

DESTINY MEDIA TECHNOLOGIES INC  
Form 10QSB  
July 15, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended May 31, 2005

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-028259

**DESTINY MEDIA TECHNOLOGIES INC.**

(Exact name of registrant as specified in its charter)

**COLORADO**

(State or other jurisdiction of  
incorporation or organization)

**84-1516745**

(IRS Employer Identification No.)

**1055 West Hastings Street, Suite 1040, Vancouver,  
British Columbia Canada V6E 2E9**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(604) 609-7736**

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 past 12 months and (2) has been subject to the above filing requirements for the past 90 days.

Yes ☑ No ☐

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:  
**36,434,223 Shares of \$0.001 par value common stock outstanding as of May 31, 2005.**

Transitional small business disclosure format (check one):

Yes o No ý

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**PART I - FINANCIAL INFORMATION**

**Item 1. FINANCIAL STATEMENTS.**

Interim Consolidated Financial Statements  
(Expressed in United States dollars)

**DESTINY MEDIA TECHNOLOGIES INC.**

Nine months ended May 31, 2005

(Unaudited)

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**DESTINY MEDIA TECHNOLOGIES INC.**

Consolidated Balance Sheets

(Expressed in United States dollars)

(Unaudited)

(See Note 2 – Basis of Presentation)

|   | May 31,<br>2005   | August 31,<br>2004 |
|---|-------------------|--------------------|
| <b>Assets</b>   |                   |                    |
| <b>Current assets:</b>  |                   |                    |
| Cash  | \$ 664            | \$ 17,523          |
| Short-term investments  | -                 | 8,661              |
| Accounts and other receivables, net of allowance for doubtful<br>accounts of \$9,052 (August 31, 2004 - \$19,291) | 12,083            | 67,484             |
| Inventory   | 2,322             | 3,480              |
| Prepaid expenses  | 2,204             | 18,846             |
| <b>Total current assets</b>   | <b>17,273</b>     | <b>115,994</b>     |
| Software development costs, net of accumulated amortization<br>of \$21,632 (August 31, 2004 - \$nil)              | 107,402           | 81,857             |
| Property and Equipment, net of accumulated amortization of \$201,943<br>(August 31, 2004 - \$163,892)             | 67,639            | 73,572             |
| Other assets, net of accumulated amortization of \$82,119<br>(August 31, 2004 - \$73,306)                         | -                 | 5,198              |
| <b>Total assets</b>   | <b>\$ 192,314</b> | <b>\$ 276,621</b>  |
| <b>Liabilities and Stockholders' Deficiency</b>   |                   |                    |
| <b>Current liabilities:</b>   |                   |                    |
| Accounts payable and accrued liabilities (notes 4 and 8)  | \$ 291,792        | \$ 440,997         |
| Shareholder loans payable (note 5)  | 157,670           | 20,564             |
| Deferred revenue  | 50,673            | 62,305             |
| <b>Total current liabilities</b>  | <b>500,135</b>    | <b>523,866</b>     |
| Deferred leasehold inducement   | 60,733            | 73,071             |
| Obligation for share settlement (note 6)  | 100,000           | 100,000            |
| <b>Stockholders' deficiency: (note 7)</b>   |                   |                    |
| Common stock, par value \$0.001   |                   |                    |
| Authorized: 100,000,000 shares  |                   |                    |
| Issued and outstanding: 36,434,223 shares   |                   |                    |
| (August 31, 2004 – 35,316,098 shares)   | 36,436            | 35,318             |

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|  |             |             |
|--|-------------|-------------|
| Issued and held for settlement: 133,333 shares |             |             |
| Additional paid-in capital                     | 4,045,044   | 3,688,208   |
| Deferred stock compensation                    | (29,242)    | -           |
| Stock issuable                                 | -           | 25,000      |
| Deficit  | (4,428,684) | (4,088,494) |
| Accumulated other comprehensive loss           | (92,108)    | (80,348)    |
| Total stockholders' deficiency                 | (468,554)   | (420,316)   |
| Total liabilities and stockholders' deficiency | \$ 192,314  | \$ 276,621  |

See accompanying notes to interim consolidated financial statements.

