

ENVOY COMMUNICATIONS GROUP INC

Form 6-K

June 05, 2002

MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Six months ended March 31, 2002 compared with six months ended March 31, 2001.

Net Revenue

Net revenue for the six months ending March 31, 2002 was \$30.7 million compared to \$42.2 million for the six months ended March 31, 2001, representing a decrease of \$11.5 million or 27%. The decrease in revenue results from a combination of general economic slowdown in the North American and the U.K. marketplace as well as a specific slowdown within the advertising and technology markets, particularly in New York. Our revenue from marketing activities decreased \$6.7 million from \$14.3 million to \$7.6 million. The largest portion of this decrease being a decline in revenue in New York of \$5.8 million and a further decrease of approximately \$1.0 million in revenue relating to Canadian marketing. Technology revenue decreased \$3.2 million from \$8.8 million to \$5.6 million. Again the reduction in revenue relates largely to the decline in business in our New York operations. Net revenue from design services decreased \$1.7 million from \$19.2 million to \$17.5 million.

In the six months ended March 31, 2002, net revenue from marketing represented approximately 25% of our net revenue, while technology and design represented 18% and 57% respectively. In the six months ended March 31, 2001, marketing represented approximately 34% of net revenue, while technology and design represented 21% and 45% respectively.

The geographical breakdown of our net revenue for the six months ended March 31, 2002 was 38% from the United States, 23% from the United Kingdom and Continental Europe, and 39% from Canada. Net revenue for the six months ended March 31, 2001 was 49% from the United States, 22% from the United Kingdom and Continental Europe and 29% from Canada.

EBITDA before Goodwill write-down, Restructuring costs and Unusual item

For the six months ended March 31, 2002, we had an EBITDA loss, before goodwill write-down, restructuring costs and unusual item of (\$2.8) million and for the six months ended March 31, 2001, we earned \$7.5 million in EBITDA.

Operating Expenses

Operating expenses for the six months ended March 31, 2002 was \$33.5 million compared to \$34.7 million for the six months ended March 31, 2001, representing a decrease of \$1.3 million.

Salaries and benefits expense remained consistent at \$25.3 million for the six months ended March 31, 2002 and 2001. In response to the significant decrease in revenue experienced by the Company during the first six months of the year, management implemented a plan to reduce salary and benefit expense during the

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second quarter. As a result of this downsizing a saving of approximately \$14.5 million in annual salary and benefit expenses will be realized. Management believes that the ongoing salary and benefit expenses will be more in line with expected revenues.

General and administrative expenses for the six months ended March 31, 2002, was \$5.7 million compared to \$7.2 million for the six months ended March 31, 2001, representing a decrease of \$1.5 million. The decrease in general and administrative expenses were largely due to reduced expenditures in the area of marketing and promotion, shareholder relations as well as reduced expenditures associated with reduced level of revenue.

Occupancy costs for the six months ended March 31, 2002 was \$2.5 million compared to \$2.3 million for the six months ended March 31, 2001. Management has accrued for the anticipated costs of restructuring certain US leases in this quarter and continues to look at ways to reduce its occupancy expenses by subleasing redundant office space.

Interest charges for the six months ended March 31, 2002, was \$340,682 compared to in \$370,281 in the six months ended March 31, 2001. The slight decrease in interest charges was due to lower interest rates offset by additional interest expense relating to the amortization of deferred financing costs, which are recorded as interest expense.

Restructuring costs for the six months ended March 31, 2002, was \$7.3 million. In response to general economic downturn impacting our business, management implemented a restructuring plan during the first half of this fiscal year in order to bring costs more in line with the expected revenues. See Note 1 to the consolidated financial statements.

Unusual item for the six months ended March 31, 2002, was \$752,000. The unusual item represents the write off of unamortized financing fees incurred in connection with the credit facility. See Note 2 to the consolidated financial statements.

The above factors resulted in a decrease in our earnings before income taxes and goodwill amortization from \$5.6 million in 2001 to a loss of (\$4.6) million in 2002.

