8.4 million in the Current Nine Months compared to a loss of $141.4 million in the Prior Year Nine Months. Excluding trademark and goodwill impairment and the loss of termination of licenses, operating income from the men's segment was $14.0 million in the Current Nine Months as compared to income of $20.0 million in the Prior Year Nine Months. Operating income from the home segment was $15.9 million in the Current Nine Months compared to a loss of $77.7 million in the Prior Year Nine Months. Excluding trademark and goodwill impairment, operating income from the home segment was $20.2 million in the Prior Year Nine Months. Operating income from the international segment was $23.8 million in the Current Nine Months compared to a loss of $67.0 million in the Prior Year Nine Months. Excluding trademark and goodwill impairment, operating income from the international segment was $21.7 million in the Prior Year Nine Months. Corporate operating loss was $37.2 million in the Current Nine Months compared to operating loss of $27.9 million in the Prior Year Nine Months.

Other Expenses (income)-Net. Other expenses (income)- net was approximately income of $44.0 million for the Current Nine Months as compared to an expense of $66.4 million for the Prior Year Nine Months, a decrease of $110.4 million. The decrease was primarily related to (i) a gain of $74.8 million in the Current Nine Months related to the mark-to-market adjustment from the Company's 5.75% Convertible Notes based on the Company's accounting treatment which requires the fair value of the debt at the end of each period, (ii) a gain on the extinguishment of debt of $4.5 million in the Current Year Nine Months as compared to a loss of $20.9 million in the Prior Year Nine Months and (iii) a gain of $8.4 million in the Current Year Nine Months due to the consolidation of the Australia joint venture.

Provision for Income Taxes. The effective income tax rate for the Current Nine Months is approximately 0.6% which resulted in a $0.1 million income tax benefit, as compared to an effective income tax rate of 4.8% in the Prior Year Nine Months which resulted in the $29.2 million income tax benefit. The decrease in the effective tax rate in the Current Nine Months as compared to the Prior Year Nine Months is primarily a result of the benefits recognized from the trademark and goodwill impairment charges which is being reduced by a valuation allowance against the impairment charges. Also, during the Prior Year Nine Months, the Company expensed approximately $2.0 million as a discrete item related to a change in estimate associated with certain state and local income tax audits.

Net Income Loss from Continuing Operations. Our net loss from continuing operations was approximately $22.8 million in the Current Nine Months, compared to a net loss from continuing operations of approximately $583.6 million in the Prior Year Nine Months, as a result of the factors discussed above.

Discontinued Operations. In the three months ended March 31, 2017, our Board of Directors approved a plan to sell the businesses underlying the Entertainment segment. As a result, we have classified the results of our Entertainment segment as discontinued operations in our condensed consolidated income statement for all periods presented. On May 9, 2017, we signed a definitive agreement to sell these businesses and completed the sale on June 30, 2017. See Note 2 to our condensed consolidated financial statements included in this report.

Liquidity and Capital Resources

Liquidity

Historically, our principal capital requirements have been to fund acquisitions, working capital needs, share repurchases and, to a lesser extent, capital expenditures. Since FY 2016, our principal capital requirements have been to refinance or extinguish existing indebtedness and working capital needs. We have historically relied on internally generated funds to finance our operations and our primary source of capital needs for acquisition has been the issuance of debt and equity securities. Since FY 2016, we have relied on asset sales and issuance of indebtedness to refinance existing indebtedness. At September 30, 2018 and December 31, 2017, our cash totaled $66.5 million and $65.9 million, respectively, not including short-term restricted cash of $21.2 million and $48.8 million, respectively. Our short term restricted cash primarily consists of collection and investment accounts related to our Securitization Notes. In addition, as of September 30, 2018, approximately $8.5 million, or 10%, of our total cash (including restricted cash) was held in foreign subsidiaries. As stated earlier, during the second fiscal quarter of 2018, the Company elected to treat its Luxembourg top tier subsidiary (“Luxco”) as a disregarded entity for US tax purposes. All the operations under LuxCo were previously treated as disregarded for US tax purposes. As of the election date, all the foreign operations under LuxCo will be treated as a branch for US tax purposes and subject to US taxation. As such, the Company will no longer have any earnings in foreign subsidiaries that are not currently subject to taxation for US purposes. Before the election, the Company was indefinitely reinvested in all earnings in its foreign subsidiaries.