**DESTINY MEDIA TECHNOLOGIES INC.**

Consolidated Statements of Operations

(Unaudited)

(Expressed in United States dollars)

|  | Three<br>months<br>ended<br>May 31,<br>2005 | Three<br>months<br>ended<br>May 31,<br>2004 | Nine<br>months<br>ended<br>May 31,<br>2005 | Nine<br>months<br>ended<br>May 31,<br>2004 |
|--|---|---|--|--|
| Revenue  | \$ 154,678                                  | \$ 169,549                                  | \$ 575,103                                 | \$ 568,172                                 |
| Operating expenses:  |   |   |  |  |
| General and administrative                                       | 101,187                                     | 91,657                                      | 299,098                                    | 388,274                                    |
| Sales and marketing  | 86,148                                      | 117,431                                     | 294,271                                    | 317,294                                    |
| Research and development   | 88,782                                      | 69,491                                      | 264,267                                    | 249,459                                    |
| Depreciation and amortization                                    | 19,341                                      | 17,752                                      | 49,513                                     | 31,680                                     |
|  | 295,458                                     | 296,331                                     | 907,149                                    | 986,707                                    |
| Loss before undernoted   | (140,780)                                   | (126,782)                                   | (332,046)                                  | (418,535)                                  |
| Other earnings (expenses):                                       |   |   |  |  |
| Gain on extinguishment of debt                                   | -   | 11,385                                      | -  | 79,215                                     |
| Interest and other income  | -   | 779   | 67   | 12,205                                     |
| Interest and other expense                                       | (2,957)                                     | (839)                                       | (8,211)                                    | (5,289)                                    |
|  | (2,957)                                     | 11,325                                      | (8,144)                                    | 86,131                                     |
| Net loss for the period  | \$ (143,737)                                | \$ (115,457)                                | \$ (340,190)                               | \$ (332,404)                               |
| Net Loss per common share,                                       |   |   |  |  |
| Basic and diluted  | \$ (0.01)                                   | \$ (0.01)                                   | \$ (0.01)                                  | \$ (0.01)                                  |
| Weighted average common shares<br>outstanding, basic and diluted | 36,381,723                                  | 35,253,598                                  | 35,866,274                                 | 34,501,773                                 |

See accompanying notes to interim consolidated financial statements.

**DESTINY MEDIA TECHNOLOGIES INC.**

Consolidated Statements of Stockholders' Deficiency  
(Expressed in United States dollars)

|   | Common stock  |           | Additional   | Shares    | Deferred     | Deficit        | Accumulated   |
|---|---------------|-----------|--------------|-----------|--------------|----------------|---------------|
|   | Shares        | Amount    | Paid-in      | Issuable  | stock        |                | and other     |
|   |               |           | capital      |           | compensation |                | comprehensive |
|   |               |           |              |           |              |                | loss          |
| Balance, August 31, 2004                          | 35,316,098 \$ | 35,318 \$ | 3,688,208 \$ | 25,000 \$ | -            | \$ (4,088,494) | \$ (80,348)   |
| Loss for the period                               | -             | -         | -            | -         | -            | (340,190)      | -             |
| Cumulative translation adjustment                 | -             | -         | -            | -         | -            | -              | (11,760)      |
| Comprehensive loss                                | -             | -         | -            | -         | -            | -              | -             |
| Common stock issued on options exercised (note 7) | 1,118,125     | 1,118     | 317,059      | (25,000)  | -            | -              | -             |
| Deferred stock compensation                       | -             | -         | 39,777       | -         | (29,242)     | -              | -             |
| Balance, May 31, 2005                             | 36,434,223 \$ | 36,436 \$ | 4,045,044 \$ | - \$      | (29,242)     | \$ (4,428,684) | \$ (92,108)   |

See accompanying notes to interim consolidated financial statements.



