MDC PARTNERS INC
Form 10-Q
May 05, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2006

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: 001-13178

MDC Partners Inc.
(Exact name of registrant as specified in its charter)

Canada	**98-0364441**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
45 Hazelton Avenue Toronto, Ontario, Canada	**M5R 2E3**
(Address of principal executive offices)	(Zip Code)

(416) 960-9000
Registrant s telephone number, including area code:

950 Third Avenue, New York, New York 10022
(646) 429-1809

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 whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12(b)-2 of the Exchange Act (check one)

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.

Yes o No x

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Act subsequent to the distributions of securities under a plan confirmed by a court. Yes o No x

The numbers of shares outstanding as of May 1, 2006 were: 24,118,876 Class A subordinate voting shares and 2,502 Class B multiple voting shares.

Website Access to Company Reports

MDC Partners Inc. s Internet website address is www.mdc-partners.com. The Company s annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act, will be made available free of charge through the Company s website as soon as reasonably practical after those reports are electronically filed with, or furnished to, the Securities and Exchange Commission.

MDC PARTNERS INC.

QUARTERLY REPORT ON FORM 10-Q

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Item 1. Financial Statements

MDC PARTNERS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(thousands of United States dollars, except share and per share amounts)

	Three Months Ended March 31, 2006	2005
Revenue:		
Services	$ 98,074	$ 73,710
Products	18,566	17,171
	116,640	90,881
Operating Expenses:		
Cost of services sold (1)	59,740	47,191
Cost of products sold	11,839	10,883
Office and general expenses (2)	35,802	29,254
Depreciation and amortization	7,904	4,513
	115,285	91,841
Operating proft (loss)	1,355	(960)
Other Income (Expenses):		
Other income	657	237
Interest expense	(3,282)	(1,336)
Interest income	118	62
	(2,507)	(1,037)
Loss from continuing operations before income taxes, equity in affiliates and minority interests	(1,152)	(1,997)
Income tax recovery	497	911
Loss from continuing operations before equity in affiliates and minority interests	(655)	(1,086)
Equity in earnings of non-consolidated affiliates	274	183
Minority interests in income of consolidated subsidiaries	(4,751)	(2,809)
Loss from continuing operations	(5,132)	(3,712)
Discontinued operations		(71)
Net loss	$ (5,132)	$ (3,783)
Loss Per Common Share:		
Basic:		
Continuing operations	$ (0.22)	$ (0.17)
Discontinued operations		(0.0)
Net loss	$ (0.22)	$ (0.17)
Diluted:		
Continuing operations	$ (0.22)	$ (0.17)
Discontinued operations		(0.0)
Net loss	$ (0.22)	$ (0.17)
Weighted Average Number of Common Shares Outstanding:		
Basic	23,777,590	22,207,229
Diluted	23,777,590	22,207,229

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(1) *Includes non cash stock-based compensation of $2,564 and $35, respectively in 2006 and 2005.*

(2) *Includes non cash stock-based compensation of $961 and $957, respectively in 2006 and 2005.*

The accompanying notes to the unaudited condensed consolidated financial statements are an integral part of these statements.

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MDC PARTNERS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(thousands of United States dollars)

	March 31, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 5,298	$ 12,923
Accounts receivable, less allowance for doubtful accounts of $1,153 and $1,250	117,320	117,319
Expenditures billable to clients	19,932	7,838
Inventories	10,188	10,359
Prepaid	5,286	4,401
Other current assets	427	356
Total Current Assets	158,451	153,196
Fixed assets, at cost, less accumulated depreciation of $74,450 and $71,220	65,275	63,528
Investment in affiliates	10,682	10,929
Goodwill	196,981	195,026
Other intangibles assets, net	53,272	57,139
Deferred tax asset	16,868	16,057
Other assets	12,311	11,440
Total Assets	$ 513,840	$ 507,315
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Short term debt	$ 2,372	$ 3,739
Revolving credit facility	66,400	73,500
Accounts payable	73,131	63,452
Accruals and other liabilities	77,242	69,891
Advance billings	38,136	38,237
Current portion of long-term debt	2,311	2,571
Deferred acquisition consideration	1,067	1,741
Total Current Liabilities	260,659	253,131
Long-term debt	7,957	8,475
Convertible notes	38,527	38,694
Other liabilities	7,837	7,937
Deferred tax liabilities	2,370	2,446
Total Liabilities	317,350	310,683
Minority interests	45,979	44,484
Commitments, contingencies and guarantees (Note 12)		
Shareholders Equity:		
Preferred shares, unlimited authorized, none issued		
Class A Shares, no par value, unlimited authorized, 24,118,876 and 23,437,615 shares issued in 2006 and 2005	183,198	178,589
Class B Shares, no par value, unlimited authorized, 2,502 shares issued in 2006 and 2005, each convertible into one Class A share	1	1
Share capital to be issued, 266,856 Class A shares in 2005		4,209

Additional paid-in capital	23,248	20,028
Accumulated deficit	(58,207)	(53,075)
Accumulated other comprehensive income	2,271	2,396
Total Shareholders Equity	150,511	152,148
Total Liabilities and Shareholders Equity	$ 513,840	$ 507,315

The accompanying notes to the unaudited condensed consolidated financial statements are an integral part of these statements.