Goodwill amortization increased from \$1.5 million to \$1.8 million due to increased amount of goodwill derived from acquisitions and earnout payments. In the second quarter of 2002, a \$28.4 million write-down of goodwill was recorded, as discussed in Note 1 to the consolidated financial statements.

Net Earnings (Loss)

As a result of the foregoing factors, we had a net loss of (\$37.6) million for the six months ended March 31, 2002, compared to net earnings of \$1.6 million for the six months ended March 31, 2001.

Per Share Amounts

The per share amounts are as follows: for the six months ended March 31, 2002, the fully diluted EBITDA loss before goodwill write-down, restructuring, and unusual item per share was (\$0.13), the fully diluted earnings (loss) before amortization and write-off of goodwill per share was (\$0.36) and the fully diluted net earnings (loss) per share was (\$1.80). For the six months ended March 31, 2001, the fully diluted EBITDA per share was \$0.35, the fully

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diluted earnings before goodwill amortization per share was \$0.15 and the fully diluted net earnings per share was \$0.08.

Cash Flows

Net cash provided by (used in) operating activities before any increase/decrease in non-cash operating working capital was (\$7.3) million for the six months ended March 31, 2002, and \$4.9 million for the six months ended March 31, 2001. Decrease in net cash provided by operating activities is primarily due to decreased earnings, offset by the write-down of goodwill, as discussed previously.

Net cash used in financing activities was (\$263,874) for the six months ended March 31, 2002 and net cash used in financing activities was (\$5.4) million for the six months ended March 31, 2001. The decrease is primarily due to the increase in debt in the current period reduced by the redemption of common shares.

Net cash used in investing activities was (\$855,571) for the six months ended March 31, 2002 and (\$3,456,789) for the six months ended March 31, 2001. The decrease is primarily due to fewer payments related to acquired businesses and a decrease in the purchase of capital assets.

RESULTS OF OPERATIONS

Three months ended March 31, 2002 compared with three months ended March 31, 2001

Net Revenue

Net revenue for the three months ending March 31, 2002 was \$14.0 million compared to \$20.4 million in the three months ended March 31, 2001, representing a decrease of \$6.4 million or 31%. The explanations for the decreases are the same as previously discussed in the six month comparison.

EBITDA before Goodwill write-down, Restructuring costs and Unusual item

For the three months ended March 31, 2002, we had an EBITDA loss before goodwill write-down, restructuring costs and unusual item, of (\$2.5) million and for the three months ended March 31, 2001, we earned \$3.1 million in EBITDA.

Operating Expenses

Operating expenses for the three months ended March 31, 2002 were \$16.6 million, compared to \$17.4 million for the three months ended March 31, 2001, representing a decrease of \$780,000. As discussed previously above in the six-month comparison, management implemented a restructuring plan primarily enacted during the first half of this fiscal year, see Note 1 to the consolidated financial statements.

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Net Earnings (Loss)

As a result of the restructuring charges and goodwill write-downs noted above, we had a net loss of (\$35.8) million for the three months ended March 31, 2002, compared to net earnings of \$531,972 for the three months ended March 31, 2001.

Per Share Amounts

The per share amounts are as follows: for the three months ended March 31, 2002, the fully diluted EBITDA loss before goodwill write-down, restructuring and unusual item per share was (\$0.12), the fully diluted earnings (loss) before goodwill per share was (\$0.31) and the fully diluted net earnings (loss) per share was (\$1.71). For the three months ended March 31, 2001, the fully diluted EBITDA per share was \$0.15, the fully diluted earnings before goodwill per share was \$0.06 and the fully diluted net earnings per share was \$0.03.

Cash Flows

Net cash used in operating activities before any increase/decrease in non-cash operating working capital was (\$6.3) million for the three months ended March 31, 2002 and \$2.2 million for the three months ended March 31, 2001. Decrease in net cash provided by operating activities is primarily due to decreased earnings offset by the write down of goodwill.