The Company’s Securitization Notes include a test that measures the amount of principal and interest required to be paid on the Co-Issuers’ debt to the approximate cash flow available to pay such principal and interest; the test is referred to as the debt service coverage ratio (“DSCR”). As a result in the decline in royalty collections received by the Co-Issuers during the twelve months ended June 30, 2018, the DSCR fell below 1.45x as of June 30, 2018. Beginning July 1, 2018, the Co-Issuers are required to allocate 25% of residual royalty collections (i.e. collections less debt service, management, servicing, administrative and other fees) to a restricted reserve account administered by the securitization program’s trustee, which will result in cash remaining inside the securitization program. The DSCR fell below 1.35x as of September 30, 2018 and as a result, beginning October 1, 2018, the Co-Issuers are required to allocate 50% of residual royalty collections (i.e. collections less debt service, management, servicing, administrative and other fees) to a restricted reserve account administered by the securitization program’s trustee, which will result in cash remaining inside the securitization program and not being distributed to the Company. The cash required to be maintained inside the securitization program may be released to the Company if the DSCR is at least 1.45x for two consecutive quarters.

Due to certain developments during the year ended December 31, 2017, including the decision by Target Corporation not to renew the existing Mossimo license agreement following its expiration in October 2018 and by Walmart, Inc. not to renew the existing Danskin Now license agreement following its expiration in January 2019, and the Company’s revised projected future earnings, the Company had initially forecasted that it would unlikely be in compliance with certain of its financial debt covenants in 2018 and beyond and that it may otherwise face possible liquidity challenges in 2018 and beyond. As a result, the Company amended its Senior Secured Term Loan to provide relief under certain covenants and implemented a cost savings plan to improve liquidity.

Additionally, the Company considered Sears Holdings Corporation's bankruptcy filing on October 15, 2018 and determined that the bankruptcy filing does not currently expect it to have a material impact on the Company's ability to continue as a going concern. Refer to Note 4 and 22 for further details.

While conditions and events do exist that may raise substantial doubt about the Company's ability to continue as a going concern for the next twelve months, management believes as a result of implemented and planned cost savings, that its plans alleviate this substantial doubt, and therefore the management believes that it will continue as a going concern for the next twelve months.

For additional information, please refer to Note 1 of Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

We may, from time to time, seek to retire or repurchase our outstanding debt through cash purchases and/or exchanges for equity or debt securities, in open market transactions, privately negotiated transactions, or otherwise. Such repurchase or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved in any such transactions may individually or in the aggregate, be material.

Changes in Working Capital

At September 30, 2018 and December 31, 2017, the working capital ratio (current assets to current liabilities) was 1.72 to 1 and 2.07 to 1, respectively.

Operating Activities

Net cash provided by operating activities increased $53.6 million from net cash used in operating activities of $3.9 million in the Prior Year Nine Months to net cash provided by operating activities of $49.7 million in the Current Nine Months. The increase is primarily due to cash provided by working capital items of $18.9 million in the Current Nine Months as compared to cash used in working capital items of $50.4 million in the Prior Year Nine Months. Excluding non-cash items, net income decreased from $102.9 million in the Prior Year Nine Months to $30.8 million in the Current Nine Months which is primarily as a result of the decrease in total revenues period over period.

Investing Activities

Net cash used in investing activities increased approximately $335.8 million, from cash provided by investing activities of $328.5 million in the Prior Year Nine Months to cash used in investing activities of $7.3 million in the Current Nine Months. The increase between both periods is primarily due $336.7 million cash received in the Prior Year Nine Months associated with the sale of the Entertainment segment as compared to cash paid of $7.1 million associated with the Company's acquisition of the remaining ownership interest in Iconix Canada in the Current Nine Months.