**DESTINY MEDIA TECHNOLOGIES INC.**

## Interim Consolidated Statements of Cash Flows

(Unaudited)

(Expressed in United States dollars)

|  | Nine months<br>Ended<br>May 31,<br>2005 | Nine months<br>Ended<br>May 31,<br>2004 |
|--|---|---|
| Operating activities:                                  |   |   |
| Net loss for the period                                | \$ (340,190)                            | \$ (332,404)                            |
| Items not involving cash:                              |   |   |
| Depreciation and amortization                          | 49,513                                  | 31,680                                  |
| Shares issued for services rendered                    | -                                       | 80,000                                  |
| Deferred lease benefit                                 | (15,953)                                | -                                       |
| Stock-based compensation – employees                   | -                                       | 865                                     |
| Stock-based compensation – non-employees               | 10,535                                  | 70,361                                  |
| Changes in non-cash working capital:                   |   |   |
| Short term investments                                 | 9,204                                   | -                                       |
| Accounts and other receivables                         | 59,442                                  | 102,676                                 |
| Inventory  | 1,339                                   | 1,049                                   |
| Prepaid expenses                                       | 17,789                                  | (8,791)                                 |
| Accounts payable and accrued liabilities               | (171,545)                               | (173,923)                               |
| Deferred revenue                                       | (14,733)                                | (35,966)                                |
| Net cash used in operating activities                  | (394,599)                               | (264,453)                               |
| Investing activities:                                  |   |   |
| Purchase of equipment                                  | (7,512)                                 | (6,618)                                 |
| Purchase of other assets                               | -                                       | (1,782)                                 |
| Software development costs                             | (49,481)                                | -                                       |
| Net cash used in investing activities                  | (56,993)                                | (8,400)                                 |
| Financing activities:                                  |   |   |
| Net proceeds (repayments) to shareholder loans payable | 138,330                                 | 9,013                                   |
| Proceeds from exercise of stock options                | 293,177                                 | 9,375                                   |
| Proceeds from issuance of common stock                 | -                                       | 270,000                                 |
| Net cash provided by financing activities              | 431,507                                 | 288,388                                 |
| Net (decrease) increase in cash<br>during the period   | (20,082)                                | 15,535                                  |
| Effect of foreign exchange rate changes on cash        | 3,226                                   | (3,297)                                 |
| Cash, beginning of period                              | 17,523                                  | 6,123                                   |
| Cash, end of period                                    | \$ 664                                  | \$ 18,361                               |

Supplementary disclosure:

Cash paid for:

|          |    |       |    |       |
|----------|----|-------|----|-------|
| Interest | \$ | 5,254 | \$ | 5,289 |
|----------|----|-------|----|-------|

See accompanying notes to interim consolidated financial statements.

# DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Nine months ended May 31, 2005

## 1. Organization:

Destiny Media Technologies Inc. (the "Company") was incorporated in August 1998 under the laws of the State of Colorado. The Company develops enabling technologies that allow for the distribution over the Internet of digital media files in either a streaming or digital download format. The technologies are proprietary. The Company operates out of Vancouver, BC, Canada and serves customers predominantly located in the United States and Canada.

## 2. Basis of Presentation:

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with Item 310(b) of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended May 31, 2005 are not necessarily indicative of the results that may be expected for the year ended August 31, 2005.

The balance sheet at August 31, 2004 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended August 31, 2004.

The interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future.

The Company incurred an operating loss of \$340,190 for the nine months ended May 31, 2005 (May 31, 2004 - \$332,404), has incurred cumulative losses of \$4,428,684 at May 31, 2005 and has a working capital deficiency of \$482,862 as at May 31, 2005 that raises substantial doubt about its ability to continue as a going concern. Management has been able, thus far, to finance the operations through a series of equity financings and shareholder loans. Management plans to continue to seek sources of financing on favorable terms; however, there are no assurances that any such financing can be obtained on favorable terms, if at all. Management expects to keep its operating costs to a minimum until cash is available through financing or operating activities. There are no assurances that the Company will be successful in achieving these goals.

## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Nine months ended May 31, 2005

### **2. Basis of Presentation (continued):**

In view of these conditions, the ability of the Company to continue as a going concern is in substantial doubt and dependent upon achieving a profitable level of operations and on the ability of the Company to obtain necessary financing to fund ongoing operations. Management believes that its current and future plans enable it to continue as a going concern. These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

### **3. Recent Accounting Pronouncements:**

In December 2004, the FASB issued Statement of Financial Accounting Standards 123R "Share-Based Payment," a revision to FAS 123. FAS 123R replaces existing requirements under FAS 123 and APB 25, and requires public companies to recognize the cost of employee services received in exchange for equity instruments, based on the grant-date fair value of those instruments, with limited exceptions. FAS 123R also affects the pattern in which compensation cost is recognized, the accounting for employee share purchase plans, and the accounting for income tax effects of share-based payment transactions. For small-business filers, FAS 123R will be effective for interim or annual periods beginning after December 15, 2005. Early adoption is permitted in periods in which financial statements have not yet been issued. The Company expects to adopt FAS 123R on March 1, 2006. As permitted by FAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, the adoption of FAS 123R's fair value method will have a significant impact on the Company's statement of operations, although it will have no impact on the Company's overall financial position. The impact of adoption of FAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted FAS 123R in prior periods, the impact of that standard would have approximated the impact of FAS 123 as described in the disclosure of pro forma net loss and loss per share in Note 7 to these unaudited interim consolidated financial statements.

### **4. Accounts payable and accrued liabilities:**

Accrued liabilities as at May 31, 2005 totaled \$60,310 (August 31, 2004 - \$33,648). Accounts payable includes \$164,498 of disputed items, including those outlined in note 8.

### **5. Shareholder loans:**

Shareholder loans payable as at May 31, 2005 totaled \$157,670 (August 31, 2004 - 20,564). These amounts are non-interest bearing and have no specific repayment terms.

### **6. Obligation for share settlement:**

During the fiscal year ended August 31, 2003, the Company issued 133,333 common shares to be delivered in settlement for proceeds of \$100,000 received in respect of a private placement that did not complete in August of 2000. As the private placement did not complete and although management expects that the amount ultimately will be settled through the release of the shares, the obligation for share settlement is recorded as a liability until settlement results between the Company and parties involved in the August 2000 private placement.

**DESTINY MEDIA TECHNOLOGIES INC.**

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Nine months ended May 31, 2005

**7. Share capital:**

## (a) Common shares issued for cash:

During the nine month period ended May 31, 2005, the Company issued 1,118,125 common shares. These shares were issued pursuant to option agreements, for which the Company received gross proceeds of \$318,177. Included in this amount is \$25,000 for 100,000 shares that remained issuable at August 31, 2004 for net proceeds during the period of \$293,177.

## (b) Stock option plan:

Pursuant to a stock option plan amended March 29, 2004, the Company has reserved 3,750,000 common shares for future issuance under its stock option plan. At May 31, 2004 2,387,000 (August 31, 2004, 3,127,000) options had been granted and were outstanding and an additional 182,375 (August 31, 2004 – 623,000) shares were available for grant under the Plan.

Stock option activity is presented below:

|                              | Number of<br>options | Weighted<br>average<br>exercise<br>price |
|------------------------------|----------------------|--|
| Outstanding, August 31, 2004 | 3,127,000            | 0.49                                     |
| Granted                      | 658,125              | 0.46                                     |
| Exercised                    | (1,018,125)          | 0.29                                     |
| Forfeited                    | (330,000)            | 0.94                                     |
| Expired                      | (50,000)             | 0.50                                     |
| Outstanding, May 31, 2005    | 2,387,000            | \$ 0.44                                  |

Of the total options outstanding at May 31, 2005, 1,895,000 (August 31, 2004 – 2,525,000) were granted to employees and 492,000 (August 31, 2004 – 602,000) were granted to non-employees of the Company. The compensation expense related to options granted to non-employees was \$10,535 for the nine months ending May 31, 2005 (May 31, 2004 – \$70,361) and \$6,321 for the 3 months ending May 31, 2005 (May 31, 2004 - \$19,921), calculated in accordance with SFAS 123

## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Nine months ended May 31, 2005

### 7. Share Capital (continued):

(c) Pro-forma disclosure of stock based compensation:

Pro forma information regarding results of operations and earnings (loss) per share is required by SFAS 123, as amended by SFAS 148, for stock-based awards to employees as if the Company had accounted for such awards using the fair value method.