Net cash provided by (used in) financing activities was (\$105,204) for the three months ended March 31, 2002 compared with a use of (\$4.0) million for the three months ended March 31, 2001. The use of cash in the current period relates to a repayment of long-term debt.

Cash used from investing activities for the three months ended March 31, 2002 was \$544,000, compared with \$2.8 million for the three months ended March 31, 2001. The use of cash relates to the purchase of capital assets and the payment of contingent consideration relating to prior acquisitions.

Financial Condition and Liquidity

As at March 31, 2002 compared to September 30, 2001

As at March 31, 2002 the Company had a working capital deficit of (\$7.3) million compared with a working capital deficit of (\$429,933) at September 30, 2001. This working capital deficiency arises due to the fact that the borrowings under the bank credit facility must be classified as a current liability as a result of the Company not being in compliance with one of its covenants. The decrease in working capital in this period is primarily the result of the operating loss during this period.

On April 29, 2002, as disclosed in Note 4 of the consolidated financial statements, the Company issued \$1.8 million in convertible debentures. The net proceeds from the sale of the debentures were used for general working capital purposes to support the Company's restructuring activities. During fiscal 2001, the Company established an extendable revolving line of credit under which it can borrow funds in either Canadian dollars, U.S. dollars or U.K. Pounds Sterling, provided the aggregate borrowings do not exceed \$40.0 million Canadian. Advances under the line of credit can be used for general

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purposes (to a maximum of \$2.0 million), and financing acquisitions which have been approved by the lenders. As at March 31, 2002 approximately \$9.8 million has been borrowed under the facility, none of which is for general corporate purposes.

As at March 31, 2002 and September 30, 2001, the Company was not in compliance with its covenant calculations involving trailing 12 month earnings before interest, taxes, depreciation and amortization. As the lenders have the right to demand repayment of the outstanding borrowings if the covenants are not met, the entire amount of the debt is classified as a current liability. The Company is continuing to have discussions with its lenders regarding the amendments to the terms of the facility. The lenders have indicated additional borrowings under the facility will not be permitted without their prior approval, other than the \$2.0 million available for general corporate purposes.

Historically the Company has funded its liquidity needs through funds provided from operating activities, equity offerings and long term borrowings. Management believes that it has a number of options available to finance the repayment of the non-interest bearing promissory notes due on June 30, 2002, amounts owing under the restructuring plans and expected cashflow shortfalls (or other operating obligations). These options include, additional debt or equity financing under private placements, renegotiating its bank credit facilities, renegotiating the payment terms of its promissory note, and the sale of some of its businesses. In addition, management has made every effort to negotiate the restructuring charges in such a way as to minimize the short term cash requirements.

ENVOY COMMUNICATIONS GROUP INC.
CONSOLIDATED BALANCE SHEETS
(In Canadian dollars)
(Unaudited - Prepared by Management)

| As at | March 31 2002 | September 30 2001 |
|--------------------------|------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$ 2,844,716 | \$21,781,809 |
| Restricted cash | 618,666 | 158,500 |
| Accounts receivable | 26,120,211 | 26,940,137 |
| Income taxes recoverable | 3,434,479 | 230,389 |
| Future income taxes | 2,105,000 | 712,000 |
| Prepaid expenses | 1,479,500 | 1,315,009 |
| | 36,602,572 | 51,137,844 |
| Capital assets | 9,997,999 | 11,533,736 |
| Goodwill | 20,571,003 | 49,675,115 |
| Other assets | - | 681,387 |
| Future income taxes | 1,677,869 | 822,156 |
| | \$ 68,849,444 | \$ 113,850,238 |

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Liabilities and Shareholders' Equity

