

Iconix Brand Group, Inc. (ICON)

Sell Short / Sell

Stock Price: \$35.72 as of February 13, 2015

Stock at Risk Score -1.2 Weak SAR score; Company exhibits significant risk characteristics*Measured in standard deviations, a lower number indicates a riskier stock. The SAR scores range from approximately -2.5 (riskiest) to +2.3 (least risky/most attractive).*

Summary

Sales and profits are artificially inflated. Acquisitions and newly consolidated entities inflate sales and profit growth rates. One-time gains, passed through as revenues, inflate sales and profits levels. Sales of JV stakes will reduce earnings in the future. The anniversaries of these various items will create very difficult comparisons for ICON in 2015.

Sales are declining; margins are declining. ICON's organic sales growth is negative after adjustments for these one-time items. Operating profit margins have collapsed; were artificially boosted this year by the inclusion of a "gain on revaluation of a JV stake" among other items. This is neither desirable nor repeatable.

JV transactions reduce long term potential. ICON's sales of stakes in its JV's will reduce the company's earnings in the coming quarters. The increases in Minority Interest Expense may be more difficult to spot on the P&L, but will affect EPS.

Cash flows have rolled over and are declining. The flattening of sales and the decline in profitability are affecting cash flows, which have rolled over. Free cash flow peaked in mid-2013 and has fallen since.

The sudden decline in earnings quality is troubling. Although some of these earnings quality issues surfaced in 2013, there is a marked acceleration in 2014. Could the surge in one-time figures and accounting profits point to a management team losing confidence in ICON's core business?

The company is highly levered. The company is more levered than its peer group. Net debt represents 44% of total market cap and over 7x LTM EBITDA, despite management's claim of a 4.4x ratio. Both are far higher than all but one of its peers (Quicksilver, ZQK).

Balance sheet quality is low. The asset side of the balance sheet isn't much better. The lack of physical assets exacerbates the leverage issue mentioned above. Fully \$2bn of ICON's \$2.8bn balance sheet are intangibles. The bulk of the purchase accounting write-ups were allocated to indefinite life intangibles. Retail brands are notoriously fickle and it is hard to believe that accounting values should not allow for a decline in economic value.

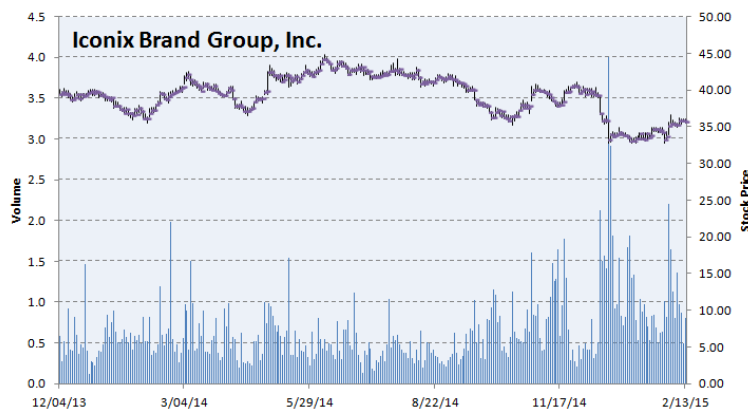
Insiders are selling. The company's insiders are selling shares, even as the company makes share buybacks and has high stock-based compensation.

Potential Catalysts: The key catalyst is the likely sales and earnings disappointment from difficult comparisons to prior periods on the anniversaries of non-repeatable economic and accounting transactions. Organic sales declines will weigh on results too.

Risks: The launch of the Peanuts movie and of related merchandising sales could boost ICON's business. Positive surprises could come from higher than expected international sales. Short interest in the stock is high, representing a possible squeeze risk.

We recommend selling Iconix stock short (selling/avoiding for long managers).

Absolute Returns for Uncertain Markets™



Trading

Date	2/13/15
Price	35.72
52 Wk H/L	44.81 / 32.70
Market Cap/Ent. Value (\$mns)	1,714 / 3,068
Avg Daily Volume (thou)	921.8
Shares Outstanding (mn)	48.0
Float (mn / %)	45.3 / 94.5%
Short Interest (mn / SISO%)	14.2 / 29.6%
Days to Cover	19.7

Source: Two Rivers Analytics; FactSet Research Systems

Company Description

Iconix is an "asset-light" owner of retail brands. The company is engaged in the licensing and marketing of a portfolio of consumer brands across apparel, footwear, sportswear, fashion accessories, home products and decor, beauty and fragrance, consumer electronics and novelty products.

Their business model has excluded many of the traditional retail functions such as sourcing or manufacturing, distribution, inventory and retail sales, intentionally limiting their activities to the ownership and management of retail brands. They seek to partner with retailers with a physical presence. Currently, ICON's key retailers include Wal-Mart, Kohl's, Target and Kmart/Sears which, together, represent 29% of revenues.

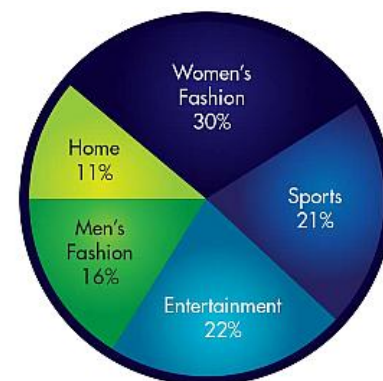
The company's brand category mix is diversified, but leans towards Women's Fashion. Revenue breakdowns are not provided by brand, but the most important brands are Candie's, Badgley Mischka, Joe Boxer, London Fog, Mossimo, Ocean Pacific/OP, Danskin and Umbro.

Sixty-five (65%) percent of the company's revenues are generated from US sales, 6.6% from Japan and 28% from other geographies (none of which represented more than 10% of sales in the last nine months.)

The company is a serial acquirer of brands and JV interests. It has engaged in 24 transactions since 1998. They typically fund acquisitions with a combination of cash and debt.

The company reports earnings on February 18th. The most recent quarter brought a small positive surprise on sales (+1.9%), on Operating Income (+2.5%), Net Income (+9%) and EPS (+18%), due to share count reduction from buybacks. (However, the numbers raise many questions and lead us to make multiple adjustments to present our view of ICON's figures, as shown in a series of adjustment tables later.) The stock rose 4.8% on the day. The company has a history of modest beats on sales and EPS, to the point where these positive surprises no longer impact the stock very much. When they disappoint, however, the stock drops quickly like it did in early 2012 on a miss.

The shorts have been circling this name and have built a higher short interest than most companies we write about. Short interest is high at 23% of float with 19 days to cover.



Absolute Returns for Uncertain Markets™



Short Investment Thesis

Sales and Profits are artificially inflated.

Icon's **reported sales, profits and growth are overstated** due to a series of transactions and the company's accounting treatment for these transactions. The issues can be grouped into four categories summarized below and detailed in tables later in this report.

Description	Impact
<p>Acquisitions - ICON has made 24 acquisitions over the past 8 years. The inclusion of acquired sales in consolidated statements overstates the company's intrinsic growth rate.</p>	<p>Masks negative organic growth</p> <p>Overstates the company's growth</p>
<p>Newly consolidated entities - In two cases in 2014, the company increased its stake in a joint venture, enabling the company to consolidate the entity. Previously, the entities had been accounted for via the equity method. Consolidating allows 100% of the sales and operating profit to be shown on the income statement as opposed to zero sales and just the company's share of the JV's income. New minority income expense is then subsequently deducted such that net income shouldn't change. Unfortunately, some analysts don't look below operating profit or EBITDA.</p>	<p>Overstates sales, EBITDA and Operating Profit by showing 100% of on the P&L.</p> <p>Valuation multiples (apart from P/E) would need to be adjusted to reflect non-control shareholders.</p>
<p>Gains on JV stakes treated as revenues - Gains on sales of JV stakes are included in Licenses and Other Revenue, when they are clearly neither. In some cases, payments to be received from these sales are to be received over several years, yet the gains are booked primarily in year one. This is a way to pull revenues from distant periods forward.</p>	<p>Overstates revenue</p> <p>Selling off half of a JV reduces ICON's future income from that brand or territory.</p>
<p>Other, revaluations - The acquisition of the 50% of Iconix Latin America allowed ICON to book a revaluation gain on the stake they already owned. The gain flowed through the P&L as an offset to operating expenses, inflating operating income. There was no economic impact from the revaluation of the stake already owned and no economic difference in earnings from this transaction.</p>	<p>Understates expenses</p> <p>Overstates operating profit and margins</p>

Source: Two Rivers Analytics, Inc. Company filings.

Revenues and margins are overstated and declining

Our work on ICON's published figures led us to create three categories of adjustment, which we will take in turn below:

1. estimates of actual **LTM** sales, EBIT and EBITDA
2. corrections to show **true organic growth** in sales, EBIT and EBITDA
3. estimates of **recurring** sales, EBIT and EBITDA

A summary of the results of our adjustments can be found in this table:

Results of Adjustments	Operating		
	Sales	Income	Margin
LTM			
as reported	\$ 454.10	\$ 264.34	58.2%
as adjusted by TRA	\$ 370.10	\$ 148.64	40.2%
change	-18.5%	-43.8%	-18.0%
Growth Rates, 19M Sept 2014			
as reported	6.6%	3.5%	
as adjusted by TRA	-7.4%	-38.4%	
change	-13.9%	-41.9%	
Recurring, LTM			
as estimated by TRA	\$ 411.41	\$ 182.79	44.4%
change	-9.4%	-30.9%	-13.8%

* all adjustments detailed in tables below

Source: Two Rivers Analytics, Inc.

The following tables rely on the same adjustments, but include or exclude items based on whether our goal is corrected LTM figures, growth rates or going-forward sustainable figures.

1. Estimated LTM figures

Once adjusted for the items discussed above, it becomes clear that ICON sales are not what they appear. As reported, sales were \$454mn over the past 12 months (LTM). After adjustments, primarily for gains on sale treated as revenues, **we estimates sales were \$370mn LTM or 18% less than reported.** The same adjustments take operating profit from a reported \$264mn to an adjusted \$148mn. **EBIT margins fall from 58.2% to 40.2%.** The biggest offender in the margin adjustment is the non-cash equity revaluation adjustment, followed by recognition of gains on the sales of JV stakes being treated as revenue and, hence, flowing through operating profit. (Please see table below.)