MDC PARTNERS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(thousands of United States dollars)

	Three Months Ended March 31,	
	2006	2005 Revised Note 1
Cash flows from operating activities:		
Net loss	$ (5,132)	$ (3,783)
Adjustments to reconcile net loss to cash provided by (used in) operating activities		
Depreciation and amortization	7,904	4,513
Non-cash stock-based compensation	3,304	992
Amortization of deferred finance charges	411	216
Deferred income taxes	(887)	(1,134)
Gain on sale of assets	(367)	(20)
Earnings of non-consolidated affiliates	(273)	(184)
Minority interest and other	(439)	(547)
Changes in non-cash working capital:		
Accounts receivable	(1)	(721)
Expenditures billable to clients.	(12,094)	897
Inventories	171	1,103
Prepaid expenses and other current assets	(1,056)	(1,640)
Accounts payable, accruals and other liabilities	17,575	(17,841)
Advance billings	(101)	(5,486)
Discontinued operations		297
Net cash provided by (used in) operating activities	9,015	(23,338)
Cash flows from investing activities:		
Capital expenditures	(5,803)	(2,203)
Acquisitions, net of cash acquired	(2,735)	(123)
Proceeds of dispositions		138
Profit distributions from non-consolidated affiliates	460	457
Other assets, net		252
Discontinued operations		(110)
Net cash used in investing activities	(8,078)	(1,589)
Cash flows from financing activities:		
Increase (decrease) in bank indebtedness	(1,487)	4,226
Proceeds from (payments of) revolving credit facility	(7,100)	7,169
Repayment of long-term debt	(585)	(564)
Issuance of share capital	150	
Subsidiary issuance of share capital	385	
Net cash provided by (used in) financing activities	(8,637)	10,831
Effect of exchange rate changes on cash and cash equivalents	75	112
Net decrease in cash and cash equivalents	(7,625)	(13,984)
Cash and cash equivalents at beginning of period	12,923	22,644
Cash and cash equivalents at end of period	$ 5,298	$ 8,660
Supplemental disclosures:		
Cash income taxes paid	$ 397	$ 324
Cash interest paid	$ 1,400	$ 843
Non-cash transactions:		
Share capital issued on acquisitions	$ 4,459	$
Note receivable exchanged for shares in subsidiary	$ 1,155	$ 122

The accompanying notes to the unaudited condensed consolidated financial statements are an integral part of these statements.

MDC PARTNERS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(thousands of United States dollars, unless otherwise stated)

1. Basis of Presentation

MDC Partners Inc. (the Company) has prepared the unaudited condensed consolidated interim financial statements included herein pursuant to the rules and regulations of the United States Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) of the United States of America (US GAAP) have been condensed or omitted pursuant to these rules.

The accompanying financial statements reflect all adjustments, consisting of normally recurring accruals, which in the opinion of management are necessary for a fair presentation, in all material respects, of the information contained therein. Results of operations for interim periods are not necessarily indicative of annual results.

These statements should be read in conjunction with the consolidated financial statements and related notes included in the annual report on Form 10-K for the year ended December 31, 2005.

As of the quarter ended September 30, 2005 the Company has changed the composition of its reportable segments as set out in Note 11. Accordingly, to reflect this change in composition, the Company has restated the previously reported segment information for the first quarter of 2005.

As of the quarter ended December 31, 2005, the Company revised the 2005 statement of cash flows to separately disclose the operating, investing and financing portions of the cash flows attributable to its discontinued operations. Accordingly, the three months ended March 31, 2005 statement of cash flows has been revised to conform to such presentation.

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2. Significant Accounting Policies

The Company s significant accounting policies are summarized as follows:

Principles of Consolidation. The accompanying condensed consolidated financial statements include the accounts of MDC Partners Inc. and its domestic and international controlled subsidiaries that are not considered variable interest entities, and variable interest entities for which the Company is the primary beneficiary. Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities including goodwill, intangible assets, valuation allowances for receivables and deferred tax assets, and the reporting of variable interest entities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The estimates are evaluated on an ongoing basis and estimates are based on historical experience, current conditions and various other assumptions believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Concentration of Credit Risk. The Company provides marketing communications services and secure products to over 200 clients who operate in most industry sectors. Credit is granted to qualified clients in the ordinary course of business. Due to the diversified nature of the Company s client base, the Company does not believe that it is exposed to a concentration of credit risk as no client accounted for more than 10% of the Company s consolidated accounts receivable at March 31, 2006 or revenue for the three months ended March 31, 2006 and 2005.

Cash and Cash Equivalents. The Company s cash equivalents are primarily comprised of investments in overnight interest-bearing deposits, commercial paper and money market instruments and other short-term investments with original maturity dates of three months or less at the time of purchase. Included in cash and cash equivalents at March 31, 2006 and December 31, 2005, is $1,458 and $1,301, respectively, of cash restricted as to withdrawal pursuant to a collateral agreement and a customer s contractual agreeement.

Stock-Based Compensation. Effective January 1, 2003, the Company prospectively adopted fair value accounting for stock-based awards as prescribed by SFAS No. 123 Accounting for Stock-Based Compensation (SFAS No. 123). Prior to January 1, 2003, the Company elected not to apply fair value accounting to stock-based awards to employees, other than for direct awards of stock and awards settleable in cash, which required fair value accounting. Prior to January 1, 2003, for awards not elected to be accounted for under the fair value method, the Company accounted for stock-based awards in accordance with Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees (APB 25). APB 25 is based upon an intrinsic value method of accounting for stock-based awards. Under this method, compensation cost is measured as the excess, if any, of the quoted market price of the stock issuance at the measurement date over the amount to be paid by the employee.