Financing Activities

Net cash used in financing activities decreased approximately $254.4 million, from cash used in financing activities of $323.4 million in the Prior Year Nine Months to cash used in financing activities of $69.0 million in the Current Nine Months. The decrease between both periods is primarily due to the decrease in the cash used in the payment of long-term debt from $583.2 million in the Prior Year Nine Months to $145.7 million in the Current Nine Months offset by the proceeds received of $95.7 million in the Current Nine Months which represents the drawdown of the Company's Second Delayed Draw Term Loan as compared to $288.0 million in the Prior Year Nine Months which represents the proceeds received from the Company's Senior Secured Term Loan.

Other Matters

Critical Accounting Policies

The Company's consolidated financial statements are based on the accounting policies used. Certain accounting polices require that estimates and assumptions be made by management for use in the preparation of the financial statements. Critical accounting policies are those that are central to the presentation of the Company's financial condition and results and that require subjective or complex estimates by management. With the exception of the adoption of ASC 606 related to revenue recognition (refer to Note 3 in Notes to Condensed Consolidated Financial Statements), there have been no material changes with respect to the Company's critical accounting policies from those disclosed in its 2017 Annual Report on Form 10-K filed with the SEC on March 14, 2018.

Recent Accounting Pronouncements

See Note 20 of the notes to unaudited condensed consolidated financial statement for recent accounting pronouncements.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995. The statements that are not historical facts contained in this Quarterly Report are forward looking statements that involve a number of known and unknown risks, uncertainties and other factors, all of which are difficult or impossible to predict and many of which are beyond our control, which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. These risks are detailed in our Form 10-K for the fiscal year ended December 31, 2017 and other SEC filings. The words “believe,” “anticipate,” “expect,” “confident,” “project,” “provide,” “guidance” and similar expressions identify forward-looki statements. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date the statement was made.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We limit exposure to foreign currency fluctuations by requiring the majority of our licenses to be denominated in U.S. dollars. Certain other licenses are denominated in Euro. To mitigate interest rate risks, we have, from time to time, purchased derivative financial instruments such as forward contracts to convert certain portions of our revenue and cash received in foreign currencies to fixed exchange rates. If there were an adverse change in the exchange rate from Euro to U.S. Dollars of less than 10%, the expected effect on net income would be immaterial.

The effect, if any, of these transactions and activities on the trading price of our common stock will depend in part on market conditions and cannot be ascertained at this time, but any of these activities could adversely affect the value of our common stock.

Item 4. Controls and Procedures

The Company, under the supervision and with the participation of its management, including its principal executive officer and principal financial and accounting officer, evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, herein referred to as the Exchange Act) as of the end of the period covered by this Quarterly Report. The purpose of disclosure controls is to ensure that information required to be disclosed in our reports filed with or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls are also designed to ensure that such information is accumulated and communicated to our management, including our interim principal executive officer and interim principal financial officer, to allow timely decisions regarding required disclosure. In 2015, 2016 and 2017, material weaknesses were identified in certain of the Company’s review and other controls, which have been enumerated in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Addressing the Material Weaknesses

Material weaknesses identified in 2017, related to the financial reporting for reconsideration events of joint venture accounting and monitoring controls related to the identification of the need for a valuation allowance against certain deferred tax assets associated with the Company’s intangible asset impairment charges, were remediated at December 31, 2017. However, management concluded at December 31, 2017, that certain management review controls related to our statement of cash flows, our intangible asset impairment testing, the calculation of long term incentive program (“LTIP”) compensation expense, and the financial reporting for the modification of our debt were not adequate as the controls in place failed to detect certain material errors. In 2018, management identified a material weakness in internal control over financial reporting, specifically dealing with the management review controls surrounding the calculation of the adjustment to retained earnings resulting from the implementation of the new revenue recognition standard (ASC 606). In 2018, additional review procedures were performed by the former Senior Vice President-Finance and the former Chief Financial Officer until their departure, and are currently being performed by the Vice President – Controller, Senior Director of Financial Reporting and the Interim Chief Financial Officer and certain additional control procedures have been adopted to mitigate these material weaknesses.