LTM Sales, EBIT & EBITDA	9m/e Sep 2013	2013		9M/e Sep 2014		Adjustments		Type	Recur?	dMI Expense	dEPS ongoing	Notes
		Sales adjustment	Op Income adjustment	Sales	Op Income adjustment	Sales	Op Income adjustment					
Iconix Latin America	Feb-14					37.9		O	N			Purchased remaining 50% of the JV; began to consolidate, previously equity method
						5.4	4.6	C	Y			non-cash equity value remeasurement gain booked as "Other Income"
Iconix Europe	Jan-14					2.0	0.1	C	Y	incr	--	impact of new consolidation; added to revenues and income for the year.
						1.5	1.5	G	N			Bought 1% to bring stake to 51%. Now consolidates; added to revenues and income for the year.
LC Partners US	Mar-14					4.0	4.0	G	N	incr	decr	Consent fee for allowing transfer of minority JV interest from BIV to LF Asia (neither an affiliate of ICON) included
Iconix Israel JV	Nov-13			2.3	2.3			G	N	incr	decr	Minority equity interest booked as accreting mezzanine debt due to put/call arrangement
Iconix SE Asia, Ltd.	Oct-13			4.7	4.7	?	?	G	N	incr	decr	Multi-year installment sale of 50% of license interest, all booked as revenue in current year
Iconix SE Asia, Korea	Jun-14					13.6	13.6	G	N	incr	decr	Gain on JV interest sale treated as revenue
Iconix SE Asia, greater China	Sep-14					18.7	18.7	G	N	incr	decr	Sale of 50% interest, on installment. Gain was booked as License and Other Revenue. Some additional gain to fall into 2014.
Iconix Canada	Jun-13	9.8	9.8	9.8	9.8	?	?	G	N	incr		Multi-year installment sale of license interest, all booked as revenue in current year, received \$4mn at closing
Iconix Australia	Sep-13	5.1	5.1	5.1	5.1	?	?	G	N	incr		Multi-year installment sale of license interest, all booked as revenue in current year, received \$4.3mn at closing; Certain minimum license liabilities assumed by the company (may have inflated the sales price); Entity not previously consolidated, equity accounting.
Sale of SharperImage.com						7.8	7.8	G	N		decr	Five year installment sale. Gain booked as revenues. Gain was booked as License and Other Revenue. Some additional gain to fall into 2014-2016.
Lee Cooper	Feb-13	6.2	3.9	10.7	6.7	?	?	A	Y			All received up front. Gain booked as revenues. But not sales and non-recurring
Umbro	Dec-13			10.0	10.0			G	N	incr	decr	Gain on sale included in revenues
Buffalo Brand	Feb-13	13.4	10.8	22.9	18.5	?	?	A	Y			Acquired the brand
												Purchased Umbro in 2012; sold the license to S Korea in Dec 2013; gain on sale booked as revenue
												Bought 51% of JV, consolidated
Total		34.5	29.6	65.5	57.1	53.0	88.2	84.0	115.7			

KEY:
A = Acquired sales; overstates growth going forward
C = Newly consolidated; brought onto the income statement fully
G = Sale of ownership; gain treated as revenue; non-recurring
O = Other

	9m/e Sep 2013		2013		9M/e Sep 2014		LTM 9/2014	
	Sales	Op Income	Sales	Op Income	Sales	Op Income	Sales	Op Income
As reported	327.4	199.2	432.6	257.4	348.8	206.1	454.1	264.3
Margin		60.9%		59.5%		59.1%		58.2%
As Adjusted by TRA	292.9	169.6	367.1	200.3	295.8	117.9	370.1	148.6
Margin		57.9%		54.6%		39.9%		40.2%
Adjusted vs. Reported	-11%	-15%	-15%	-22%	-15%	-43%	-18%	-44%
								148.6
								7.3
								156.0

Source: Two Rivers Analytics, Inc.

2. Corrected growth rates

A different cut at the adjustments shows much lower growth rates than those based on reported numbers. Over the past nine months the year over year growth in reported sales is 6.6% and growth in reported operating profit is 3.5%. **After our adjustments, the growth in sales drops into negative territory at -7.4% while the unfavorable change in operating profit is -38%.** (Please see table below.)

Adjustments to Growth		9m/e Sep 2013		9M/e Sep 2014		Type	Recur?	dMI Expense	dEPS ongoing	Notes
		Sales effect	Op Income effect	Sales effect	Op Income effect					
Iconix Latin America	Feb-14							decr	incr	Purchased remaining 50% of the JV; began to consolidate, previously equity method
				37.9		O	N			non-cash equity value remeasurement gain booked as "Other Income"
						C	Y			impact of new consolidation; added to revenues and income for the year
Iconix Europe	Jan-14					C	Y	incr	--	Bought 1% to bring stake to 51%. Now consolidates; added to revenues and income for the year
				1.5	1.5	G	N			Consent fee for allowing transfer of minority JV interest from BIV to LF Asia (neither an affiliate of ICON) included
										Minority equity interest booked as accreting mezzanine debt due to put/call arrangement
LC Partners US	Mar-14			4.0	4.0	G	N	incr	decr	Multi-year installment sale of 50% of license interest, all booked as revenue in current year
Iconix SE Asia, Korea	Jun-14			13.6	13.6	G	N	incr	decr	Multi-year installment sale of license interest, all booked as revenue in current year, received \$4mn at closing
Iconix SE Asia, greater Chir	Sep-14			18.7	18.7	G	N	incr	decr	Multi-year installment sale of license interest, all booked as revenue in current year, received \$4.3mn at closing; Certain minimum license liabilities assumed by the company (may have inflated the sales price); Entity not consolidated, equity accounting.
Sale of SharperImage.com				7.8	7.8	G	N		decr	Gain on sale included in revenues
Total		-	-	45.6	83.5					

KEY:
 A = Acquired sales; overstates growth going forward
 C = Newly consolidated; brought onto the income statement fully
 G = Sale of ownership; gain treated as revenue; non-recurring
 O = Other

	9m/e Sep 2013		9m/e Sep 2014	
	Sales	Op Income	Sales	Op Income
As reported	327.4	199.22	348.8	206.1
Growth \$			21.5	6.9
Growth %			6.6%	3.5%
As Adjusted by TRA	327.4	199.2	303.2	122.6
Growth \$			-24.1	-76.6
Growth %			-7.4%	-38.4%

Source: Two Rivers Analytics, Inc.

As a sanity check on these numbers, we looked at trends in Cash Flow from Operations. CFFO is more difficult to manipulate than Operating Income. In ICON's case, it has declined in sympathy. CFFO declined 22.3% to \$124.4mn in the L9M from \$160.2mn the same period the prior year.

3. Recurring Sales and EBIT adjustments

A final cut at the adjustments shows that **recurring sales and EBIT are lower than reported LTM numbers**. This table shows downward adjustments from gains on sale and revaluation gains that are not repeatable, offset by positive adjustments for full year sales and earnings impacts on JVs held for less than one year. It shows that LTM sales, based on **reported figures, of \$454mn dwindles to \$411mn** and LTM Operating Profit and margins, based on reported figures, of \$264mn and 58%, respectively, are cut to \$183mn and 44%, respectively. See table below.

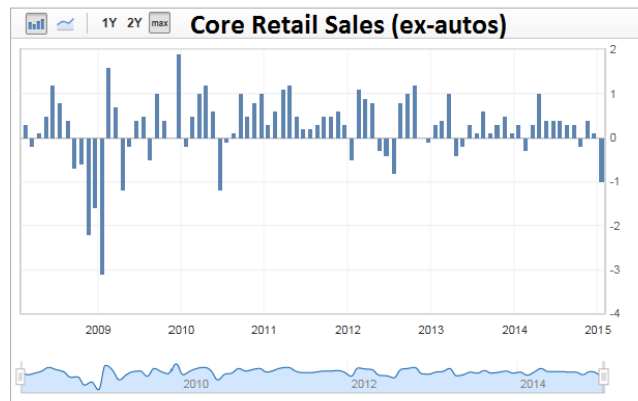
Recurring Sales and EBIT		9m/e Sep 2013		2013		9M/e Sep 2014		Adjustment: Recurring		Type	Recur?	dMI Expense	dEPS ongoing	Notes
		Sales adjustment	Op Income adjustment	Sales adjustment	Op Income adjustment	Sales adjustment	Op Income adjustment	Sales adjustment	Op Income adjustment					
Iconix Latin America	Feb-14							-	-			decr	incr	Purchased remaining 50% of the JV; began to consolidate, previously equity method
						(37.9)		-	(37.9)	O	N			non-cash equity value remeasurement gain booked as "Other Income"
						5.4	4.6	2.3	1.9	C	Y			impact of new consolidation; added to revenues and income for the year. Added full year impact
Iconix Europe	Jan-14					2.0	0.1	0.7	0.0	C	Y	incr	--	Bought 1% to bring stake to 51%. Now consolidates; added to revenues and income for the year. Added full year GAAP impact, Net of MI, EPS changes very little.
						1.5	1.5	(1.5)	(1.5)	G	N			Consent fee for allowing transfer of minority JV interest from BIV to LF Asia (neither an affiliate of ICON) included
								-	-					Minority equity interest booked as accreting mezzanine debt due to put/call arrangement
LC Partners US	Mar-14					4.0	4.0	(4.0)	(4.0)	G	N	incr	decr	Multi-year installment sale of 50% of license interest, all booked as revenue in current year
Iconix Israel JV	Nov-13			2.3	2.3					G	N	incr	decr	Gain on JV interest sale treated as revenue
Iconix SE Asia, Ltd.	Oct-13			4.7	4.7	?	?			G	N	incr	decr	Sale of 50% interest, on installment. Gain was booked as License and Other Revenue. Some additional gain to fall into 2014.
Iconix SE Asia, Korea	Jun-14					13.6	13.6	(13.6)	(13.6)	G	N	incr	decr	Multi-year installment sale of license interest, all booked as revenue in current year, received \$4mn at closing
Iconix SE Asia, greater Chi	Sep-14					18.7	18.7	(18.7)	(18.7)	G	N	incr	decr	Multi-year installment sale of license interest, all booked as revenue in current year, received \$4.3mn at closing; Certain minimum license liabilities assumed by the company (may have inflated the sales price); Entity not previously consolidated, equity accounting.
Iconix Canada	Jun-13	9.8	9.8	9.8	9.8	?	?			G	N	incr		Five year installment sale. Gain booked as revenues. Gain was booked as License and Other Revenue. Some additional gain to fall into 2014-2016.
Iconix Australia	Sep-13	5.1	5.1	5.1	5.1	?	?			G	N	incr		All received up front. Gain booked as revenues. But not sales and non-recurring
Sale of SharperImage.com						7.8	7.8	(7.8)	(7.8)	G	N		decr	Gain on sale included in revenues
Lee Cooper	Feb-13	6.2	3.9	10.7	6.7	?	?			A	Y			Acquired the brand
Umbro	Dec-13			10.0	10.0					G	N	incr	decr	Purchased Umbro in 2012; sold the license to S Korea in Dec 2013; gain on sale booked as revenue
Buffalo Brand	Feb-13	13.4	10.8	22.9	18.5	?	?			A	Y			Bought 51% of JV, consolidated
Total		34.5	29.6	65.5	57.1	53.0	12.4	(42.7)	(81.6)					

KEY:
 A = Acquired sales; overstates growth going forward
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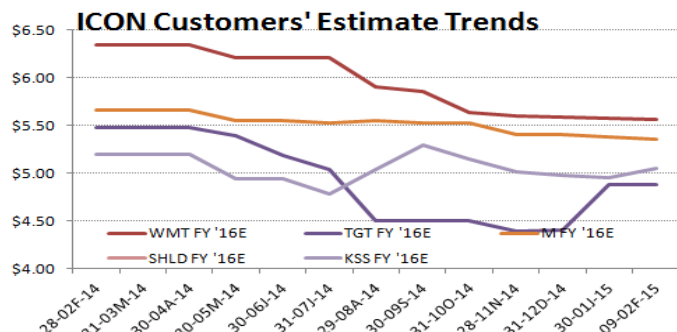
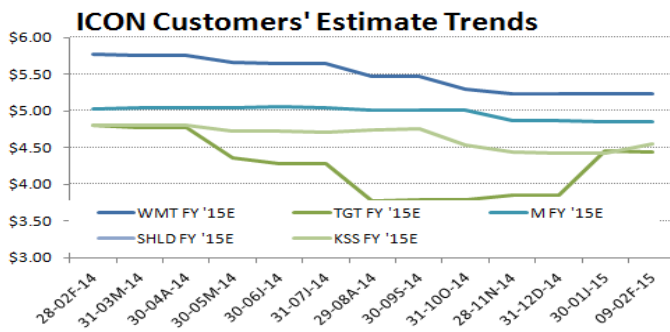
	9m/e Sep 2013		2013		9M/e Sep 2014		Recurring, based on LTM 9/2014	
	Sales	Op Income	Sales	Op Income	Sales	Op Income	Sales	Op Income
As reported	327.362	199.22	432.6	257.4	348.8	206.1	454.1	264.3
Margin		60.9%		59.5%		59.1%		58.2%
As Adjusted by TRA	292.9	169.6	367.1	200.3	295.8	193.7	411.4	182.8
Margin		57.9%		54.6%		65.5%		44.4%
Adjusted vs. Reported	-11%	-15%	-15%	-22%	-15%	-6%	-9%	-31%
								182.8
								7.3
								190.1

Source: Two Rivers Analytics, Inc.