The fair value of the Company's stock-based awards granted to employees for the three and nine-month periods ended May 31, 2005 was estimated using the Black-Scholes option-pricing model. The weighted average assumptions used and the resulting estimates of weighted average fair value of stock options granted issued during the following periods were as follows:

|  | For the Three Months<br>ended May 31 |         | For the Nine Months<br>ended May 31 |         |
|--|--------------------------------------|---------|-------------------------------------|---------|
|  | 2005                                 | 2004    | 2005                                | 2004    |
| Expected life of employee stock options (in years)   | 2.42                                 | 2.00    | 2.42                                | 2.00    |
| Volatility   | 99%                                  | 180%    | 99%                                 | 180%    |
| Risk-free interest rate  | 5.50%                                | 5.50%   | 5.50%                               | 5.50%   |
| Dividend yields  | 0%                                   | 0%      | 0%                                  | 0%      |
| Weighted average fair value of stock options under<br>employee stock option plans granted during the<br>period | \$ 0.20                              | \$ 0.27 | \$ 0.20                             | \$ 0.27 |

For pro forma purposes, the estimated value of the Company's stock-based awards to employees is amortized over the vesting period of the underlying options. The effect on the Company's net loss and loss per share of applying SFAS 123 to the Company's stock-based awards to employees would approximate the following:

|  | For the 3 months ended |              | For the 9 months ended |              |
|--|------------------------|--------------|------------------------|--------------|
|  | May 31, 2005           | May 31, 2004 | May 31, 2005           | May 31, 2004 |
| Net loss for the period:                           |                        |              |                        |              |
| As reported  | \$ (143,737)           | \$ (115,457) | \$ (340,190)           | \$ (332,404) |
| Stock-based compensation<br>expense recognized     | -                      | -            | -                      | 865          |
| Compensation expense based<br>on fair value method | (4,925)                | (52,395)     | (8,265)                | (157,186)    |
| Pro forma loss                                     | \$ (148,662)           | \$ (167,852) | \$ (348,455)           | \$ (488,725) |
| Net loss per share, basic and<br>diluted:          |                        |              |                        |              |

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|             |    |        |    |        |    |        |    |        |
|-------------|----|--------|----|--------|----|--------|----|--------|
| As reported | \$ | (0.01) | \$ | (0.01) | \$ | (0.01) | \$ | (0.01) |
| Pro forma   | \$ | (0.01) | \$ | (0.01) | \$ | (0.01) | \$ | (0.02) |



## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Nine months ended May 31, 2005

### 8. Contingencies:

- (a) A subsidiary of the Company commenced legal proceedings against Impatica.com Inc. ("Impatica") for payment of approximately \$512,500 in unpaid technology licensing fees. It is the Company's position that Impatica repudiated the licensing agreement and that the unpaid license fees totaling \$512,500 are a debt owing by Impatica to the Company.

The defendant has denied liability to the Company on the basis that the license agreement was not formalized. The defendant has filed a counterclaim against the Company seeking return of \$162,500 advanced to the Company on an alleged "good faith" agreement based on the allegation that the technology did not perform as represented. These funds were recorded as revenues earned in accordance with the Company's revenue recognition policy in fiscal 2001. At May 31, 2005 the outcome of this claim and counterclaim is not determinable. As such, no amounts have been accrued at quarter end.

- (b) On September 14, 2004, a statement of claim was filed against the Company by its former solicitor for fees and accrued interest of \$145,978 CDN relating to legal services provided in connection with a failed transaction in 2001 and other general corporate matters. It is the Company's position that a significant portion of the fees being sought by its former solicitor are unwarranted and that the fees should not be borne by the Company. The Company has engaged legal counsel to defend itself and has launched a counterclaim. The Writ of Summons was filed in the BC Supreme Court on September 14, 2004. As at August 31, 2004 and May 31, 2005, the company has accrued for the disputed fees, but not the accrued interest and will seek all options available to extinguish this debt. Any adjustments to the amounts recognized will be recorded when determinable.