Current liabilities:

| | | |
|--|---------------|---------------|
| Accounts payable and accrued liabilities | \$ 26,183,553 | \$ 38,728,210 |
| Deferred revenue | 1,020,443 | 300,071 |
| Amounts collected in excess of pass-through costs incurred | 5,200,634 | 1,574,407 |
| Bank credit facility and current portion of long-term debt (Note 2a) | 11,458,548 | 10,965,089 |
| | 43,863,179 | 51,567,777 |

| | | |
|---|-----------|---------|
| Long-term debt (Note 2a) | 833,826 | 963,076 |
| Long-term portion of restructuring costs (Note 1) | 1,101,231 | - |
| | 1,935,057 | 963,076 |

Shareholders' equity:

| | | |
|-----------------------------------|---------------|----------------|
| Share Capital | 54,468,380 | 54,883,305 |
| Retained earnings (Deficit) | (32,033,109) | 5,603,200 |
| Cumulative translation adjustment | 615,937 | 832,880 |
| | 23,051,208 | 61,319,385 |
| | \$ 68,849,444 | \$ 113,850,238 |

ENVOY COMMUNICATIONS GROUP INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT / RETAINED EARNINGS
(In Canadian dollars)
(Unaudited - Prepared by Management)

| | | |
|--------------------------|------------------|------------------|
| For the six months ended | March 31 2002 | March 31 2001 |
|--------------------------|------------------|------------------|

| | | |
|-------------|---------------|---------------|
| Net revenue | \$ 30,655,912 | \$ 42,206,388 |
|-------------|---------------|---------------|

Operating expenses:

| | | |
|----------------------------|------------|------------|
| Salaries and benefits | 25,296,931 | 25,271,455 |
| General and administrative | 5,665,989 | 7,168,230 |
| Occupancy costs | 2,487,111 | 2,258,223 |
| | 33,450,031 | 34,697,908 |

Earnings (loss) before interest expense,
income taxes, depreciation, goodwill,

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| | | |
|---|-----------------|---------------|
| amortization and write-down, restructuring costs and unusual item | (2,794,119) | 7,508,480 |
| Depreciation | 1,506,752 | 1,504,762 |
| Interest expense | 340,682 | 370,281 |
| ----- | | |
| Earnings (loss) before income taxes and goodwill amortization and write-down | (4,641,553) | 5,633,437 |
| Restructuring costs and unusual item (Note 1) | 8,024,442 | - |
| Income tax expense (recovery) | (5,207,003) | 2,536,201 |
| ----- | | |
| Earnings (loss) before goodwill amortization and write-down | (7,458,993) | 3,097,236 |
| Goodwill amortization, net of income taxes of \$12,000 (2001-\$12,000) | 1,751,050 | 1,481,016 |
| Write-down of Goodwill (Note 1) | 28,426,266 | - |
| ----- | | |
| Net earnings (loss) | \$ (37,636,309) | \$ 1,616,220 |
| Retained earnings, beginning of period | 5,603,200 | 8,403,367 |
| ----- | | |
| Retained earnings (deficit), end of period | \$ 32,033,109) | \$ 10,019,587 |
| ----- | | |
| Net earnings (loss) per share - basic | \$ (1.80) | \$ 0.08 |
| Net earnings (loss) per share - fully diluted | (1.80) | 0.08 |
| Earnings (loss) per share before goodwill amortization and write-down - basic | (0.36) | 0.15 |
| Earnings (loss) per share before goodwill amortization and write-down- fully diluted | (0.36) | 0.15 |
| Weighted average number of common shares outstanding | 20,910,136 | 21,190,401 |

See accompanying notes to consolidated financial statements.

ENVOY COMMUNICATIONS GROUP INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT / RETAINED EARNINGS
(In Canadian dollars)
(Unaudited - Prepared by Management)

| | | |
|----------------------------|------------------|------------------|
| For the three months ended | March 31 2002 | March 31 2001 |
| ----- | | |
| Net revenue | \$ 14,035,676 | \$ 20,430,030 |
| Operating expenses: | | |