The Company adopted fair value accounting for stock-based awards using the prospective application transitional alternative available in SFAS 148 Accounting for Stock-Based Compensation Transition and Disclosure . Accordingly, the fair value method is applied to all awards granted, modified or settled on or after January 1, 2003. Under the fair value method, compensation cost is measured at fair value at the date of grant and is expensed over the service period, that is the award s vesting period. When awards are exercised, share capital is credited by the sum of the consideration paid together with the related portion previously credited to additional paid-in capital when compensation costs were charged against income or acquisition consideration.

Stock-based awards that are settled in cash or may be settled in cash at the option of employees are recorded as liabilities. The measurement of the liability and compensation cost for these awards is based on the intrinsic value of the award, and is recorded as a charge to operating income over the service period, that is the vesting period of the award in accordance with FASB Interpretation Number 28- Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans an interpretation of APB Opinions No. 15 and 25 (FIN 28). Changes in the Company s payment obligation subsequent to vesting of the award and prior to the settlement date are recorded as compensation cost in operating

income in the period of the change. The final payment amount for such awards is established on the date of the exercise of the award by the employee.

Stock-based awards that are settled in cash or equity at the option of the Company are recorded at fair value on the date of grant and recorded as additional paid-in capital. The fair value measurement of the compensation cost for these awards is based on using the Black-Scholes option pricing model, and is recorded as a charge to operating income over the service period, that is the vesting period of the award.

Effective January 1, 2006, the Company adopted FAS 123(R) and has opted to use the modified prospective application transition method. Under this method the Company will not restate its prior financial statements. Instead, the Company will apply FAS 123(R) for new awards granted after the adoption of FAS 123(R), any portion of awards that were granted after December 15, 1994 and have not vested as of January 1, 2006, and any outstanding liability awards.

Measurement of compensation cost for awards that are outstanding and classified as equity, at January 1, 2006, will be based on the original grant-date fair value calculations of those awards. The Company had previously adopted FAS 123 and as such has been expensing the fair value of all awards issued after January 1, 2003. For all previously issued awards, the Company has been providing pro-forma disclosure for such awards. Upon the adoption of FAS 123(R), the Company will now expense the fair value of the awards granted prior to January 1, 2003. The Company will also adopt the straight-line attribution method for determining the compensation cost to be recorded during each accounting period. The adoption of FAS 123(R) did not have a material effect on the Company s financial position or results of operations.

The table below summarizes the quarterly pro forma effect for the three months ended March 31, 2005, had the Company adopted the fair value method of accounting for stock options and similar instruments for awards issued prior to 2003 and prior to the adoption of FAS 123(R):

	Three Months Ended March 31, 2005		
Net loss as reported	$	(3,783	)
Fair value costs, net of income tax, of stock-based employee compensation for options issued prior to 2003	191		
Net loss pro forma	$	(3,974	)
Basic net loss per share, as reported	$	(0.17	)
Basic net loss per share, pro forma	$	(0.18	)
Diluted net loss per share, as reported	$	(0.17	)
Diluted net loss per share, pro forma	$	(0.18	)

The fair value of the stock options and similar awards at the grant date were estimated using the Black-Scholes option-pricing model with the following weighted average assumptions for the following period:

	Three Months Ended March 31, 2005	
Expected dividend	0.00	%
Expected volatility	40	%
Risk-free interest rate	3.3	%
Expected option life in years	3	
Weighted average stock option fair value per option granted	$ 3.80	

There were no stock options issued by the Company during the three months ended March 31, 2006.

On February 28, 2006, the Company issued 247,500 Class A shares of financial performance-based restricted stock, and 475,000 financial performance-based restricted stock units, to its employees under the 2005 Stock Incentive Plan. The Class A shares underlying each grant of restricted stock or restricted stock units will vest upon achievement by the Company of specified financial performance criteria in 2006, 2007 and 2008. Based on the Company s expected financial performance in 2006, the Company currently believes that 50% of the financial performance-based awards to employees will vest on March 15, 2007. Accordingly, the Company is recording a non-cash stock based compensation charge of $3,089 from the date of grant through March 15, 2007.

On March 6, 2006, the Company issued 16,000 Class A shares of restricted stock and 8,000 restricted stock units to its non-employee Directors under the 2005 Stock Incentive Plan. These awards to non-employee Directors vest on the third anniversary of the grant date. Accordingly, the Company is recording a $205 non-cash compensation charge over the three year vesting period.

For the three months ended March 31, 2006 the Company has recorded a $263 charge relating to these grants. The value of the awards was determined based on the fair market value of the underlying stock on the date of grant. The 263,500 Class A shares of restricted stock granted to employees and non-employee Directors are included in the Company s calculation of Class A shares outstanding as of March 31, 2006.

Derivative Financial Instruments. The Company follows SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities . SFAS No.133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts and debt instruments) be recorded in the balance sheet as either an asset or liability measured at its fair value. The accounting for the change in fair value of the derivative depends on whether the instrument qualifies for and has been designated as a hedging

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relationship and on the type of hedging relationship. There are three types of hedging relationships: a cash flow hedge, a fair value hedge and a hedge of foreign currency exposure of a net investment in a foreign operation. The designation is based upon the exposure being hedged. Derivatives that are not hedges, or become ineffective hedges, must be adjusted to fair value through earnings.

Effective June 28, 2005, the Company entered into a cross currency swap contract (Swap), a form of derivative. The Swap contract provides for a notional amount of debt fixed at $45,000 Canadian dollars (C$) and at $36,452, with the interest rates fixed at 8% per annum for the Canadian dollar amount and fixed at 8.25% per annum for the US dollar amount. Consequently, under the terms of this Swap, semi-annually, the Company will receive interest of C$1,800 and will pay interest of $1,503 per annum. The Swap contract matures June 30, 2008.