We are in the process of remediating the above weaknesses and testing the operating effectiveness of the new and existing controls. The material weaknesses cannot be considered completely remediated until the applicable additional controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. As a result of the foregoing, the principal executive officer and the principal financial and accounting officer concluded that as of September 30, 2018, certain of the Company’s disclosure controls and procedures, including management review controls related to our statement of cash flows, our intangible asset impairment testing, calculation of LTIP compensation expense, and the financial reporting for the modification of our debt were not effective in timely alerting them to material information required to be included in our periodic SEC filings and ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms.

Notwithstanding the discussion above, our principal executive officer and principal financial and accounting officer have concluded that the financial statements included in this Quarterly Report present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States.

The principal executive officer and principal financial officer also conducted an evaluation of internal control over financial reporting, herein referred to as internal control, to determine whether any changes in internal control occurred during the six months ended June 30, 2018, that may have materially affected, or which are reasonably likely to materially affect internal control. Based on that evaluation, there has been no change in the Company's internal control during the nine months ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control, except for the matters discussed above.

The foregoing has been approved by our management team, including our Interim Chief Executive Officer and Interim Chief Financial Officer, who have been involved with the reassessment and analysis of our internal control over financial reporting.

The Audit Committee, which consists of independent, non-executive directors, will continue to meet regularly with management, the Director of Internal Audit, and the independent accountants to review accounting, reporting, auditing and internal control matters. The Audit Committee has direct and private access to the Director of Internal Audit and the external auditors, and will meet with each, separately, in executive sessions. The Company reviewed the results of management's assessment of its internal control over financial reporting with the Audit Committee of the Board of Directors and they agreed with the conclusions.

PART II. Other Information

Item 1. Legal Proceedings.

On May 1, 2017, 3TAC, LLC, referred to as 3TAC, a former licensee of the Company, and West Loop South, LLC, referred to as West Loop (3TAC and West Loop collectively referred to as Plaintiffs), filed a second amended complaint against the Company, its affiliate, IP Holdings Unltd., LLC, referred to as IPHU, and the Company's former CEO, Neil Cole (the Company, IPHU, and Cole are collectively referred to as the Iconix Parties), in the action captioned 3TAC, LLC and West Loop South, LLC v. Iconix Brand Group, Inc.,IP Holdings Unltd, LLC and Neil Cole, Case No. 16-cv-08795-GBD-RWL in the United States District Court for the Southern District of New York. Plaintiffs asserted claims for breach of contract, tortious interference with contract and business relations, unjust enrichment, trade libel, unfair competition and prima facie tort relating to the Iconix Parties' alleged breach of a Global License Agreement, as amended, between 3TAC and IPHU concerning intellectual property rights in and to the Marc Ecko brands, the Iconix Parties' alleged interference with 3TAC's performance thereunder, and the Iconix Parties' alleged interference with a related sublicense between 3TAC and West Loop. On October 27, 2017, Judge Katherine B. Forrest granted the Iconix Parties' motion to dismiss Plaintiffs' unjust enrichment, trade libel, unfair competition and prima facie tort claims. Plaintiffs filed a Third Amended Complaint on June 11, 2018, in which no new claims were asserted, and the only additional allegations are related to the allegedly "inconsistent" exclusive license of New Rise Brand Holdings, LLC. Plaintiffs seek damages of at least $22 million for their remaining claims as well as punitive damages, attorneys' fees and costs. The Iconix Parties are vigorously defending against the remaining claims. At this time, the Company is unable to estimate the ultimate outcome of this matter.