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| | | |
|--|-----------------|------------|
| Salaries and benefits | 12,127,253 | 13,061,386 |
| General and administrative | 3,294,088 | 3,123,478 |
| Occupancy costs | 1,156,600 | 1,170,912 |
| | ----- | ----- |
| | 16,577,941 | 17,355,776 |
| | ----- | ----- |
| Earnings (loss) before interest expense, income taxes, depreciation, goodwill amortization and write-down, restructuring costs and unusual item | (2,542,265) | 3,074,254 |
| Depreciation | 759,810 | 794,272 |
| Interest expense | 150,119 | 137,038 |
| | ----- | ----- |
| Earnings (loss) before income taxes and goodwill amortization | (3,452,195) | 2,142,944 |
| Restructuring costs and unusual item (Note 1) | 7,638,442 | - |
| Income tax expense (recovery) | (4,666,213) | 860,823 |
| | ----- | ----- |
| Earnings (loss) before goodwill amortization and write-down | (6,424,425) | 1,282,121 |
| Goodwill amortization, net of income taxes of \$6,000 (2001-\$6,000) | 955,637 | 750,149 |
| Write-down of Goodwill (Note 1) | 28,426,266 | - |
| | ----- | ----- |
| Net earnings (loss) | \$ (35,806,327) | \$ 531,972 |
| | ----- | ----- |
| Net earnings (loss) per share - basic | \$(1.71) | \$0.03 |
| Net earnings (loss) per share - fully diluted | (1.71) | 0.03 |
| Earnings (loss) per share before goodwill amortization and write-down - basic | (0.31) | 0.06 |
| Earnings (loss) per share before goodwill amortization and write-down- fully diluted | (0.31) | 0.06 |
| | ----- | ----- |
| Weighted average number of common shares outstanding | 20,892,584 | 21,192,462 |

See accompanying notes to consolidated financial statements.

ENVOY COMMUNICATIONS GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(In Canadian dollars)
(Unaudited-Prepared by Management)

| | | |
|--------------------------|------------------|------------------|
| For the six months ended | March 31 2002 | March 31 2001 |
|--------------------------|------------------|------------------|

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Cash flows from operating activities:

| | | |
|---------------------|-----------------|--------------|
| Net earnings (loss) | (\$ 37,636,309) | \$ 1,616,220 |
|---------------------|-----------------|--------------|

Items not involving cash:

| | | |
|--|-------------|-----------|
| Future income tax expense (recovery) | (2,248,713) | 287,514 |
| Depreciation | 1,506,752 | 1,504,762 |
| Goodwill amortization | 1,763,050 | 1,493,016 |
| Amortization of deferred financing charges | 91,347 | - |
| Write-down of capital assets | 843,219 | - |
| Write-down of goodwill | 28,426,266 | - |

Net changes in non-cash working capital balances:

| | | |
|---|--------------|-------------|
| Restricted cash | (460,166) | - |
| Accounts receivable | 1,166,808 | 1,347,116 |
| Prepaid expenses | (144,491) | (1,704,099) |
| Accounts payable and accrued liabilities | (12,802,612) | 12,915,584 |
| Income taxes (recoverable) payable | (3,243,219) | 283,708 |
| Deferred revenue | 720,372 | (374,719) |
| Amounts collected in excess of pass-through costs incurred | 2,920,598 | 364,174 |
| Long-term restructuring costs | 1,101,231 | - |
| Other | 590,040 | 144,904 |

| | | |
|--|--------------|------------|
| Net cash provided by (used in) operating activities | (17,405,825) | 17,878,180 |
|--|--------------|------------|

Cash flows from financing activities:

| | | |
|------------------------------------|-------------|-------------|
| Long-term debt borrowings | 1,987,641 | - |
| Long-term debt repayments | (1,623,432) | (4,953,578) |
| Issuance of common shares for cash | - | 397,893 |
| Redemption of common shares | (628,083) | - |
| Reduction in restricted cash | - | (254,399) |
| Other | - | (613,165) |

| | | |
|---|-----------|-------------|
| Net cash (used in) financing activities | (263,874) | (5,423,249) |
|---|-----------|-------------|