We should not be surprised at a trend that shows declines in sales and profits for a portfolio of retail brands. The **retail backdrop is not encouraging**. Despite the drop in oil and gasoline prices, consumer spending growth ex-autos has declined for months. The most recent print was a decline.



Another perspective on the retail outlook is also pessimistic. Sales expectations for some of ICON's largest customers shows cuts over the past year. ICON's customers are faced with declining traffic and weak consumer demand.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

JV transactions reduce long term potential.

In 2014 and, to a lesser extent, 2013, **ICON sold minority interests in a series of joint ventures**. The most significant transactions included sales of JV stakes in Korea and greater China. In all cases, ICON received some cash up front at closing. In most cases, some of the consideration was to be received over time, often several years from closing. While **the gains were booked up front as revenue**, the transactions reduced the earnings potential of ICON by the proportion of the JV sold.

Also, in some cases the transactions had a put/call component where the JV stake buyer could "put" its stake back to ICON at a price based on a prearranged formula. This creates a contingent liability for ICON where a JV license stake can be forced back onto ICON in exchange for a payment from ICON. ICON treats some of these contingent liabilities as mezzanine finance. This seems to imply a high likelihood of a put scenario where ICON will need to pay out cash.

The JV stake sales provide two of our important short catalysts. First, **the company's earnings, after minority interest expense, will be reduced in proportion to the income streams of the JV's sold**. Second, it goes without saying that **ICON can't sell off pieces of itself indefinitely**. They are limited by the licenses owned and by the limits of consolidation accounting. If a JV stake drops below 50%, it is much more difficult to maintain consolidation treatment. Without consolidating the JVs, ICON loses the ability to show the JVs sales and operating income on its own books. This is exactly the inverse of what they have been doing in 2014.

Indeed, the adjustment has already started. In the nine months ended September 2014, distributions to non-controlling interest more than doubled to \$10.1mn from \$4.4mn the prior year. In the last quarter, minority interest expense

increased to \$3.4mn from \$1.5mn the prior year's quarter. We'll continue to see increases until the anniversary of the JV stake sales.

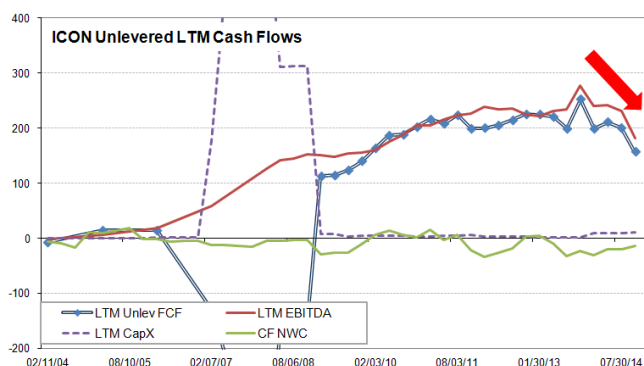
The sudden decline in earnings quality is troubling.

Some of the actions that caused ICON's quality of earnings to decline were also seen in 2013. However, the current year showed a dramatic acceleration. The adjustments we made to sales and operating profit are much higher for 2014 than for 2013.

A skeptical analyst might be inclined to think that management, seeing sales flatten and margins come under pressure, **began to sell off JV's to limit their downside exposure**. We're not sure where the justification for the accounting treatment for these sales comes from, but **including gains on sale in License and Other Revenues is, at best, misleading** to investors. Our adjustments move those gains "below the line", to extraordinary income where they belong. These gains are not only not revenue, but they are non-recurring and should not be considered in any valuation.

Cash flows have rolled over and are declining.

As a result of the above, cash flows have started to trend downward. The drop in EBITDA is the driver here as the company has little working capital or capex to speak of.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

Not factored in, above, are cash flows related to existing JVs. We note that in 2013, distributions from affiliated entities to ICON exceeded income from these entities. In the last 9 months, however, **Distributions from Affiliates have been lower than GAAP income from them**.

Looking forward, cash flows look worse. It would only be fair to adjust EBITDA by the minority interest expense for which the company will be responsible going forward. However, there is no public information that would allow those estimates. The proceeds from the two largest stake sales (Korea and greater China) were \$37.4mn. At an average acquisition EV/S multiple of 2x and an EBITDA margin of 50%, this gives us a "back of the envelop" estimate for an EBITDA loss of approximately \$9mn every year going forward.

The company is highly levered

Perhaps investors are relying on management assertions that net debt to EBITDA is 4.4x. We tried to replicate management's numbers and came very close. However, **we disagree with management's measure of leverage**. The table below shows that **the company has not made necessary adjustments to EBITDA**. Our estimate is **7.6x net debt to EBITDA**, even giving the company credit for newly acquired JVs (annualizing stub periods).

Net Debt to EBITDA Calculations

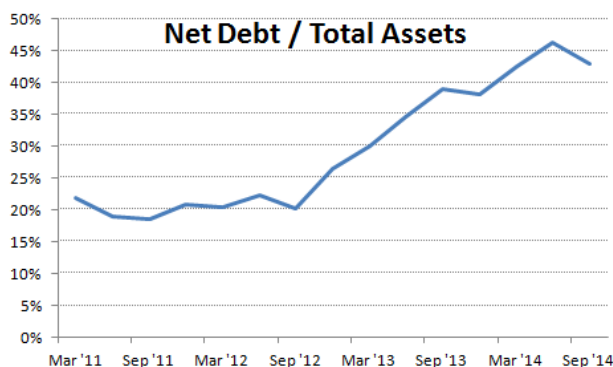
	Management Figures (a)			TwoRivers Adjustments
	2013	9m 9/2013	9m 9/2014	LTM
Net Income	128,048	101,902	128,866	155,012
Income Taxes	58,075	47,432	56,239	66,882
Net Interest/Other Expense	67,995	46,825	23,604	44,774
Depreciation/Amortization	8,825	6,654	4,715	6,886
EBITDA	262,943	202,813	213,424	273,554
Operating Income as Reported				264,337
less: non cash equity revaluation, Iconix Latin America				(37,900)
less: Installment sale of Korea JV stake booked as revenue				(13,600)
less: Installment sale of Greater China JV stake booked as revenue				(18,700)
less: other Adjustments				18,683
LTM Deprec & Amortization (L9M annualized)				7,333
EBITDA, LTM, Recurring, as adjusted				182,787 (b)
CMLTD			61,123	61,123
LTD			1,349,660	1,349,660
Less: Unrestricted cash			(129,527)	(129,527)
Less: Restricted cash			(48,688)	
Minority Interest			?	117,033
Net Debt			1,232,568	1,398,289
Net Debt/EBITDA			4.4x (a)	7.6x

(a) from press releases or earnings calls

(b) EBITDA is not adjusted for less than 100% stakes in JV (no adjustment for minority interest changes)

Source: Two Rivers Analytics, Inc.,

ICON has seen a steady increase in leverage since 2012. Currently, net debt stands at 42% of total assets.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

The company faces a significant maturity of \$300mn in June 2016. However, if the stock price remains above \$30.75, the bonds will convert into 13.3mn shares. The next maturity is in 2018 on the 1.5s of March 2018, which are also convertible but at \$30.86.

Balance sheet quality is low

The lack of physical assets at ICON gives it a lower quality balance sheet. Of the **\$2.8b balance sheet, fully \$2bn are intangibles**. These intangibles were created via purchase accounting of the company's brands. Note however, that of the \$2.03bn in intangibles, **nearly all (\$2.02bn) of the purchase accounting adjustments were made to "indefinite life intangibles"**, meaning that they are not amortized. The company may have made this allocation based on a desire to minimize amortization expense, which would reduce GAAP EPS. However, it defies reality to assume that any given consumer brand will have the same value forever, i.e., that these brands can maintain relevance indefinitely in the face of competition over any reasonable time horizon (CROX, Lululemon anyone?).

Estimates are too high

The bull case on ICON rests on growth in the underlying business, additional acquisitions and on sales from the Peanuts franchise.

ICON's organic sales are declining

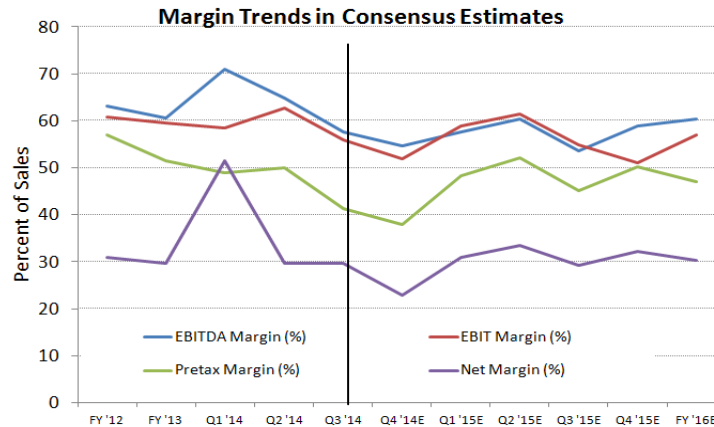
Given our adjustments from above, it is clear **the company is not growing its top line**. After removing one-time gains, **both Sales and Operating Income are falling**:

	9m/e Sep 2013		9m/e Sep 2014	
	Sales	Op Income	Sales	Op Income
As reported	327.4	199.22	348.8	206.1
Growth \$			21.5	6.9
Growth %			6.6%	3.5%
As Adjusted by TRA	327.4	199.2	303.2	122.6
Growth \$			-24.1	-76.6
Growth %			-7.4%	-38.4%

Source: Two Rivers Analytics, Inc., FactSet Data Systems

In fact, the various sales of JV interests leave us with a smaller ICON at the end of 2014 than at the beginning. Sales and earnings don't reflect the shrinkage yet. As the declines in earnings flow through earnings (hidden in higher minority interest expense), **the company will have to overcome a drop in its net income and EPS in 2015 and beyond**.

Importantly, **sell-side analysts have not adjusted minority interest expense** for the JV sales. A quick look at consensus margin estimates show flat lines for net income margins. Recall that with the newly consolidated entities, sales figures will be high, but the **net income that corresponds to those JVs will be impacted by new minority interest and will show half the margin that fully owned entities would**. As such, the resulting **income estimates are simply too high**.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

Further, ICON's acquisition pace has slowed, partly due to the company's high leverage and partly due to management's pessimistic view on the retail environment.

