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

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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					