At March 31, 2006 and December 31, 2005, the Swap fair value was estimated to be a receivable of $158 and $180, respectively and is reflected in other assets on the Company s balance sheet with the change in the value of the swap reflected in interest expense. The Company only enters into derivatives for purposes other than trading.

3. Loss Per Common Share

The following table sets forth the computation of basic and diluted loss per common share from continuing operations for the three months ended March 31:

	Three Months Ended March 31, 2006	2005
Numerator		
Numerator for basic loss per common share - loss from continuing operations	$ (5,132)	$ (3,712)
Effect of dilutive securities:		
Interest expense on convertible debentures, net of taxes of nil		
Numerator for diluted loss per common share - loss from continuing operations plus assumed conversion	$ (5,132)	$ (3,712)
Denominator		
Denominator for basic loss per common share - weighted average common shares	23,777,590	22,207,229
Effect of dilutive securities:		
8% convertible debentures		
Employee stock options, warrants, and stock appreciation rights		
Dilutive potential common shares		
Denominator for diluted loss per common share - adjusted weighted shares and assumed conversions	23,777,590	22,207,229
Basic loss per common share from continuing operations	$ (0.22)	$ (0.17)
Diluted loss per common share from continuing operations	$ (0.22)	$ (0.17)

The 8% convertible debentures, options and other rights to purchase 8,842,935 shares of common stock, which includes 263,500 shares of non-vested restricted stock, were outstanding during the three months ended March 31, 2006, but were not included in the computation of diluted loss per common share because their effect would be antidilutive. Similarly, during the three months ended March 31, 2005, options and other rights to purchase 4,385,537 shares of common stock were outstanding but were not included in the computation of diluted loss per common share because either the exercise prices were greater than the average market price of the common shares and/or their effect would be antidilutive.

4. Acquisitions

2006 First Quarter Acquisitions

On February 7, 2006, the Company purchased the remaining outstanding membership interests of 12.33% of Source Marketing LLC (Source) pursuant to an exercise of a put option notice delivered in October 2005. The purchase price of $2,287 consisted of cash of $1,830 and the delivery of 1,063,516 shares of LifeMed Media Inc. (LifeMed) valued at $457. The Company s carrying value of these LifeMed shares was $27, thus the Company recorded a gain on the disposition of these shares of $430, which has been included in other income.

On February 15, 2006, Source issued 15% of its membership interests to certain members of management. The purchase price for these membership interests was $1,540, which consisted of $385 cash and recourse notes in an aggregate principal amount equal to $1,155. In addition, the purchaser also received a fully vested option to purchase an additional 5% of Source at an exercise price equal to the price paid above. The option is exercisable any time prior to December 31, 2010. An amended and restated LLC agreement was entered into with these new members. The agreement also provides these members with an option to put to the Company these membership interests from December 2008-2012. As a result of the above transactions, the Company now owns 85% of Source. For the three months ended March 31, 2006, the Company recorded a non-cash stock based compensation charge of $2,338 relating to the price paid for the membership interests which was less than the fair value of such membership interests and the fair value of the option granted.

2005 Acquisitions

Zyman Group

On April 1, 2005, the Company, through a wholly owned subsidiary, purchased approximately 61.6% of the total outstanding membership units of Zyman Group, LLC (Zyman Group) for purchase price consideration of $52,389 in cash and 1,139,975 Class A shares of the Company, valued at $11,257 based on the share price on or about the announcement date. Related transaction costs of approximately $976 were also incurred. In addition, the Company may be required to pay up to an additional $12,000 to the sellers if Zyman Group achieves specified financial targets for the twelve month period ending June 30, 2006 and/or June 30, 2007. As part of this transaction, approximately 10% of the total purchase price was delivered to an escrow agent to be held in escrow for one year in order to satisfy potential future indemnification claims by the Company against the sellers under the purchase agreement.

In connection with the Zyman Group acquisition, the Company, Zyman Group and the other unitholders of Zyman Group entered into a new Limited Liability Company Agreement (the LLC Agreement). The LLC Agreement sets forth certain economic, governance and liquidity rights with respect to Zyman Group. Zyman Group initially has seven managers, four of whom were appointed by the Company. Pursuant to the LLC Agreement, the Company will have the right to purchase, and may have an obligation to purchase, for a combination of cash and shares, additional membership units of Zyman Group from the other members of Zyman Group, in each case, upon the occurrence of certain events or during certain specified time periods.

The Zyman Group name is well recognized for strategic marketing consulting and as such was acquired by the Company for its assembled workforce to enhance the creative talent within the Company s Strategic Marketing Service segment of businesses.

The Zyman Group acquisition was accounted for as a purchase business combination. The purchase price of the net assets acquired in this transaction is $64,622. The final allocation of the cost of the acquisition to the fair value of net assets acquired and minority interests is as follows:

Cash and cash equivalents	$ 5,653
Accounts receivable and other current assets	6,734
Fixed assets and other assets	7,785
Goodwill (tax deductible)	45,349
Intangible assets	20,143
Accounts payable, accrued expenses and other liabilities	(7,475)
Total debt	(8,524)
Minority interest at carrying value	(5,043)
Total cost of the acquisition	$ 64,622

Identifiable intangible assets of $20,143 are comprised primarily of customer relationships and related backlog and trademarks. The allocation of the purchase price to assets acquired and liabilities assumed is based upon estimates of fair values and certain assumptions that the Company believes are reasonable under the circumstances. The Company s consolidated financial statements include Zyman Group s results of operations subsequent to its acquisition on April 1, 2005.