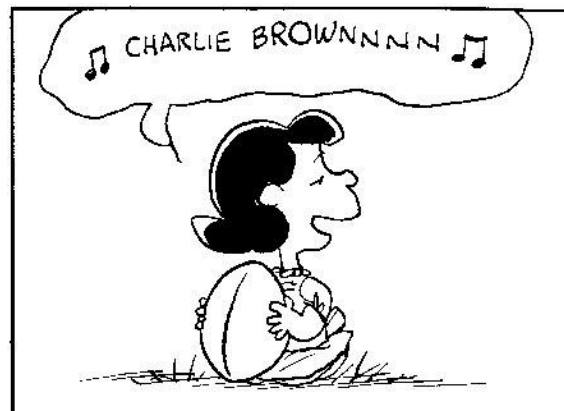
Charlie Brown to the rescue?

In admission that core sales will not grow much if at all, ICON elected to make advances into entertainment licensing.

"With what is happening in America we don't see large growth there over the next couple of years but we do see stability," Chief Executive Neil Cole

ICON owns 80% of the rights to the Charles Shultz Peanuts characters. The Peanuts comic strip is being brought to the big screen by Fox and is set to be released in November. The economics of the movie deal aren't known but movie analysts¹ have estimated that ICON could get a fee of \$5 to \$10mn for the movie release and additional fees contingent on meeting certain box-office milestones. In addition, ICON might receive royalties of 7% to 14% of the film merchandise tie-ins.

It is never easy to forecast the success of a new brand initiative, especially one based on a movie outcome. But we do know that **Charlie Brown will have to overcome the organic decline in ICON's business.**



Clearly, Snoopy has his work cut out for him!

¹ Charles Grimes, an attorney who works with licensing including Archie comics and Disney characters

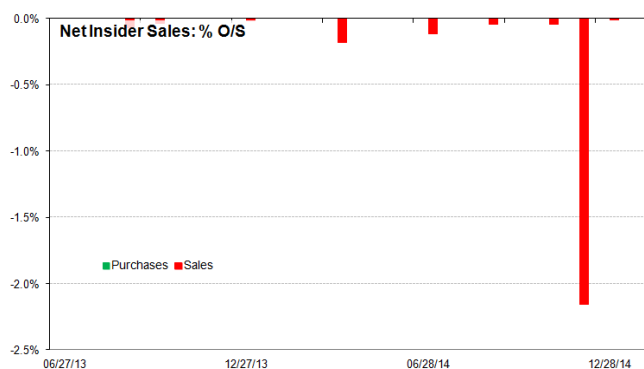
The stock is expensive

ICON stock is expensive. Earlier we showed the adjustments to sales and EBITDA that are warranted from one-time gains and other events and accounting decisions. Taking these adjustments into account puts **ICON's LTM EBITDA multiple at 20.7x and forward EBITDA (based on our estimate of recurring EBITDA and zero growth) at 16.2x**. Both are very expensive next to our comparables. (Note that we don't refer to sales multiples due to the company's asset-lite business model).

Consensus earnings (and sales) figures for FY2 and beyond are based on artificially high 2014 and 2013 figures. Accordingly, the multiples for forward periods make the company appear artificially cheap.

Insiders are selling.

Insiders own 5.5% of the company's outstanding shares. Founder and CEO, Neil Cole, owns 4.2%. Recently, insiders have been selling.

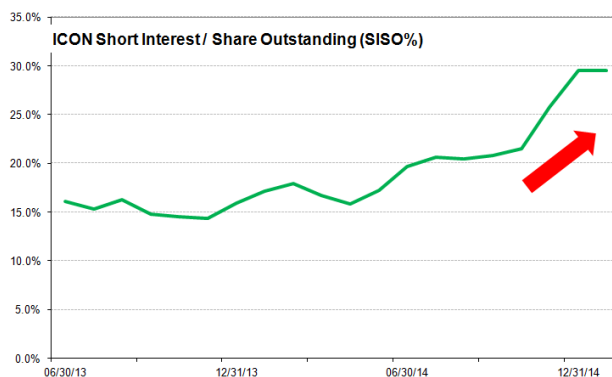


Source: Two Rivers Analytics, Inc., FactSet Data Systems

Other

Short Interest is high

While our (and others') backtests have shown there is alpha to be earned by emulating short investors, short interest is higher than most companies we recommend shorting. It needs to be recognized that this is a more dangerous short given the risk of a short squeeze. One might consider expressing a bearish trade through derivatives. A bear spread with options is an obvious choice.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

Acquisitions in 2015

Iconix has made two acquisitions since year end. They acquired 100% of the Strawberry Shortcake brand for \$105mn in cash and they acquired rights to PONY brands in North America (only) for \$37mn. The company discloses very limited financial information about acquisitions, but claim these acquisitions were made in line with prior acquisition criteria, per management.

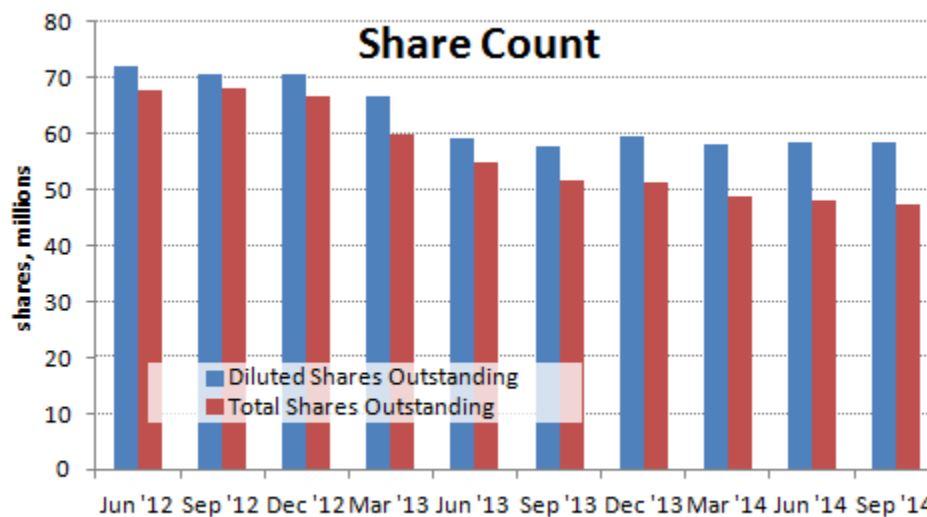
Proportion of cash held abroad is increasing fast

At the end of 2013, ICON held 16% of its cash balances (\$44mn) in foreign (non-US) subsidiaries. By September 2014, those figures had risen to 30% and \$52mn outside the US. If the need arose to repatriate that cash, for instance, to service their large debt, it could pose adverse tax consequences to ICON.

A buyback program & convertible debt

ICON has an active share buyback program. In the last 9 months, they have repurchased \$168mn in shares on the open market. In 2013, buybacks totaled \$436mn. At the same time, the issuance of convertible securities and issuance of stock based compensation have partly offset the reduction in diluted share count such that the diluted share count is roughly flat since mid-2013.

The company has authorized \$1.3bn of share repurchases since 2011. As of the latest balance sheet date, they have repurchased \$782mn leaving some \$520mn of room under existing plans.



Source: Two Rivers Analytics, Inc., FactSet Data Systems

Potential Catalysts to a short call

- A probable earnings shortfall from the company's shrinking organic business.
- Sales and earnings disappointments on the anniversaries of the JV transactions that artificially inflated sales and growth. The JV sales creates a high hurdle for 2015 comparables.
- Management has mentioned their interest in doing more acquisitions, perhaps larger ones. While not a short catalyst in the traditional sense, it does raise the risk profile of the company.

Risks to a short call include

- The company has several quarters to report before the Peanuts movie is released. There is time for the catalysts to work out. However, if the Peanuts movie should boost merchandising sales dramatically, it could provide a positive catalyst to the stock.
- On the latest earnings call, management mentioned the possibility of "taking control" of some of their existing JVs. If they do that, they have the ability to bring those future earnings back in-house. In addition, if they continue their practice of reporting revaluation gains as an offset to operating expenses, they will be able to inflate earnings unsustainably and artificially for those periods involving transactions.
- Lastly, as mentioned, the stock shows higher short interest than we like to see in a short recommendation. The catalysts and inflation of financial figures are so clear that we feel compelled to publish on this stock.

Model Results for ICONIX BRAND GROUP INC (ICON)

Data as of: 12-Feb-15

Stock at Risk Score*	◆ -1.2	Weak SAR score; Company exhibits significant risk characteristics
Valuation *	◆ -1.0	Expensive. Ignoring EV/S due to the licensing nature of ICON's business (and resulting high margins), ICON's EBITDA multiples are high at 15x trailing and 12x forward EBITDA.
Financial Condition *	◆ -1.2	Poor, mixed. The company is a serial acquirer of brands. Financing mostly with debt, its balance sheet is stretched with 5.5x EBITDA and 39% net debt to total market cap. Receivables are high as well at 112 days. Other current asset turnovers sit at 33 days.
Business Trends *	◆ -1.4	Poor. Sales are declining single digits and have for two quarters. Margins have eased as well with the combination pushing EBITDA and Cash from Operations down double digits. Other Current Asset turnover days have spiked this past quarter, often an indication of improper capitalization. Sellside estimate trends are flat to down.
Earnings Quality *	◆ -1.2	Poor. Accruals are building on the balance sheet. There is high potential equity dilution (a gap between basic and diluted shares). The company also booked gains on sale in revenues making it appear that sales are growing, when in fact, they declined.
Red Flags *	● 1.7	Gains on sale treated as revenues; one time non-cash revaluations treated as offsets to operating expenses.
Shortable?	B	Short interest is high at 29% of float with 19 days to cover.
Timing	A	Good momentum pattern for a short: a decline over the intermediate term followed by a stock spike.

Source: Two Rivers Analytics

* The SAR scores are measures of stock riskiness. Measured in standard deviations, a lower number indicates a riskier stock. The SAR scores range from approximately -2.5 (riskiest) to +2.3 (least risky/most attractive). It measures risk in the areas of Valuation, Financial Condition, Business Trend, Earnings Quality, and Red Flags for 1200+ US equities. The riskiest SAR names (approximately 40) are published weekly.