On November 1, 2017, Seth Gerszberg and EGRHC, LLC, collectively referred to as Plaintiffs, (EGRHC, LLC suing in its capacity as a successor-in-interest to Suchman, LLC, referred to as Suchman, a company wholly-owned by Gerszberg that entered into a joint venture with the Company pursuant to which they formed IP Holdings Unltd., LLC, referred to as IPHU), filed an action captioned Gerszberg and EGRHC, LLC v. Iconix Brand Group, Inc., IP Holdings Unltd, LLC and Neil Cole, Case No. 17-cv-08421-GBD-RWL in the United States District Court for the Southern District of New York. Plaintiffs asserted claims against the Company, IPHU, and Neil Cole (collectively referred to as the Iconix Parties) for breach of IPHU's Operating Agreement and related breaches of fiduciary duties, breach of an agreement pursuant to which the Company bought out Suchman's interest in IPHU and fraudulent inducement and unjust enrichment regarding that buyout agreement; and also asserted claims for fraudulent inducement regarding the fourth amendment of the Global License Agreement between 3TAC, LLC and IPHU concerning the intellectual property rights in and to the Marc Ecko brands. On May 7, 2018, Judge Katherine B. Forrest dismissed the breach of fiduciary duty, breach of the IPHU Operating Agreement, and unjust enrichment claims, based largely upon a release provision in the buyout agreement. Further, the court narrowed the remaining claims in the following manner: limiting the fraudulent inducement claim to the fourth amendment to the Global License Agreement (ruling that the fraudulent inducement claim as to the buyout agreement was released), and limiting the breach of the buyout agreement claim to the government investigation representation. Plaintiffs seek more than $100 million in damages, including compensatory and punitive damages, disgorgement and restitution. The Iconix Parties are vigorously defending against the remaining claims asserted by Plaintiffs. At this time, the Company is unable to estimate the ultimate outcome of this matter.

In April 2016, New Rise Brands Holdings, LLC, referred to as New Rise, a former licensee of the Ecko Unlimited trademark, and Sichuan New Rise Import & Export Co. Ltd., referred to as Sichuan, the guarantor under New Rise's license agreement, commenced an action captioned New Rise Brands Holdings, LLC and Sichuan New Rise Import & Export Co. Ltd v. IP Holdings Unltd, LLC, et al., Index No. 652278/2016 in the New York State Supreme Court, New York County against the Company's subsidiary, IP Holdings Unltd, LLC, referred to as IP Holdings, seeking damages of at least $15 million, plus punitive damages of $50 million, counsel fees and costs. Among other claims, New Rise and Sichuan allege improper termination of New Rise's license agreement, fraud and misappropriation. On September

21, 2018, New Rise and Sichuan served an expert report claiming damages ranging from $15.6 million to $44.2 million. IP Holdings is vigorously defending against the claims and has asserted counterclaims against New Rise and Sichuan. At this time, the Company is unable to estimate the ultimate outcome of this matter.

Two shareholder derivative complaints captioned James v. Cuneo et al, Docket No. 1:16-cv-02212 and Ruthazer v. Cuneo et al, Docket No. 1:16-cv-04208 have been consolidated in the United States District Court for the Southern District of New York, and three shareholder derivative complaints captioned De Filippis v. Cuneo et al. Index No. 650711/2016, Gold v. Cole et al, Index No. 53724/2016 and Rosenfeld v. Cuneo et al., Index No. 510427/2016 have been consolidated in the Supreme Court of the State of New York, New York County. The complaints name the Company as a nominal defendant and assert claims for breach of fiduciary duty, insider trading and unjust enrichment against certain of the Company's current and former directors and officers arising out of the Company's restatement of financial reports and certain employee departures. At this time, the Company is unable to estimate the ultimate outcome of these matters.

The Company continues to cooperate in the previously disclosed SEC investigation.

Three securities class actions have been consolidated in the United States District Court for the Southern District of New York, under the caption In re Iconix Brand Group, Inc., et al., Docket No. 1:15-cv-4860, against the Company and certain former officers and one current officer (the "Class Action"). The plaintiffs in the Class Action purport to represent a class of purchasers of the Company's securities from February 22, 2012 to November 5, 2015, inclusive, and claim that the Company and individual defendants violated sections 10(b) and 20(a) of the Exchange Act, by making allegedly false and misleading statements regarding certain aspects of the Company's business operations and prospects. On October 25, 2017, the Court granted the motion to dismiss the consolidated amended complaint filed by the Company and the individual defendants with leave to amend. On November 14, 2017, the plaintiffs filed a second consolidated amended complaint. On February 2, 2018, the defendants moved to dismiss the second consolidated amended complaint. The Company and the individual defendants intend to vigorously defend against the claims. At this time, the Company is unable to estimate the ultimate outcome of these matters.

From time to time, the Company is also made a party to litigation incurred in the normal course of business. In addition, in connection with litigation commenced against licensees for non-payment of royalties, certain licensees have asserted unsubstantiated counterclaims against the Company. While any litigation has an element of uncertainty, the Company believes that the final outcome of any of these routine matters will not, individually or in the aggregate, have a material effect on the Company's financial position or future liquidity.