During the first five years following MDC s acquisition of the Zyman Group, MDC s allocation of profits of the Zyman Group may differ from its proportionate share of ownership. On an annual basis, the Company receives a 20% priority return calculated based on its total investment in Zyman Group. Thereafter, based on calculations set forth in the operating agreement of Zyman Group (the LLC Agreement), the Company s share of remaining Zyman Group profits in excess of the annual threshold amount of $20.6 million may be disproportionately less than its equity ownership in Zyman Group. Specifically, on an annual basis, if Zyman operating results exceed a defined operating margin, the Company would be entitled to 25% of the excess margins in the first two years of the LLC Agreement and 30% of the excess margins in the following three years of the LLC Agreement, rather than the Company s equity portion of 61.6%. After the first five years, the earnings of the Zyman Group will be allocated in a proportion equal to the respective equity interests of the members.

As of March 31, 2006, the annual priority return is expected to be approximately $12.7 million, with the minority owners receiving the next $7.9 million up to the threshold amount.. If profits are insufficient to meet the Company s priority return during any of the first five years, the Company will receive a catch-up payment through year five equal to any shortfall from the prior year(s). Furthermore, if profits do not reach the threshold amount during the first five years, the minority owners will be entitled to receive a catch-up payment through year five equal to any shortfall from the prior year(s). Based on Zyman Group s expected results for 2006, the Company expects to receive not more than its priority return from Zyman Group in 2006.

Neuwirth

On December 1, 2005, the Company, through its subsidiary Northstar Research Partners (USA) LLC (NS LLC), purchased the business of Neuwirth Research, Inc. (Neuwirth) for purchase price consideration of $450 in cash, a 20% equity interest in NS LLC valued at $225 based on the estimated market value of NS LLC on or about the announcement date, and 48,391 MDC Class A shares valued at $300. Related transaction costs of approximately $100 were also incurred. In addition, the Company was required to pay up to an additional $625 in cash to the seller if the acquired Neuwirth business achieves specified financial targets for the year ended December 31, 2005 and/or December 31, 2006. As of March 31, 2006, the Company determined that these targets were achieved and, accordingly, the $625 payment obligation was settled by the Company s issuance of 30,058 Class A shares MDC stock valued at $250 and cash of $375.

In connection with the Neuwirth acquisition, the Company and seller entered into agreements related to governance and certain put option rights with respect to the seller s 20% equity interest in NS LLC which becomes 50% exercisable in 2010 and 100% exercisable in 2015.

Neuwirth is a recognized market research firm and was acquired by the Company for its list of blue chip clients and synergies with NS LLC existing business. This acquisition is part of the Specialized Communications Services segment of businesses.

The Neuwirth acquisition was accounted for as a purchase business combination. The allocation of the cost of the acquisition to the fair value of net assets acquired is as follows:

Accounts receivable and other current assets	$ 492
Fixed assets and other assets	50
Intangible assets	1,680
Accounts payable, accrued expenses and other liabilities	(522)
Total cost of the acquisition	$ 1,700

Identifiable intangible assets, estimated to be $1,680, are being amortized on a straight line basis over ten years. The allocation of the purchase price to assets acquired and liabilities assumed is based upon estimates of fair values and certain assumptions that the Company believes are reasonable under the circumstances. The Company s consolidated financial statements include Neuwirth s results of operations subsequent to its acquisition on December 1, 2005.

Powell

On July 25, 2005, the Company, through its subsidiary Margeotes Fertitta Powell, LLC, (MFP) purchased the business of Powell, LLC (Powell) for purchase price consideration of $332 in cash and a 5% equity interest in MFP valued at $400 based on the estimated market value of MFP on or about the announcement date. The issuance of equity interests by MFP resulted in a loss of $103 on the dilution of the Company s equity interest in its subsidiary. Related transaction costs of approximately $20 were also incurred. In addition, the Company may be required to pay up to an additional $300 in cash to the seller if the acquired Powell business achieves specified financial targets for the year ended July 31, 2006. As of December 31, 2005, the Company accrued $300 of the additional consideration as the financial targets have been met and continue to be met as of March 31, 2006.

In connection with the Powell acquisition, the Company and seller entered into agreements related to governance and certain put option rights with respect to seller s 5% equity interest in MFP, which become exercisable in 2010.

Powell is a well recognized, highly creative advertising agency and as such was acquired by the Company for its creative talent to supplement existing creative agencies within the Company s Strategic Marketing Services segment of businesses.

The Powell acquisition was accounted for as a purchase business combination. The allocation of the cost of the acquisition to the fair value of net assets acquired is as follows:

Accounts receivable and other current assets	$ 32
Fixed assets and other assets	31
Intangible assets	1,130
Accounts payable, accrued expenses and other liabilities	(141)
Total cost of the acquisition	$ 1,052

Identifiable intangible assets, estimated to be $1,130, are being amortized on a straight-line basis over five years. The allocation of the purchase price to assets acquired and liabilities assumed is based upon estimates of fair values and certain assumptions that the Company believes are reasonable under the circumstances. The Company s consolidated financial statements include Powell s results of operations subsequent to its acquisition on July 25, 2005.

Other Acquisitions and Transactions

On July 31, 2005, the Company acquired a further 20% equity interest in its existing subsidiary MFP pursuant to the exercise of a put obligation under the existing purchase agreement with a minority interest holder. The purchase price of $1,740 which includes $15 of acquisition costs was paid in cash. Of the purchase price, $500 was allocated to customer relationship intangible assets and $1,240 was allocated to goodwill. The allocation of the purchase price to assets acquired and liabilities assumed is based upon certain assumptions that the Company believes are reasonable under the circumstances. As a result of this acquisition, and the Powell transaction discussed above, the Company retains a 95% equity interest in MFP.