Company Data: Iconix Brand Group, Inc. (ICON)

Trading

Date	2/13/15
Price	35.72
52 Wk H/L	44.81 / 32.70
Market Cap/Ent. Value (\$mns)	1,714 / 3,068
Avg Daily Volume (thou)	921.8
Shares Outstanding (mn)	48.0
Float (mn / %)	45.3 / 94.5%
Short Interest (mn / SISO%)	14.2 / 29.6%
Days to Cover	19.7

Balance Sheet

	Sep-14
Cash & Eqv.	178
Total Debt	1,533
Net Debt	1,355
Net Debt / Capital (@mkt)	44%
Net Debt / EBITDA	7.5x

Earnings and Cash Flow

	LTM				Forecasts		
	Dec-11	Dec-12	Dec-13	Sep-14	Dec-14	Dec-15	Dec-16
Revenue	370	348	401	378	460	499	527
EBITDA	238	222	240	181	279	296	318
Interest Expense	(51)	(47)	(76)	(85)	0	0	0
Cap Exp.	(4)	(2)	(10)	(10)	(3)	(3)	(4)
Subtotal	184	173	154	86	277	293	315
Net Income	126	109	128	155	154	159	160
EPS	1.47	1.47	2.15	2.03	2.76	3.06	3.33

Valuation

	LTM	Forecasts		
	Sep-14	Dec-14	Dec-15	Dec-16
EV/EBITDA	16.9x	11.0x	10.4x	9.6x
EV/Sales	8.1x	6.7x	6.1x	5.8x
FCF Yield	5%	16%	17%	18%
PE	16.6x	12.9x	11.7x	10.7x

Source: Two Rivers Analytics

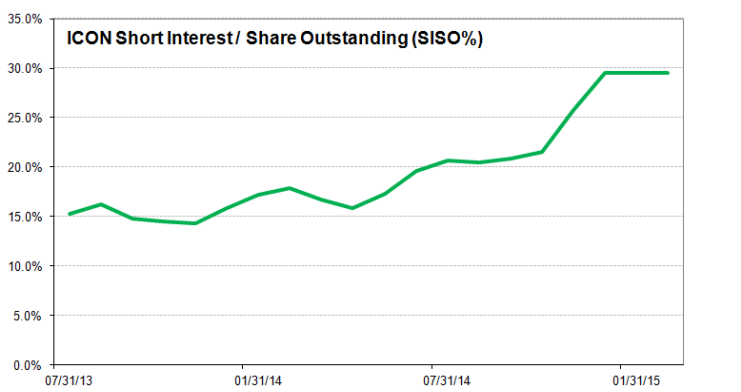
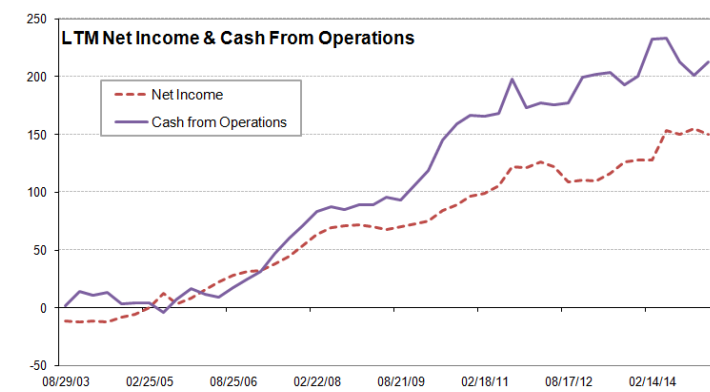
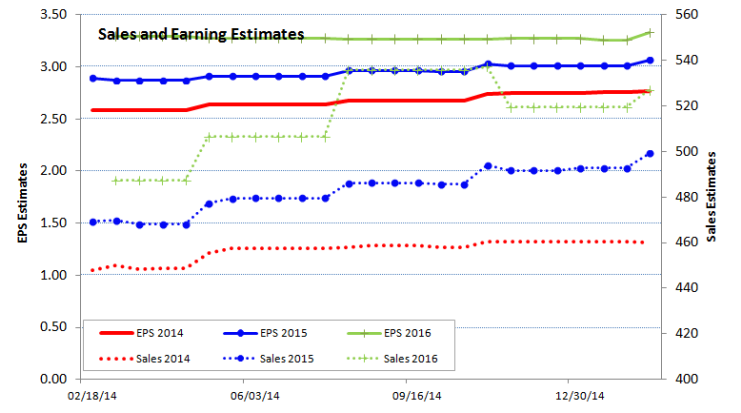
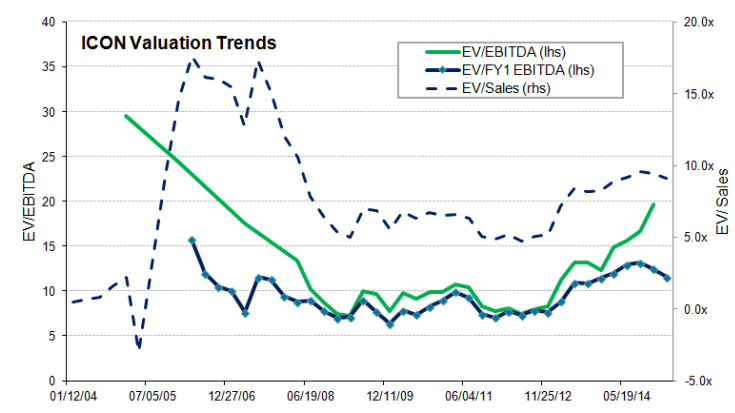
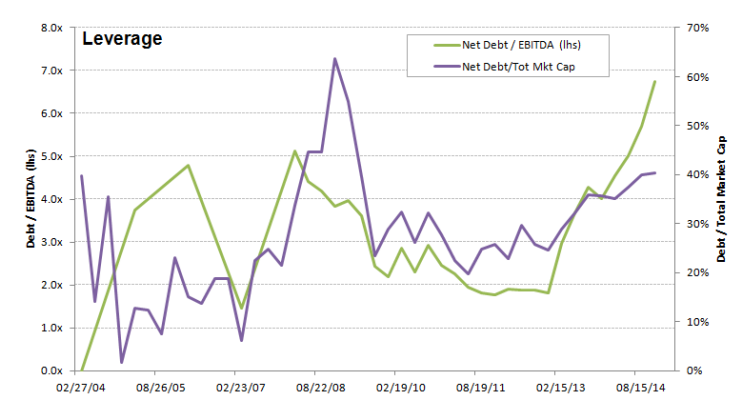
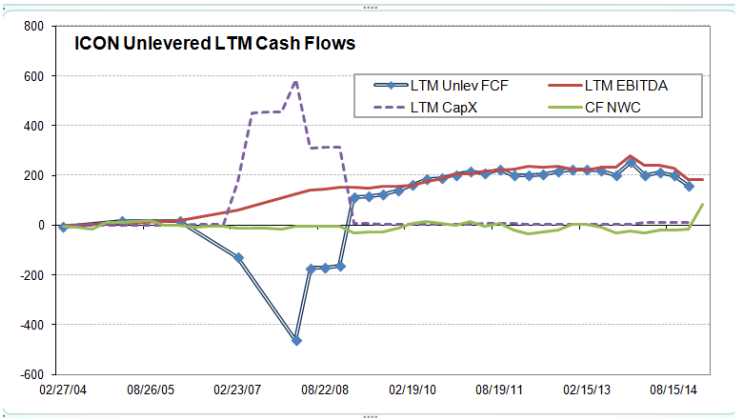
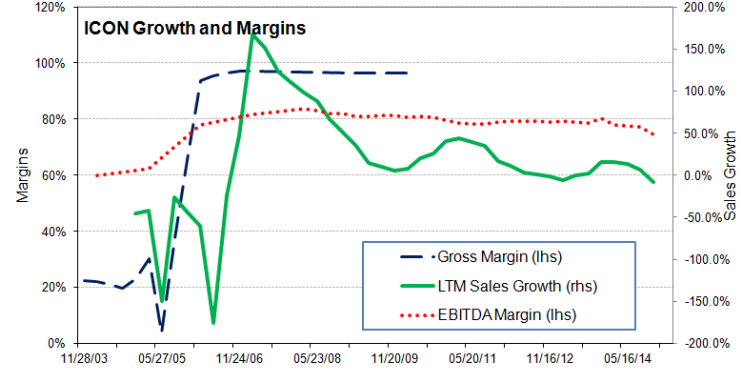
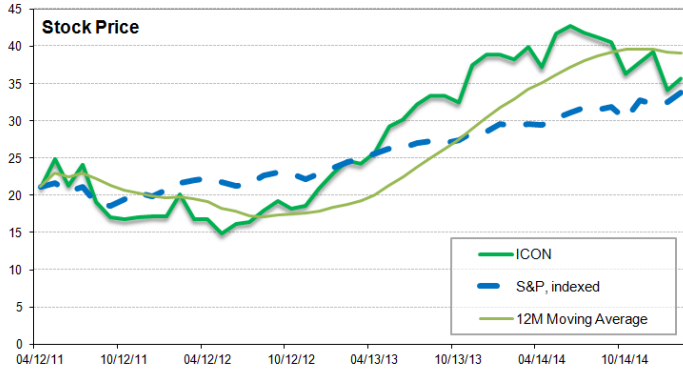
Below, please find:

- [Time series data on key company metrics](#)
- [Comparable companies analysis](#)
- [Time series charts on the company vs. its comps](#)
- [Scatter plots of forecast growth and valuation multiples](#)
- [Revisions trend vs. its comparables](#)
- [Correlations of stock price to various estimate revisions](#)

Iconix Brand Group, Inc. (ICON)