### 9. Related party transactions and balances:

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

- (a) During the nine month period ended May 31, 2005, the Company earned \$ Nil (May 31, 2004 - \$4,695) in rental revenue from space sublet to a director.
- (b) During the nine month period ended May 31, 2005, the Company earned \$ Nil (May 31, 2004 - \$7,510) in rental revenue from space sublet to a company in which an officer is a significant shareholder.

### 10. Comprehensive loss:

Comprehensive loss was \$(138,337) and \$(351,195) for the three and nine month periods ended May 31, 2005 and \$(127,021) and \$(343,138) for the three and nine month periods ended May 31, 2004.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with the accompanying financial statements and notes thereto included within this Quarterly Report on Form 10-QSB. In addition to historical information, the information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding the Company's capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "Intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors described in this Quarterly Report, including the risk factors accompanying this Quarterly Report, and, from time to time, in other reports the Company files with the Securities and Exchange Commission. These factors may cause the Company's actual results to differ materially from any forward-looking statement. The Company disclaims any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

### OVERVIEW

Destiny Media Technologies Inc. (the "Company", "Destiny Media" or "we") is a holding company which owns 100% of the outstanding shares of Destiny Software Productions, Inc. Destiny Software Productions, Inc. is the operating company. The "Company", "Destiny" or "we" refers to the consolidated activities of both companies.

The company is the developer and marketer of innovative technologies which facilitate the distribution of digital media content. All four technologies discussed below are commercially mature and ready for market.

**Clipstream™** Our Clipstream™ family of software products enables our customers to deliver audio and video streaming media via the Internet without requiring the viewer to install software media players or requiring the customer to deploy server technology.

**MPE™** Our MPE™ software is an audio and video media distribution system that enables artists and other media rights owners to securely distribute their media through the Internet. All electronic content is locked to the digital fingerprint of the destination computer.

Currently the system is being used to instantly distribute individual songs from various record labels. If the songs are exported to CD, a digital watermark is invisibly embedded into the song, so the originating computer can be identified. Our system supports the distribution of music, but it may be adopted to move video, software, research reports, or other electronic media.

**RadioDestiny Broadcaster** Our RadioDestiny Broadcaster software enables our customers to broadcast a professional Internet radio station from the customer's personal computer.



Destiny Media Player                      Our Destiny Media Player software enables a customer to listen to MP3 music files and to listen to RadioDestiny™ Internet broadcasts on their personal computer.

All four technologies are proprietary and were developed by the company.

In October 2004, the company released an adapted version of MPE™ which facilitates the transfer of music from the recording industry to radio stations and trusted users. We have begun recognizing revenue associated with this new version of MPE™ during the first three quarters of fiscal 2005 during the pilot phase of implementation. Management anticipates that revenues will grow significantly as the system gains acceptance by the industry.

Pirate Radio sales are also expected to continue and management is pursuing retail distribution of the Pirate Radio software.

We are a publicly traded company. Our common stock trades on the OTC Bulletin board under the symbol “DSNY” and on the Berlin exchange in Germany under the symbol “DME”.

Our corporate website is located on the Internet at <http://www.dsnyc.com>.

## **PLAN OF OPERATIONS**

During our fiscal year ending August 31, 2005, management will focus on the introduction of our MPE™ digital music distribution system into full time commercial use. We anticipate that our MPE™ technology will be integrated into third party products. We will continue to market the MPE™ digital rights management system to the recording industry.

We have entered into a pilot program and license agreement with the Universal Music Group (“UMG”). UMG will use the MPE™ system to securely distribute new music tracks to radio and trusted users. We have completed the pilot phase of the agreement on May 31, 2005 and negotiations of our license agreement are on-going.