On September 1, 2005, the Company, through a consolidated variable interest entity, Crispin Porter + Bogusky, LLC (CPB), purchased 20% of the total outstanding membership units of Fuseproject, LLC (Fuseproject) for purchase price consideration of $750 in cash and an additional $400, which was paid during the quarter ended March 31, 2006. Fuseproject is a design firm acquired by CPB to complement its creative offerings. The Fuseproject acquisition was accounted for using the equity method as CPB has significant influence over the operations of Fuseproject. The purchase price of the net assets acquired in this transaction is $1,150. The allocation of the cost of the acquisition to the fair value of the net assets acquired resulted in a portion being attributed to intangible assets valued at $40 and $1,090 consisting of goodwill. The allocation of the purchase price to assets acquired and liabilities assumed is based upon estimates of fair values and certain assumptions that the Company believes are reasonable under the circumstances. The Company s consolidated financial statements include Fuseproject s results of operations in equity in earnings of non consolidated affiliates subsequent to its acquisition on September 1, 2005.

During August 2005, Bryan Mills Group Ltd., (BMG) a subsidiary whose operations are consolidated by the Company, completed the acquisition of 450 shares from a minority shareholder at a price of $515.00 per share, for a total purchase price of $232. This resulted in the Company s ownership interest in BMG increasing to 71.2% from 68.0%. Also as a result of the equity transaction by BMG, the Company recorded goodwill of $146.

During the quarter ended March 31, 2005, the Company contributed $125 of cash as additional paid in capital to its existing consolidated subsidiary, Banjo Strategies Entertainment LLC. There was no change in the Company s ownership interest. This resulted in a loss on dilution of $61 and is reflected in the Company s consolidated statement of operations. During the quarter ended June 30, 2005, the Company acquired further equity interests in the existing consolidated subsidiaries of Allard Johnson Communications Inc. (0.3%) and Banjo Strategies Entertainment LLC (7.2%). In aggregate, the Company paid $143 in cash for these incremental ownership interests. During the quarter ended September 30, 2005, the Company acquired a further 0.7% equity interest in the existing consolidated subsidiary, Allard Johnson Communications Inc., for $148.

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Pro forma Information

The following unaudited pro forma results of operations of the Company for the three months ended March 31, 2005 assume that the acquisition of the operating assets of the significant businesses acquired during 2005 had occurred on January 1st of the respective year in which the business was acquired. These unaudited pro forma results are not necessarily indicative of either the actual results of operations that would have been achieved had the companies been combined during this period, or are they necessarily indicative of future results of operations.

	Three Months Ended March 31, 2005
Revenues	$ 105,267
Net loss	$ (3,353)
Loss per common share:	
Basic - net loss	$ (0.14)
Diluted - net loss	$ (0.14)

5. Inventory

The components of inventory are listed below:

	March 31, 2006	December 31, 2005
Raw materials and supplies	$ 4,387	$ 4,860
Work-in-process	5,801	5,499
Total	$ 10,188	$ 10,359

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6. Discontinued Operations

During July 2005, LifeMed, a variable interest entity whose operations had been consolidated by the Company, completed a private placement issuing approximately 12.5 million shares at a price of $0.4973 per share. LifeMed received net proceeds of approximately $6,200. Consequently, the Company s ownership interest in LifeMed was reduced to 18.3% from this transaction. As a result of the equity transaction of LifeMed, the Company recorded a gain of $1,300. This gain represents the Company s reversal of a liability related to funding obligations that the Company is no longer obligated to fund. The Company no longer has any significant continuing involvement in the management or operations of LifeMed, and has not participated in the purchase of significant new equity offerings of LifeMed. Consequently, as of July 2005, the Company no longer consolidated the operations of LifeMed, commenced accounting for its remaining investment in LifeMed on a cost basis, and has reported the results of operations of LifeMed as discontinued operations for all periods presented. In February 2006, the Company sold 27% of its remaining ownership in LifeMed as partial settlement of a put option (see Note 4). As of March 31, 2006, the Company holds a 13.4% interest in LifeMed.

In November 2004, the Company s management reached a decision to discontinue the operations of a component of its business. This component is comprised of the Company s UK based marketing communications business, a wholly owned subsidiary Mr. Smith Agency, Ltd. (formerly known as Interfocus Networks Limited). The Company decided to dispose of the operations of this business due to its unfavorable economics. Substantially all of the net assets of the discontinued business were sold during the fourth quarter of 2004 with the disposition of all activities of Mr. Smith and remaining sale of assets was substantially complete by the end of the first quarter of 2005. No significant one time termination benefits were incurred or are expected to be incurred. No further significant other charges are expected to be incurred.

Included in discontinued operations in the Company s consolidated statement of operations for the three months ended March 31, 2005 were the following:

	Three Months Ended March 31, 2005
Revenue	$ 1,498
Operating loss	$ (393)
Other income	2
Income tax recovery	60
Minority interest recovery	260
Net loss from discontinued operations	(71)

As of March 31, 2006 and December 31, 2005, Other Assets includes $75 and $100, respectively of the Company s net investment in LifeMed.