Cash flows from investing activities:

| | | |
|--|-----------|-------------|
| Acquisition of subsidiaries | (52,497) | (2,015,346) |
| Purchase of capital assets | (847,123) | (1,441,423) |
| Net proceeds on disposal of capital assets | 44,049 | - |

| | | |
|---|-----------|-------------|
| Net cash (used in) investing activities | (855,571) | (3,456,769) |
|---|-----------|-------------|

| | | |
|---|-----------|---------|
| Change in cash balance due to foreign exchange | (411,822) | 352,371 |
|---|-----------|---------|

| | | |
|-----------------------------|--------------|-----------|
| (Decrease)/Increase in cash | (18,937,093) | 9,350,533 |
|-----------------------------|--------------|-----------|

| | | |
|---------------------------|------------|-----------|
| Cash, beginning of period | 21,781,809 | 7,105,418 |
|---------------------------|------------|-----------|

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| | | |
|---------------------|--------------|---------------|
| Cash, end of period | \$ 2,844,716 | \$ 16,455,951 |
|---------------------|--------------|---------------|

Cash flow from operations per share:

| | | |
|---------------|-----------|---------|
| Basic | \$ (0.35) | \$ 0.23 |
| Fully diluted | (0.35) | 0.23 |

Supplemental cash flow information:

| | | |
|-------------------|------------|------------|
| Interest paid | \$ 202,247 | \$ 217,101 |
| Income taxes paid | 434,504 | 1,289,821 |

Supplemental disclosure of non-cash transactions:

| | | |
|--|---------|-----------|
| Shares issued for non-cash consideration | 213,000 | 4,123,821 |
|--|---------|-----------|

ENVOY COMMUNICATIONS GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(In Canadian dollars)
(Unaudited-Prepared by Management)

| | | |
|----------------------------|------------------|------------------|
| For the three months ended | March 31 2002 | March 31 2001 |
|----------------------------|------------------|------------------|

Cash flows from operating activities:

| | | |
|---------------------|-----------------|------------|
| Net earnings (loss) | (\$ 35,806,327) | \$ 531,972 |
|---------------------|-----------------|------------|

Items not involving cash:

| | | |
|--|-------------|---------|
| Future income tax expense (recovery) | (1,565,024) | 92,471 |
| Depreciation | 759,810 | 794,272 |
| Goodwill amortization | 961,637 | 756,149 |
| Amortization of deferred financing charges | 46,109 | - |
| Write-down of capital assets | 843,219 | - |
| Write-down of goodwill | 28,426,266 | - |

Net changes in non-cash working capital balances:

| | | |
|---|-------------|-------------|
| Restricted cash | 69,678 | - |
| Accounts receivable | (5,139,767) | 8,720,073 |
| Prepaid expenses | (15,320) | (1,128,140) |
| Accounts payable and accrued liabilities | 3,083,898 | 1,452,310 |
| Income taxes (recoverable) payable | (3,160,345) | (23,733) |
| Deferred revenue | 357,131 | (369,419) |
| Amounts collected in excess of pass-through costs incurred | 3,924,116 | 21,580 |
| Long-term restructuring costs | 1,101,231 | - |
| Other | 771,735 | 217,923 |