Historically our largest source of revenue has been our Clipstream™ suite of products. Management believes that our Clipstream™ suite of products has significant advantages over other competitors in the industry. Through increased expenditures on sales and marketing, management anticipates an increase in revenue as awareness of our products expands. We also anticipate the launch of new versions of various products in the Clipstream™ Suite and are currently pursuing opportunities to expand the uses of our technology in association with existing technologies such as Java based cellular phones.

We will continue to sell the Pirate Radio suite online and through Amazon.com. We will also market this internet radio broadcast system to private radio networks and retail channels.

**OPERATING RESULTS****Nine Months Ended May 31, 2005****OPERATING RESULTS****Revenue**

Revenue for the nine months ending May 31, 2005 has increased over the same period in the prior fiscal year by approximately 1%. Sales of Clipstream™ have declined over the same period last year while our MPE™ technology has resulted in the overall increase.

Revenue associated with our Clipstream™ suite of products continues to represent the majority our sales at approximately 85% for the quarter just ended while revenue associated with our MPE™ technology will represent a significant growth area. During the quarter ending May 31, 2005, revenues decreased 32% from our second quarter ending February 28, 2005 due to a decrease in Clipstream™ suite of products.

**Operating Expenses**

Our general and administrative expenses consist primarily of salaries and related personnel costs including overhead, professional fees, and other general corporate and office expenditures.

| <b>General and administrative</b><br>(unaudited) | <b>May 31,</b><br><b>2005</b><br>(9 months)<br>\$ | <b>May 31,</b><br><b>2004</b><br>(9 months)<br>\$ | <b>\$</b><br><b>Change</b> |
|--|---|---|----------------------------|
| Wages and benefits                               | 128,851   | 121,034   | 7,814                      |
| Consulting                                       | 2,873   | 3,175   | (302)                      |
| Rent   | 19,325  | 15,604  | 3,721                      |
| Telecommunications                               | 7,511   | 7,540   | (29)                       |
| Bad debt   | 23,623  | 16,528  | 7,095                      |
| Office and miscellaneous                         | 41,988  | 165,512   | (123,524)                  |
| Professional fees                                | 74,927  | 58,881  | 16,046                     |
|  | 299,098   | 388,274   | (89,176)                   |

General and administrative expenses decreased to \$299,098 for the nine months ended May 31, 2005 from \$388,274 for same period in 2004. The decrease is due primarily to a one-time charge of approximately \$80,000 for corporate initiatives relating to promotional and business development activities incurred in fiscal 2004.

Sales and marketing expenses consist primarily of salaries and related personnel costs including overhead, sales commissions, advertising, promotional fees and travel costs.

| <b>Sales and marketing</b><br>(unaudited) | <b>May 31,</b><br><b>2005</b><br>(9 months)<br>\$ | <b>May 31,</b><br><b>2004</b><br>(9 months)<br>\$ | <b>\$</b><br><b>Change</b> |
|---|---|---|----------------------------|
| Wages and benefits                        | 166,383   | 225,346   | (58,963)                   |
| Consulting                                | 2,873   | 4,233   | (1,360)                    |
| Rent                                      | 19,325  | 20,805  | (1,480)                    |
| Telecommunications                        | 7,511   | 10,053  | (2,542)                    |
| Meals and entertainment                   | 1,419   | 3,287   | (1,868)                    |
| Travel                                    | 25,619  | 8,267   | 17,352                     |
| Advertising and marketing                 | 71,141  | 45,303  | 25,838                     |
|   | 294,271   | 317,294   | (23,023)                   |

Sales and marketing expenses remained relatively consistent with the same period in the prior year. The company has incurred travel expenses associated with negotiating contracts with various customers for use of our MPE™ technology and remains committed to expanding the awareness of our Clipstream™ suite of products. The decrease in salaries and wages corresponds to a decline in commission costs.