Item 1A. Risk Factors.

In addition to the risk factors disclosed in Part 1, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2017, set forth below are certain factors that have affected, and in the future could affect, our operations or financial condition. We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could impact our operations. The risks described below and in our Annual Report on Form 10-K for the year ended December 31, 2017, are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our financial condition and/or operating results.

Our existing and future debt obligations could impair our liquidity and financial condition, and in the event we are unable to meet our debt obligations we could lose title to certain trademarks.

As of September 30, 2018, the Company's consolidated balance sheet reflects debt of approximately $691.6 million (which is net of $5.5 million of debt issuance costs), including (i) secured debt of $641.3 million comprised of our Series 2012-1 4.229% Senior Secured Notes, Class A-2, Series 2013-1 4.352% Senior Secured Notes and Class A-2 (collectively, the "Senior Secured Notes") of $376.2 million, Variable Funding Notes of $94.3 million and Senior Secured Term Loan of $170.9 million, and (ii) $55.9 million net debt carrying value of our 5.75% Convertible Notes; however, the principal amount owed to the holders of our 5.75% Convertible Notes, was $111.0 million as of such date. In accordance with ASC 825, our 5.75% Convertible Notes are included in our $691.6 million of consolidated debt at a fair value of $55.9 million. We may also assume or incur additional debt, including secured debt, in the future in connection with, or to fund, future acquisitions or refinance our existing debt obligations. Our outstanding debt obligations:

- could impair our liquidity;
- could make it more difficult for the Company to satisfy its other obligations;
- require us to dedicate a substantial portion of our cash flow to payments on our debt obligations, which reduces the availability of our cash flow to fund working capital, capital expenditures and other corporate requirements;
- could impede us from obtaining additional financing in the future for working capital, capital expenditures, acquisitions and general corporate purposes;
-

impose restrictions on us with respect to the use of our available cash, including in connection with future acquisitions;

- make us more vulnerable in the event of a downturn in our business prospects and could limit our flexibility to plan for, or react to, changes in our licensing markets; and
- could place us at a competitive disadvantage when compared to our competitors who have less debt and/or less leverage.

In addition, as of September 30, 2018, approximately $8.5 million, or 10%, of the Company's total cash (including restricted cash) was held in foreign subsidiaries.

In the event that we are unable to raise the additional financing referenced above, or we fail to make any required payment under agreements governing our indebtedness or fail to comply with the financial and operating covenants contained in those agreements, we would be in default regarding that indebtedness. A debt default could significantly diminish the market value and marketability of our common stock, result in the acceleration of the payment obligations under all or a portion of our consolidated indebtedness and impact the Company’s ability to continue as a going concern.

A substantial portion of our licensing revenue is concentrated with a limited number of licensees, such that the loss of any of such licensees or their renewal on terms less favorable than today, could slow our growth plans, decrease our revenue and impair our cash flows.

Our licenses with Walmart, Target, Kohls, Kmart/Sears and Global Brands Group represent, each in the aggregate, our five largest licensees during the three-month period ended September 30, 2018, representing approximately 2%, 7%, 10%, 8% and 6%, respectively, of our total revenue for such period.

Because we are dependent on these licensees for a significant portion of our licensing revenue, if any of them were to have financial difficulties affecting their ability to make payments, cease operations, or if any of these licensees decides not to renew or extend any existing agreement with us, or to significantly reduce its sales of licensed products under any of the agreement(s), our revenue and cash flows could be reduced substantially.

As previously disclosed, the Company was notified of the following non-renewals of license agreements: (i) the OP and Starter DTR license agreements with Walmart, (ii) the Mossimo DTR license agreement with Target, (iii) the Danskin Now DTR license agreement with Walmart, (iv) the Royal Velvet license agreement with J.C. Penney’s and (v) the Material Girl DTR license agreement with Macy’s. While the Company is actively working to place these brands with other licensees, the failure to enter into replacement license agreements for these brands on economic terms similar to such DTR arrangements may adversely affect our future revenues and cash flows.