updated 2/13/2015

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

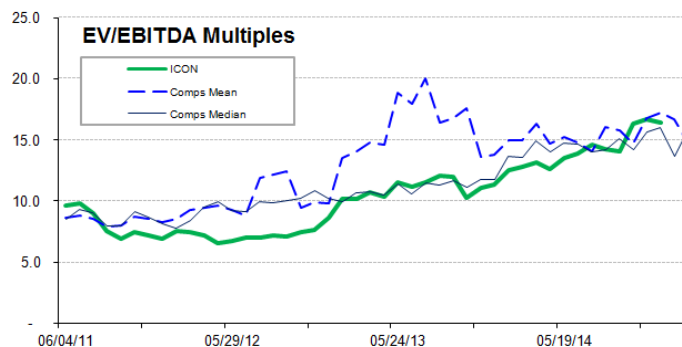
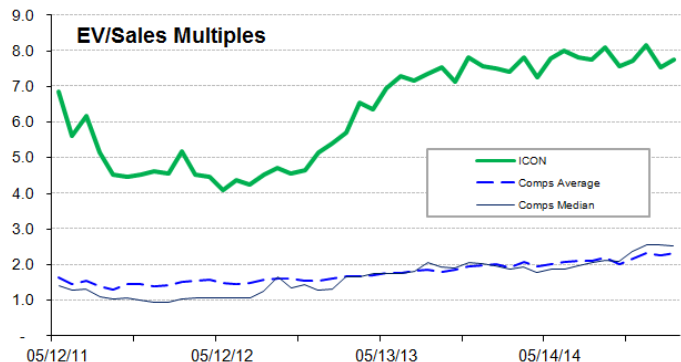
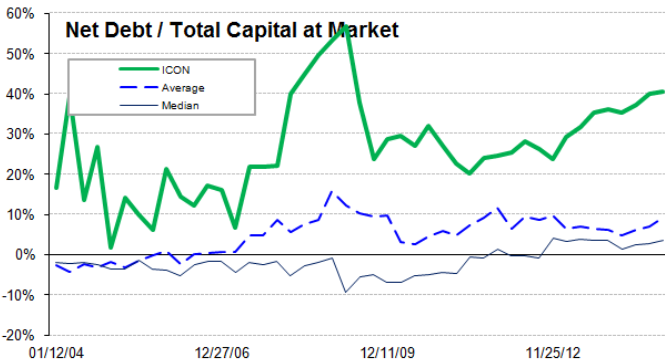
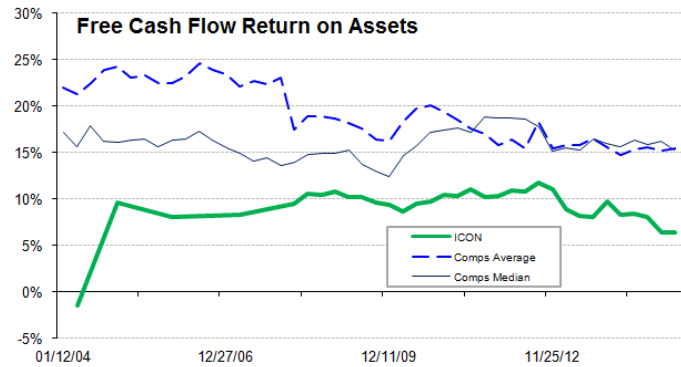
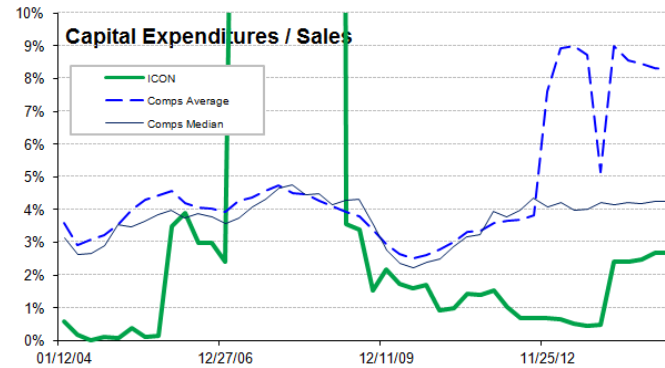
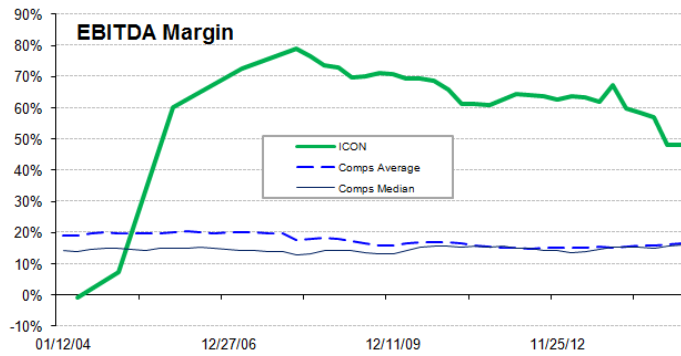
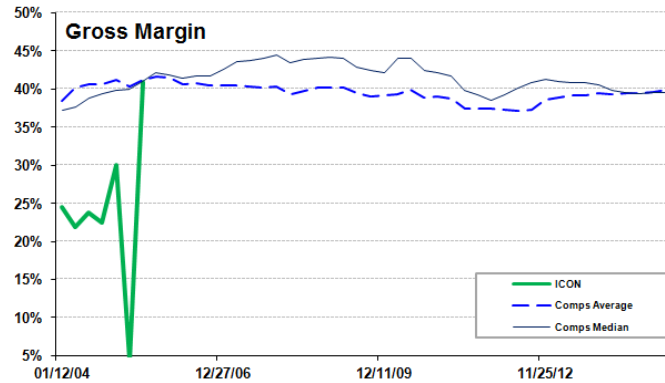
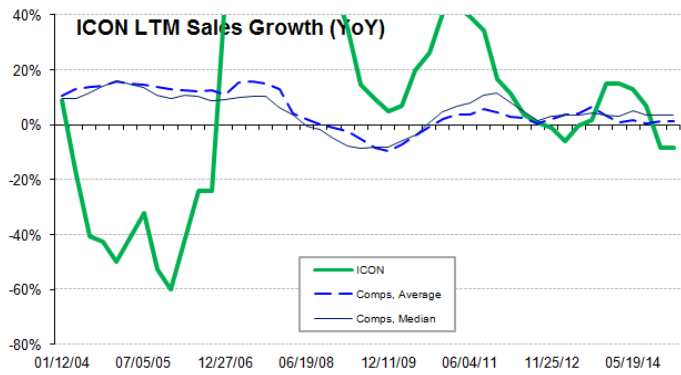


* As per GAAP financial statements; Unadjusted.

Iconix Brand Group, Inc. (ICON) and its comparable companies

updated 2/13/2015

Growth, Margins, Capex, Leverage, & Valuation



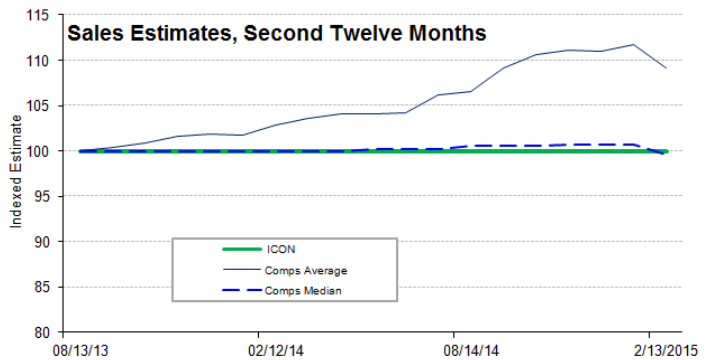
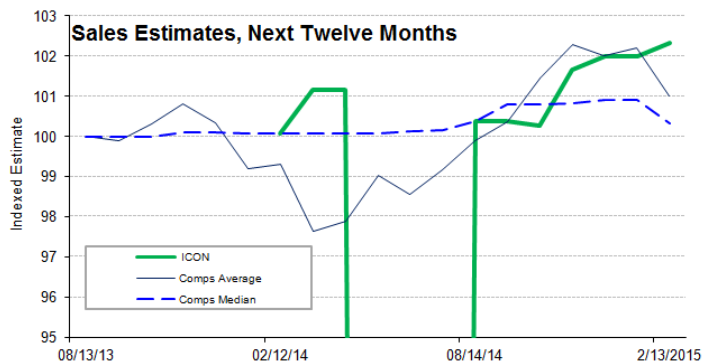
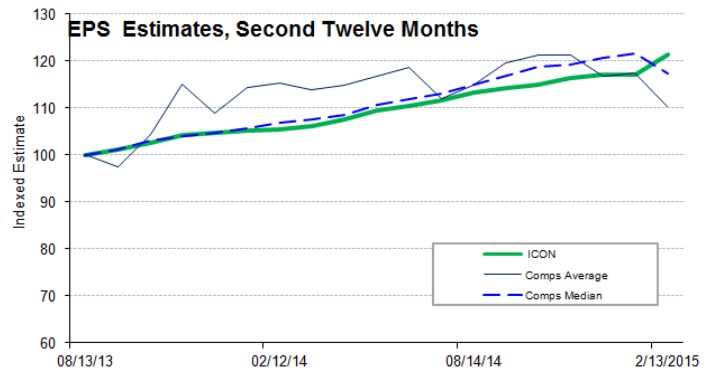
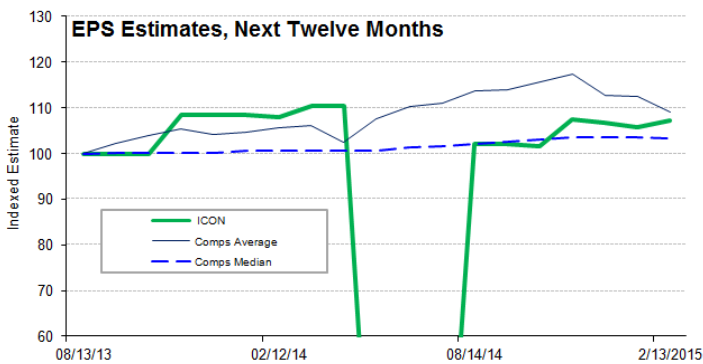
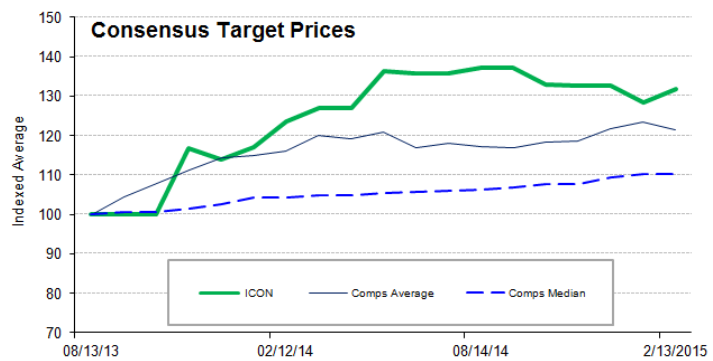
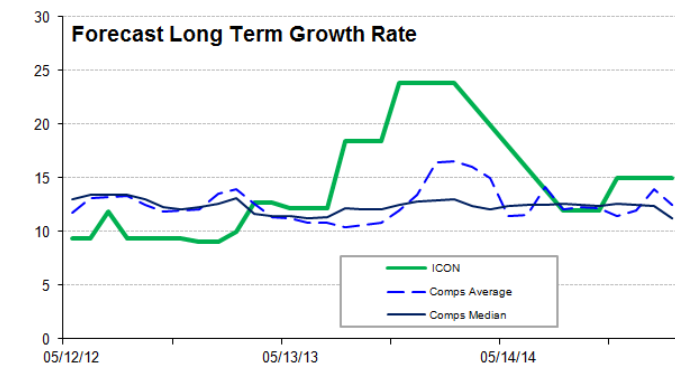
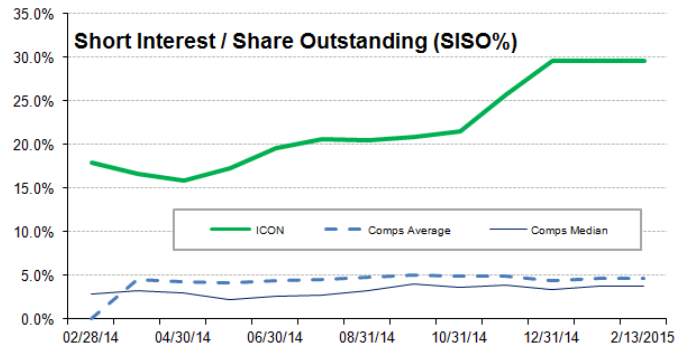
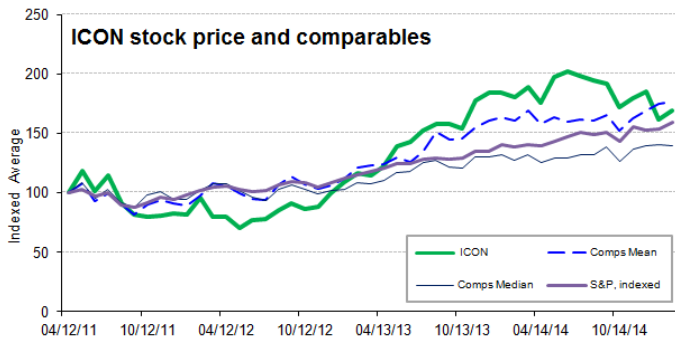
Source: Two Rivers Analytics;

Comparable companies: L Brands, Inc. (LB), V.F. Corporation (VFC), Hennes & Mauritz AB Class B (HMB-B-SE), Cherokee Inc. (CHKE), Kate Spade & Co (KATE), Quiksilver, Inc. (ZQK), Guess?, Inc. (GES), Gap, Inc. (GPS), Pacific Sunwear of California, Inc. (PSUN), Billabong International Limited (BBG-AU), ANN INC. (ANN), Hanesbrands Inc. (HBI), Ralph Lauren Corporation Class A (RL), NIKE, Inc. Class B (NKE).