7. Comprehensive Loss

Total comprehensive loss and its components were:

	Three Months Ended March 31,	
	2006	2005
Net loss for the period	$ (5,132)	$ (3,783)
Foreign currency cumulative translation adjustment	$ (125)	(545)
Comprehensive loss for the period	$ (5,257)	$ (4,328)

8. Short Term Debt, Long-Term Debt and Convertible Debentures

Long-term debt, including short term debt, consists of:

	March 31, 2006	December 31,2005
Short term debt	$ 2,372	$ 3,739
Revolving credit facility	66,400	73,500
8% convertible debentures	38,527	38,694
Notes payable and other bank loans	5,528	5,650
Obligations under capital leases	4,740	5,396
	117,567	126,979
Less:		
Short term debt	2,372	3,739
Current portions	2,311	2,571
	$ 112,884	$ 120,669

Short term debt represents the swing line under the revolving credit facility and outstanding checks at the end of the reporting periods.

MDC Revolving Credit Facility

MDC Partners Inc. and certain of its wholly-owned subsidiaries entered into a revolving credit facility with a syndicate of banks, which as of March 31, 2006, provides for borrowings of up to $100 million (including swing-line advances of up to $10 million) maturing in September 2007 (the Credit Facility). This facility bears interest at variable rates based upon the Eurodollar rate, US bank prime rate, US base rate, and Canadian bank prime rate, at the Company s option. Based on the level of debt relative to certain operating results, the interest rates on loans are calculated by adding between 200 and 325 basis points on Eurodollar and Bankers Acceptance based interest rate loans, and between 50 and 175 basis points on all other loan interest rates. The provisions of the facility contain various covenants pertaining to a minimum ratio of debt to net income before interest, income taxes, depreciation and amortization (EBITDA), a maximum debt to capitalization ratio, the maintenance of certain liquidity levels and minimum shareholders equity levels. The facility restricts, among other things, the levels of capital expenditures, investments, distributions, dispositions and incurrence of other debt. Effective April 15, 2006, a 1.0% per annum facility fee will be charged on the amount of the revolving commitments under the Credit Facility in excess of $65,000, which fee will be payable beginning on April 15, 2006 and for so long as the revolving commitments under the Credit Facility are in excess of $65,000. The facility is secured by a senior pledge of the Company s assets principally comprised of ownership interests in its subsidiaries and by the underlying assets of the businesses comprising the Company s Secure Products International Group and by a substantial portion of the underlying assets of the businesses comprising the Company s Marketing Communications Group, the underlying assets being carried at a value represented by the total assets reflected on the Company s consolidated balance sheet at March 31, 2006. In addition, in the event of a sale of the Company s secure products business, the Company must repay advances under the Credit Facility by an amount equal to the net proceeds received by the Company from such sale (Sale Net Proceeds), and the revolving commitments under the facility would be reduced by an amount equal to the Sale Net Proceeds. At March 31, 2006, the unused portion of the total facility was $26,745.

The Company has classified the swing-line component of this revolving credit facility as a current liability in accordance with EITF 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Agreement . This component, reflected as short term debt on the balance sheet, is classified as a current liability in accordance with EITF 95-22 since the swing-line contains a lock box arrangement that requires the cash receipts of the Company to be used to repay amounts outstanding under the swing-line and the entire credit facility is subject to subjective acceleration clauses. Management believes that no conditions have occurred that would result in subjective acceleration by the lenders, nor do they believe that any such conditions will exist over the next twelve months. The weighted average interest rate on these current portions of debt was 7.7% and 6.7% as of March 31 2006 and December 31, 2005, respectively.

The Company is currently in compliance with all of the terms and conditions of its amended Credit Facility and management believes that, based on its current financial projections, the Company will be in compliance with its financial covenants over the next twelve months. However, as a result of the need to obtain waivers and amend the Credit Facility in the past reporting periods, the Company has classified the outstanding debt under the Credit Facility as current. Although such debt has been classified as current, the maturity of the Credit Facility remains September 22, 2007.

As of March 31, 2006 and December 31, 2005, $3,685 and $5,336 of the consolidated cash position is held by subsidiaries, which, although available for the subsidiaries use, does not represent cash that is available for use to reduce MDC Partners Inc. indebtedness.

8% Convertible Unsecured Subordinated Debentures

On June 28, 2005, the Company completed an offering in Canada of convertible unsecured subordinated debentures amounting to $36,723 (C$45,000) (the Debentures). The Debentures mature on June 30, 2010 and bear interest at an annual rate of 8.00% payable semi-annually, in arrears, on June 30 and December 31 of each year. The Company did not have an effective resale registration statement filed with the SEC on December 31, 2005, and as a result the rate of interest increased by an additional 0.50% for the first six month period following December 31, 2005. As of April 19, 2006, the Company had an effective resale registration statement and as a result the interest rate will return to 8.0% effective July 1, 2006. Unless an event of default has occurred and is continuing, the Company may elect, from time to time, subject to applicable regulatory approval, to issue and deliver Class A subordinate voting shares to the Debenture trustee in order to raise funds to satisfy all or any part of the Company s obligations to pay interest on the Debentures in accordance with the indenture in which holders of the Debentures will be entitled to receive a cash payment equal to the interest payable from the proceeds of the sale of such Class A subordinate voting shares by the Debenture trustee.

The Debentures are convertible at the holder s option into fully-paid, non-assessable and freely tradeable Class A subordinate voting shares of the Company, at any time prior to maturity or redemption, subject to the restrictions on transfer, at a conversion price of C$14.00 ($11.98 as of March 31, 2006) per Class A subordinate voting share being a ratio of approximately 71.4286 Class A subordinate voting shares per C$1,000.00 ($856.00 as of March 31, 2006) principal amount of Debentures.