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| | | |
|---|-------------|--------------|
| Net cash provided by (used in) | | |
| operating activities | (5,341,953) | 11,065,458 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flows from financing activities: | | |
| Long-term debt borrowings | - | - |
| Long-term debt repayments | (105,204) | (3,493,582) |
| Issuance of common shares for cash | - | 130,320 |
| Redemption of common shares | - | - |
| Reduction in restricted cash | - | (8,641) |
| Other | - | (632,362) |
| <hr style="border-top: 1px dashed black;"/> | | |
| Net cash (used in) financing activities | (105,204) | (4,004,265) |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flows from investing activities: | | |
| Acquisition of subsidiaries | (287,119) | (2,015,346) |
| Purchase of capital assets | (300,795) | (829,225) |
| Net proceeds on disposal of capital assets | 44,049 | - |
| <hr style="border-top: 1px dashed black;"/> | | |
| Net cash (used in) investing activities | (543,865) | (2,844,571) |
| <hr style="border-top: 1px dashed black;"/> | | |
| Change in cash balance | | |
| due to foreign exchange | (488,383) | 395,530 |
| <hr style="border-top: 1px dashed black;"/> | | |
| (Decrease)/Increase in cash | (6,479,405) | 4,612,152 |
| Cash, beginning of period | 9,324,121 | 11,843,799 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash, end of period | \$2,844,716 | \$16,455,951 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Cash flow from operations per share: | | |
| Basic | \$ (0.30) | \$0.10 |
| Fully diluted | (0.30) | 0.10 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Supplemental cash flow information: | | |
| Interest paid | \$61,503 | \$217,101 |
| Income taxes paid | 167,529 | 263,615 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Supplemental disclosure of non-cash transactions: | | |
| Shares issued for non-cash consideration | 213,000 | 499,997 |

1. Restructuring Costs and Unusual Item

For the six month period ending March 31, 2002, the Company recorded charges for restructuring activities and the write-down of goodwill and other assets

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totaling \$36,450,709, as summarized below.

| | Cash | Non Cash | Total Provision | Paid By March 31 |
|----------------------------|--------------|---------------|--------------------|---------------------|
| Severance | \$ 2,799,166 | \$ - | \$ 2,799,166 | \$ 902,154 |
| Write down of fixed assets | - | 843,219 | 843,219 | 843,219 |
| Lease exit costs | 3,380,079 | 250,011 | 3,630,090 | 418,611 |
| Restructuring charge | 6,179,245 | 1,093,230 | 7,272,475 | 2,163,984 |
| Unusual Item (Note 2) | - | 751,968 | 751,968 | - |
| | 6,179,245 | 1,845,198 | 8,024,443 | 2,163,984 |
| Write-down of goodwill | - | 28,426,266 | 28,426,266 | - |
| Total charges | \$ 6,179,245 | \$ 30,271,463 | \$ 36,450,709 | \$ 2,163,984 |

(a) Restructuring charge

In response to a general economic downturn impacting our business, management implemented a restructuring plan during the first half of this fiscal year in order to bring costs more in line with expected revenues. The restructuring involved downsizing its workforce, exiting excess office space and write-off of redundant fixed assets. Accordingly, the Company has recorded a restructuring expense of \$7,272,475 (of which \$386,000 was expensed in the first quarter). The restructuring includes a reduction of 125 people as well as the abandonment of 18,000 square feet of leased office space in New York city. The annual expense savings in salaries, benefits, and occupancy costs associated with this restructuring is approximately \$15,750,000.

(b) Write-down of Goodwill

The Company performed an assessment of the carrying values of goodwill recorded in connection with our various businesses. The assessment was performed because a number of factors indicated that an impairment had arisen in the period ending March 31, 2002. The main indicators of impairment were significant changes in valuations of companies in the technology and marketing/advertising sectors, and significant negative industry and economic trends impacting both current operations and expected future growth rates. Based on these factors, the Company concluded that a 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.

In quantifying the impairment charge, the Company compared the expected future cashflows of each acquisition, to the respective carrying value of the assets of the business, including assigned goodwill. The cashflow periods used ranged between 5 and 20 years, consistent with the remaining goodwill amortization period.

As a result of the review, the Company determined that the carrying values of the acquired businesses were not fully recoverable. Accordingly, the Company recorded, in the second quarter of 2002, a \$28,426,266 write-down of goodwill based on the amount by which the carrying amount of the goodwill exceeded the expected future cash flows calculated as described in the preceding paragraph.