Iconix Brand Group, Inc. (ICON) and its comparable companies

updated 2/13/2015

Stock Price, forecast growth, target prices, estimates and short interest



Comparable companies: L Brands, Inc. (LB), V.F. Corporation (VFC), Hennes & Mauritz AB Class B (HM.B-SE), Cherokee Inc. (CHKE), Kate Spade & Co (KATE), Quiksilver, Inc. (ZQK), Guess?, Inc. (GES), Gap, Inc. (GPS), Pacific Sunwear of California, Inc. (PSUN), Billabong International Limited (BBG-AU), ANN INC. (ANN), Hanesbrands Inc. (HBI), Ralph Lauren Corporation Class A (RL), NIKE, Inc. Class B (NKE).

Source: Two Rivers Analytics;

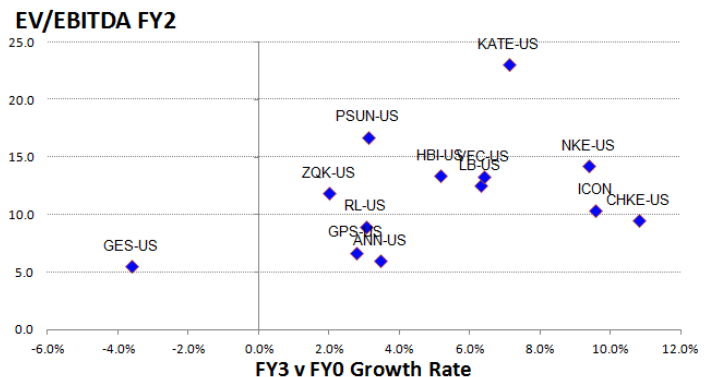
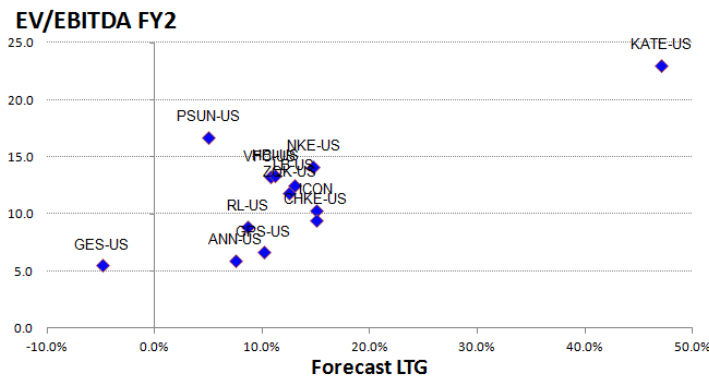
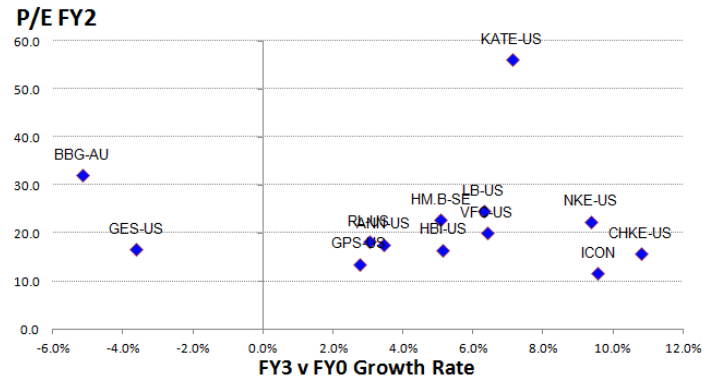
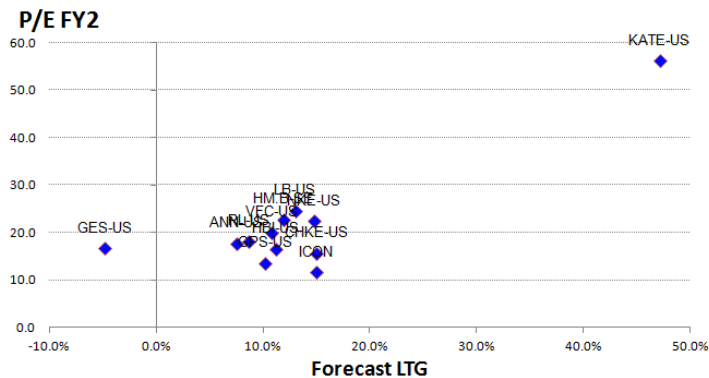
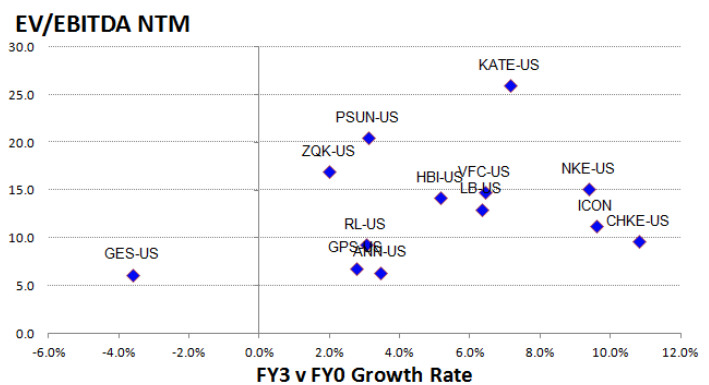
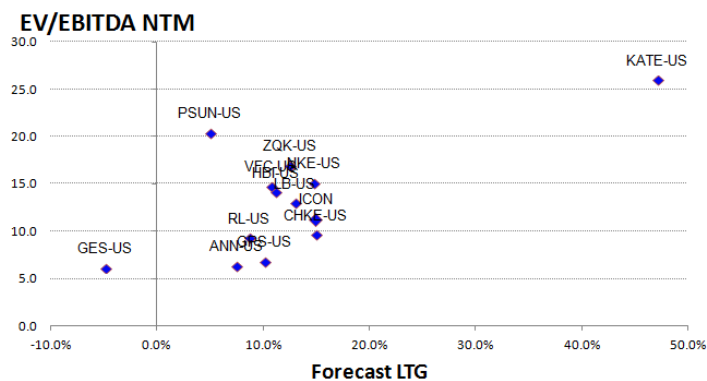
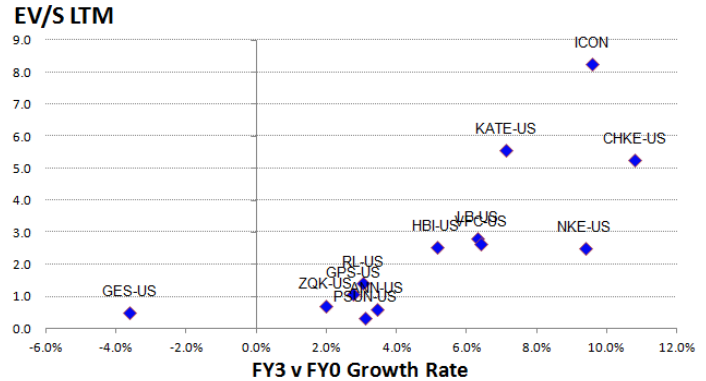
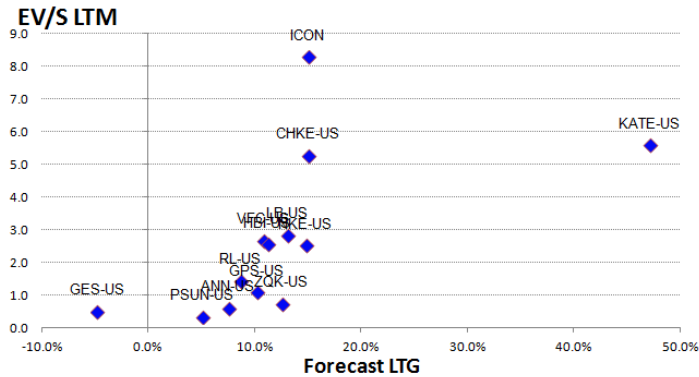
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Forecast Growth Rates vs. Valuations: Iconix Brand Group, Inc. (ICON) and its comparables

2/13/2015



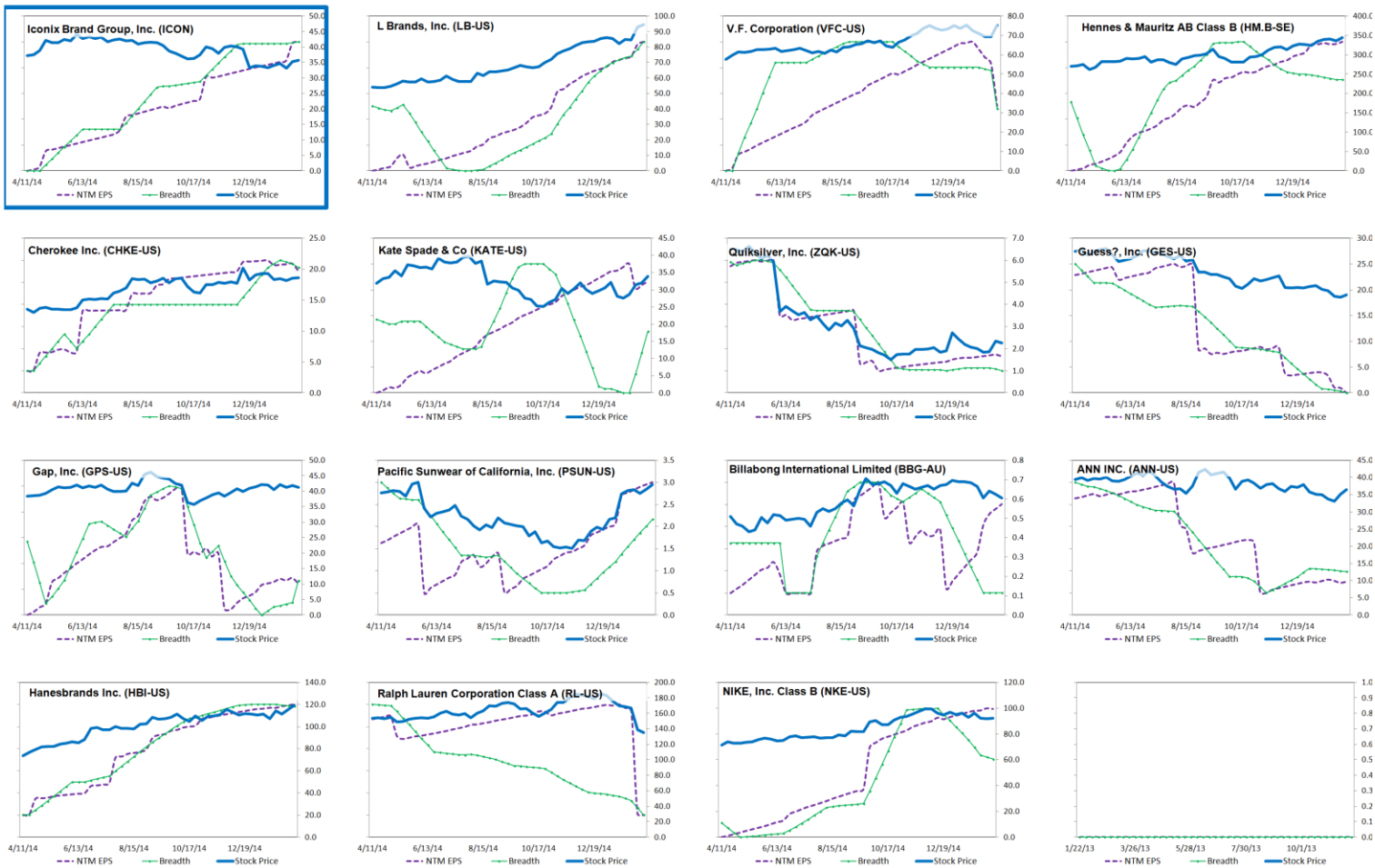
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Absolute Returns for Uncertain Markets™