In addition, we may face increasing competition in the future for direct-to-retail licenses as other companies owning established brands may decide to enter into licensing arrangements with retailers similar to those we currently have in place. Furthermore, our current or potential direct-to-retail licensees may decide to more prominently promote and market competing brands, or develop or purchase other or establish their own brands, rather than continue their licensing arrangements with us. In addition, increased competition could result in lower sales of products offered by our direct-to-retail licensees under our brands. If our competition for retail licenses increases, it may take us longer to procure additional retail licenses.

We have a material amount of goodwill and other intangible assets, including our trademarks, recorded on our balance sheet. As a result of changes in market conditions and declines in the estimated fair value of these assets, we may, in the future, be required to further write down a portion of this goodwill and other intangible assets and such write-down would, as applicable, either decrease our net income or increase our net loss.

As of September 30, 2018, goodwill represented approximately $26.1 million, or approximately 4% of the Company’s total consolidated assets, and trademarks and other intangible assets represented approximately $397.7 million, or approximately 56% of our total consolidated assets. Under current U.S. GAAP accounting standards, goodwill and indefinite life intangible assets, including most of our trademarks, are no longer amortized, but instead are subject to impairment evaluation based on related estimated fair values, with such testing to be done at least annually.

There can be no assurance that any future downturn in the business of any of the Company’s segments, or a continued decrease in our market capitalization, will not result in a further write-down of goodwill or trademarks, which would either decrease the Company’s net income or increase the Company’s net loss, which may or may not have a material impact to the Company's consolidated statement of operations.

The risks described herein and in the Company's Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company, or that are currently deemed to be immaterial, also may materially adversely affect the Company's business, financial condition and/or future operating results.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There have been no sales of unregistered equity securities in the Current Quarter.

The following table presents information with respect to purchases of common stock made by the Company during the Current Quarter:

Month of purchase	Total number of shares purchased*	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
July 1 - July 31	—	$ —	—	$ —
August 1 - August 31	—	$ —	—	$ —
September 1 - September 30	3,456	$ 0.35	—	$ —
Total	3,456	$ 0.35	—	$ —

* Amounts not purchased under the repurchase plan represent shares surrendered to the Company to pay withholding taxes due upon the vesting of restricted stock.

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Item 6. Exhibits

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
Exhibit 10.1	Amendment No. 1, dated as of September 14, 2018, to Employment Agreement of F. Peter Cuneo+***
Exhibit 10.2	Employment Agreement entered into October 15, 2018 by and between Iconix Brand Group, Inc. and Robert C. Galvin+**
Exhibit 10.3	Employment Agreement entered into October 15, 2018 by and between Iconix Brand Group, Inc. and F. Peter Cuneo+**
Exhibit 31.1	Certification of Chief Executive Officer Pursuant To Rule 13a-14 or 15d-14 of The Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002*
Exhibit 31.2	Certification of Interim Chief Financial Officer Pursuant To Rule 13a-14 or 15d-14 of The Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002*
Exhibit 32.1	Certification of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002*
Exhibit 32.2	Certification of Interim Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002*
Exhibit 101.INS	XBRL Instance Document*
Exhibit 101.SCH	XBRL Schema Document*
Exhibit 101.CAL	XBRL Calculation Linkbase Document*
Exhibit 101.DEF	XBRL Definition Linkbase Document*
Exhibit 101.LAB	XBRL Label Linkbase Document*
Exhibit 101.PRE	XBRL Presentation Linkbase Document*

*Filed herewith.
**Filed as an exhibit to the Company’s Current Report on Form 8-K for the event dated October 15, 2018 and incorporated by reference herein.
***Filed as an exhibit to the Company’s Current Report on Form 8-K for the event dated September 14, 2018 and incorporated by reference herein.
+Denotes management compensation plan or arrangement.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Iconix Brand Group, Inc. (Registrant)
Date: November 9, 2018	/s/ Robert C. Galvin Robert Galvin President and Chief Executive Officer (Principal Executive Officer)
Date: November 9, 2018	/s/ Jeffrey N. Wood Jeffrey N. Wood Senior Vice President and Interim Chief Financial Officer (Principal Financial and Accounting Officer)

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