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Note 2. Bank Credit Facility and Long-term Debt

| | 2002 | 2001 |
|---|------------------------|------------------------|
| Revolving credit facility | \$ 9,835,789 | \$ 7,841,239 |
| Non-interest-bearing promissory note, repayable in semi-annual installments due June 30, 2002 | 1,309,169 | 2,689,781 |
| Current portion of loans payable to landlords and capital leases | 313,590 | 434,069 |
| | ----- \$ 11,458,548 | ----- \$ 10,965,089 |
| Long term portion of loans payable to landlords and capital leases | \$ 833,826 | \$ 963,076 |

During fiscal 2001, the Company established an extendable revolving line of credit under which it can borrow funds in either Canadian dollars, U.S. dollars or U.K. Pounds Sterling, provided the aggregate borrowings do not exceed \$40,000,000 Canadian. Advances under the line of credit can be used for general purposes (to a maximum of \$2,000,000), and financing acquisitions which have been approved by the lenders. As at March 31, 2002 approximately \$9,800,000 has been borrowed under the facility, none of which is for general corporate purposes.

As at March 31, 2002 and September 30, 2001, the Company was not in compliance with its covenant calculations involving 12 month earnings before interest, taxes, depreciation and amortization. As the lenders have the right to demand repayment of the outstanding borrowings if the covenants are not met, the entire amount of the debt is classified as a current liability. The Company is continuing to have discussions with its lenders regarding the amendments to the terms of the facility. The lenders have indicated additional borrowings under the facility will not be permitted, other than the \$2,000,000 available for general corporate purposes.

The Company is considering all of the options available to it to finance the repayment of the non-interest bearing promissory notes due on June 30, 2002, the amounts owing under the restructuring plans, and expected cashflow shortfalls in the next six months (or other operating obligations). These options include, additional debt or equity financing under private placements, renegotiating its bank credit facilities, renegotiating the payment terms of its promissory note, and the sale of some of its businesses.

As a result of the ongoing discussions with the lenders regarding the terms of the credit facility, and the limitations on the amounts which can be borrowed, as at March 31, 2002 the Company has written off the \$751,968 remaining unamortized financing fees incurred in connection with this facility.

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3. 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 a global business and has no distinct operating segments

The tables below set out the following information:

| | By Customer Location | | By Geographic Area |
|--|----------------------|----------------|--------------------|
| March 31, 2002 | Net Revenue | Capital Assets | Goodwill |
| Canada | \$ 11,961,610 | \$ 7,880,744 | \$ 3,251,824 |
| United States | 11,605,190 | 376,544 | 9,697,039 |
| United Kingdom and Continental Europe | 7,089,112 | 1,740,711 | 7,622,140 |
| | \$ 30,655,912 | \$ 9,997,999 | \$ 20,571,003 |
| March 31, 2001 | | | |
| Canada | \$ 12,105,212 | \$ 7,948,932 | \$ 22,104,621 |
| United States | 20,843,118 | 691,310 | 16,844,740 |
| United Kingdom and Continental Europe | 9,258,058 | 1,903,402 | 7,856,344 |
| | \$ 42,206,388 | \$ 10,543,644 | \$ 46,805,705 |

The Company's external net revenue by type of service is as follows:

| March 31 | 2002 | 2001 |
|--------------|---------------|---------------|
| Net Revenue: | | |
| Marketing | \$ 7,610,699 | \$ 14,260,778 |
| Design | 17,473,700 | 19,154,239 |
| Technology | 5,571,513 | 8,791,371 |
| | \$ 30,655,912 | \$ 42,206,388 |

4. Subsequent Events:

On April 29, 2002 the Company issued \$1,800,000 in 10% convertible debentures which mature on April 27, 2007 (the "Maturity Date"). The debentures are convertible until Maturity Date into 2.5 million units of the Company ("Units") at a Conversion Price of \$.72 per Unit. Each Unit consists of one common share in the capital of the Company and one purchase warrant of the Company ("Warrant"). Each Warrant entitles the holder to purchase one common share (2.5 million commons shares in aggregate) within the earlier of (1) twelve months of the date of conversion of the debenture, and (2) the Maturity Date at a price of \$.90 per common share. The net proceeds from the sale of the

debenture were used for general corporate purposes.