The Debentures may not be redeemed by the Company on or before June 30, 2008. Thereafter, but prior to June 30, 2009, the Debentures may be redeemed, in whole or in part from time to time, at a price equal to the principal amount of the Debenture plus accrued and unpaid interest, provided that the volume weighted average trading price of the Class A subordinate voting shares on the Toronto Stock Exchange during a specified period is not less than 125% of the conversion price. From July 1, 2009 until the maturity of the Debentures, the Debentures may be redeemed by the Company at a price equal to the principal amount of the Debenture plus accrued and unpaid interest, if any. The Company may elect to satisfy the redemption consideration, in whole or in part, by issuing Class A subordinate voting shares of the Company to the holders, the number of which will be determined by dividing the principal amount of the Debenture by 95% of the current market price of the Class A subordinate voting shares on the redemption date. Upon the occurrence of a change of control of the Company involving the acquisition of voting control or direction over 50% or more of the outstanding Class A subordinate voting shares prior to June 30, 2008, the Company shall be required to make an offer to purchase all of the then outstanding Debentures at a price equal to 100% of the principal amount thereof plus an amount equal to the interest payments not yet received on the Debentures calculated from the date of the change of control to June 30, 2008, discounted at a specified rate. Upon the occurrence of a change of control on or after June 30, 2008, the Company shall be required to make an offer to purchase all of the then outstanding Debentures at a price equal to 100% of the principal amount of the Debentures plus accrued and unpaid interest to the purchase date.

Notes Payable

In connection with the Zyman acquisition, the Company assumed the following note payable in the original amount of $6,275. The note bears interest of 5.73% and is due on June 8, 2009. The balance of the note payable was $5,471 and $5,589 at March 31, 2006 and December 31, 2005, respectively. The note agreement is secured by an aircraft and related equipment with a net book value of $4,927 at March 31, 2006. The remaining balance of $57 relates to a bank loan of a subsidiary.

9. Shareholders Equity

During the quarter ended March 31, 2006 Class A share capital increased by $4,609, as the Company (i) issued 30,058 Class A shares in connection with deferred acquisition consideration, (ii) issued 266,856 Class A shares previously identified to be issued and (iii) 72,856 Class A shares related to the exercise of stock options and stock appreciation right awards. During the quarter ended March 31, 2006 Additional paid-in capital increased by $3,220, of which (a) $3,321 related to stock-based compensation that was expensed during the same period, of which $16 is included in equity in earnings of non consolidated affiliates, and (b) $101 related to the resolution of a contingency based on the Company s share price relating to a previous acquisition.

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10. Other Income (Expense)

	Three Months Ended March 31,	
	2006	**2005**
Other Income	$ 107	$ 35
Foreign currency transacation gains	76	180
Gain on sale of assets	474	22
	$ 657	$ 237

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11. Segmented Information

During the quarter ended September 30, 2005, the Company has reassessed its reportable operating segments to consist of five segments plus corporate, instead of reporting only two segments plus corporate. The Company has recast its prior year disclosures to conform to the current year presentation. The segments are as follows:

The *Strategic Marketing Services (SMS)* segment includes Crispin Porter & Bogusky, kirshenbaum bond + partners, Zyman Group LLC among others. This segment consists of integrated marketing consulting services firms that offer a full complement of marketing consulting services including advertising and media, marketing communications including direct marketing, public relations, corporate communications, market research, corporate identity and branding, interactive marketing and sales promotion. Each of the entities within SMS share similar economic characteristics, specifically related to the nature of their respective services, the manner in which the services are provided and the similarity of their respective customers. Due to the similarities in these businesses, they exhibit similar long term financial performance and have been aggregated together.

The *Customer Relationship Management (CRM)* segment provides marketing services that interface directly with the consumer of a client s product or service. These services include the design, development and implementation of a complete customer service and direct marketing initiative intended to acquire, retain and develop a client s customer base. This is accomplished using several domestic and a foreign-based customer contact facilities.

The *Specialized Communications Services* (SCS) segment includes all of the Company s other marketing services firms that are normally engaged to provide a single or a few specific marketing services to regional, national and global clients. These firms provide niche solutions by providing world class expertise in select marketing services.

The *Secure Cards Business (SCB)* segment provides secure products and services related to electronic transaction products such as credit, debit, telephone and smart cards. The businesses included in this segment have similar types of clients, risks and cost structures. Due to the similarities in these businesses, they exhibit similar long-term financial performance and have been aggregated together.

The *Secure Paper Business (SPB)* segment produces secure specialty printed products which include stamps, labels and tickets. Products for each of these entities are only manufactured for specific customers. The businesses included in this segment have similar types of clients, risks and cost structures. Due to the similarities in these businesses, they exhibit similar long-term financial performance and have been aggregated together.

The significant accounting polices of these segments are the same as those described in the summary of significant accounting policies included in the notes to the consolidated financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2005, except as where indicated.

The SCS segment is an Other segment pursuant SFAS 131 Disclosures about Segments of an Enterprise and Related Information .

Summary financial information concerning the Company s operating segments is shown in the following tables:

Three Months Ended March 31, 2006

	Strategic Marketing Services	Customer Relationship Management	Specialized Communications Services	Secure Cards Business	Secure Paper Business	Corporate	Total
Revenue	$ 60,399	$ 18,906	$ 18,769	$ 6,821	$ 11,745	$	$ 116,640
Cost of services sold	31,740	13,797	14,203				59,740
Cost of products sold				4,023	7,816		11,839