Stock prices and Estimate Revisions

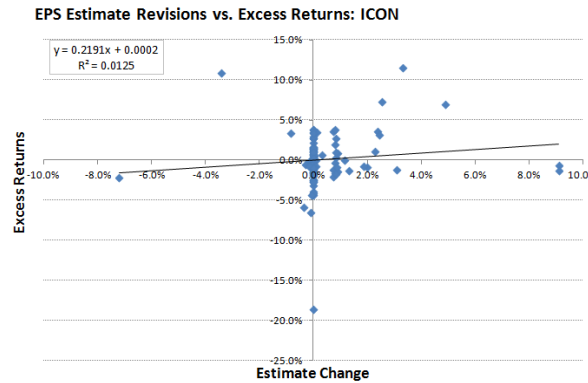
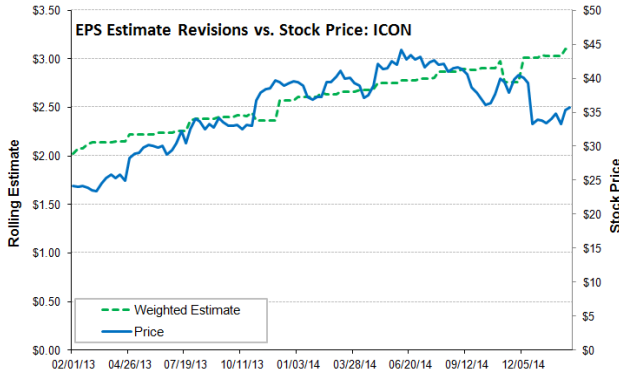
2/13/15



Source: Two Rivers Analytics; FactSet Research System Key: NTM EPS: The time weighted annual next twelve months consensus mean EPS. (FY1 EPS * % of year remaining in FY1 + FY2 EPS * (1 - % of year remaining in FY1))
 Breadth: The percent of analysts increases minus percent decreases over the past 45 days. The total is accumulated to create the time series. (If this period, more analysts cut than raise, the net % is subtracted from the prior period's total.)
 Stock Price: Only the stock price is scaled on the chart. The other metrics are to be viewed for their trends.

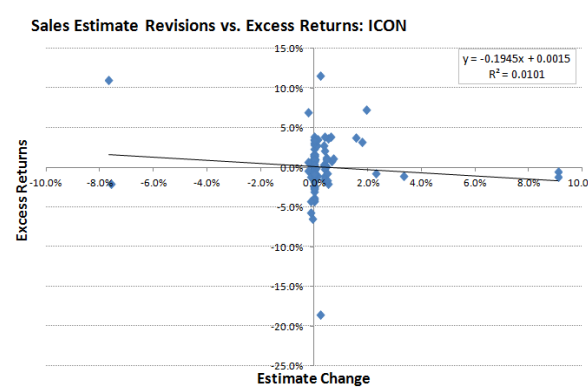
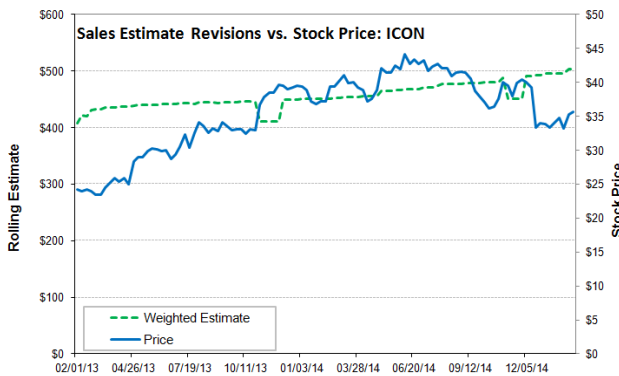
Iconix Brand Group, Inc. (ICON)
 Correlations with Wall Street Analysts Estimates

updated 2/13/2015



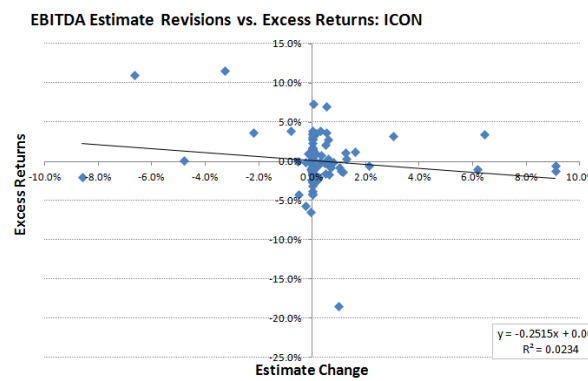
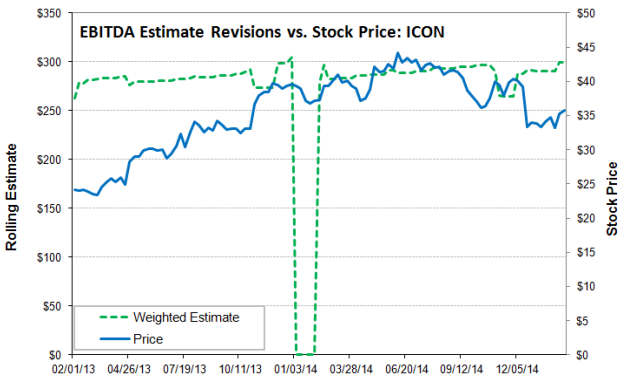
2 Yr. Correl. 11.2%
 6 Mon. Correl. 10.9%
 3 Mon. Correl. 7.3%

Economic Significance:
 Slope 0.22
 "a 1% increase in estimates = an x% increase in stock price"
 R-squared 0.01



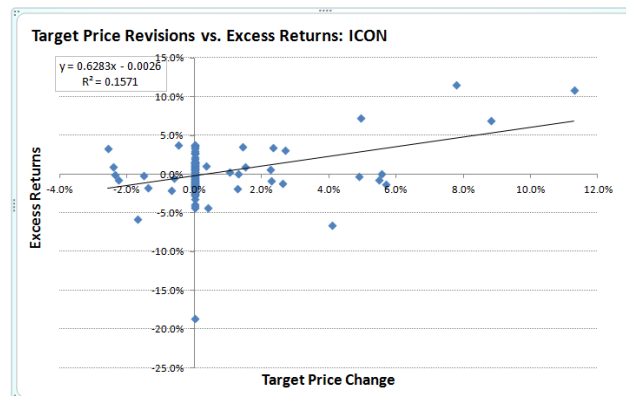
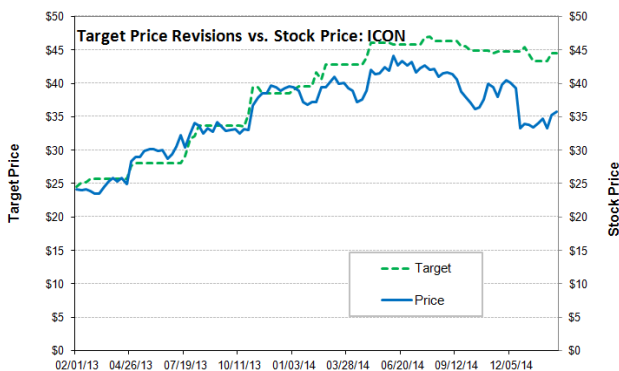
2 Yr. Correl. -10.1%
 6 Mon. Correl. 6.8%
 3 Mon. Correl. 4.5%

Economic Significance:
 Slope -0.19
 "a 1% increase in estimates = an x% increase in stock price"
 R-squared 0.01



2 Yr. Correl. nm
 6 Mon. Correl. -2.2%
 3 Mon. Correl. 1.4%

Economic Significance:
 Slope nm
 "a 1% increase in estimates = an x% increase in stock price"
 R-squared nm



2 Yr. Correl. 39.6%
 6 Mon. Correl. 16.9%
 3 Mon. Correl. 9.0%

Economic Significance:
 Slope 0.63
 "a 1% increase in target price = an x% increase in stock price"
 R-squared 0.16

Source: Two Rivers Analytics; data from FactSet Research Systems
 Outliers cut off at +70% and -70%.

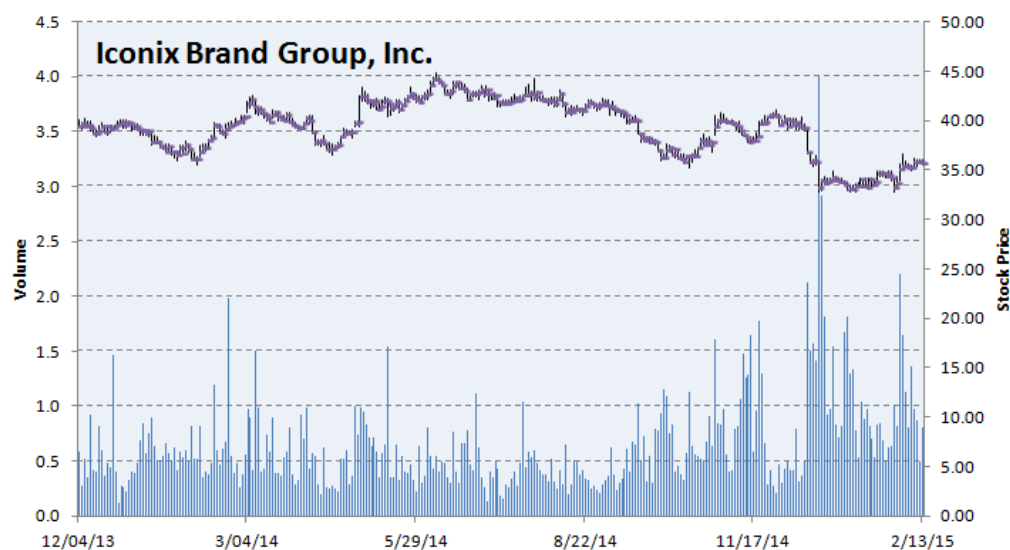
About Two Rivers Analytics

Two Rivers is dedicated to providing actionable, high quality investment ideas, with an emphasis on short ideas, to institutional investors.

Our work uses a hybrid quantitative/qualitative process to identify companies at high risk of a declining equity price. Our quantitative screening process identifies multiple categories of risk to create this Stock at Risk ranking. The ranking is vetted further through a timing/catalyst analysis and a shortability assessment. The best short ideas are analyzed fundamentally and presented to clients.

For more information, including our process, influences and biographies, please visit TwoRiversAnalytics.com.

Important Disclosures



Ratings History: We are initiating coverage with a short recommendation.

Two Rivers Analytics rates a stock Sell/Sell Short based on characteristics that we feel indicate the stock is poised for a significant downturn and will underperform the market substantially. We have not issued any Buy or Hold ratings to date.

Analyst Certification

I, Eric Fernandez, hereby certify that the views expressed in the foregoing research report accurately reflect my personal views about the subject securities and issuer(s) as of the date of this report. I further certify that no part of my compensation was, is or will be directly, or indirectly, related to the specific recommendations or views contained in this report. Neither I, nor a member of my household is an officer, director, or advisory board member of the issuer(s) or has another significant affiliation with the issuer(s) that is/are the subject of this research report. I do not know or have reason to know at the time of this publication of any other material conflict of interest.

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