Research and development costs consist primarily of salaries and related personnel costs including overhead and consulting fees with respect to product development and deployment

| <b>Research and development</b><br>(unaudited) | <b>May 31,</b><br><b>2005</b><br>(9 months)<br>\$ | <b>May 31,</b><br><b>2004</b><br>(9 months)<br>\$ | <b>\$</b><br><b>Change</b> |
|--|---|---|----------------------------|
| Wages and benefits                             | 214,751   | 201,722   | 13,029                     |
| Consulting                                     | 4,789   | 5,293   | (504)                      |
| Rent   | 32,209  | 26,006  | 6,203                      |
| Telecommunications                             | 12,518  | 12,567  | (49)                       |
| Repairs and maintenance                        | -   | 3,871   | (3,871)                    |
|  | 264,267   | 249,459   | 14,808                     |

Research and development expenses remained relatively consistent for the same period in the prior year.

Increases in costs associated with less favorable US dollar exchange rate are offset by the capitalization of certain development costs associated with our MPE™ technology.

**Depreciation and Amortization.** Depreciation and amortization expenses arose from equipment and other assets. Depreciation and amortization increased to \$49,513 for the nine months ended May 31, 2005 as compared to \$31,680 for the nine months ended May 31, 2004, an increase of \$17,833 or 56%.

The increase in depreciation and amortization is due to the capitalization (and subsequent amortization) of development costs associated with our MPE™ technology. We began depreciating the development costs in the first quarter of 2005, as this digital transmission system was ready for use in our pilot program with UMG and was generating income.



## **Other Income and Expenses**

In the prior year, a gain on extinguishment of debt amounted to \$79,215 for the nine months ended May 31, 2004. In 2004, we were successful in negotiating a reduction in fees associated with past services provided by various professionals and our telecommunications carrier. Interest and other income amounted to \$12,205 for the nine months ended May 31, 2004 compared to \$67 for the same period ended May 31, 2005. In 2004 we had rented part of our office space while in 2005 this space was used by the Company. These balances consisted primarily of rental revenue realized on vacant office space sublet during the prior period. No rental revenue was realized in the period ending May 31, 2005.

## **Income (loss) from operations**

Loss from operations for the quarter ended May 31, 2005 was \$143,737 compared to \$115,457 for the same quarter ending May 31, 2004.

Loss from operations for the nine months ended May 31, 2005 was \$340,190 compared to a loss of \$332,404 for the same period ending May 31, 2004. Revenue associated with MPE™ has begun to grow but is still at preliminary levels and was insufficient to generate a positive net income for the period.

## **LIQUIDITY AND FINANCIAL CONDITION**

We had cash of \$664 as at May 31, 2005 compared to cash of \$17,523 as at August 31, 2004. We had a working capital deficiency of \$482,862 as at May 31, 2005 compared to \$407,872 as at August 31, 2004. We had a shareholders' deficiency of \$468,554 as at May 31, 2005 compared to a shareholders' deficiency of \$420,316 as at August 31, 2004.

## **CASHFLOWS**

### **Operating**

Net cash used in operating activities increased to \$394,599 for the nine months ending May 31, 2005, compared to \$264,453 for the nine months ended May 31, 2004.

### **Investing**

The company invested \$56,993 in the purchase of equipment and software development for the nine months ending May 31, 2005 compared to \$8,400 for the same period ending May 31, 2004. The increase is due to the development of our music digital delivery system.

### **Financing**

During the first nine months of fiscal 2005, we received \$293,177 from the exercise of 1,018,125 options. Additionally, the company received net proceeds of \$138,330 from shareholder loans.

### **Going Concern**

We have incurred recurring losses from operations and we have a working capital deficiency. As a result, substantial doubt exists about the company's ability to continue as a going concern. Operations to date have been primarily financed by equity transactions. Depending on our ability to continue to grow sales and related cash flows, we will need additional capital through public or private financings that may not be available on reasonable terms. Accordingly, we will require the continued financial support from our shareholders and creditors until we are able to



generate sufficient cash flows from operations on a sustained basis. There can be no assurances that we will be successful. If we are not, we will be required to reduce operations or liquidate assets. Our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern. Our predecessor auditors have referred to the substantial doubt about our ability to continue as a going concern in their audit report on

our financial statements included with our Annual Report on Form 10-KSB for our fiscal year ended August 31, 2004.

## CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, and make estimates and assumptions that affect our reported amounts of assets, liabilities, revenue and expenses, and the related disclosures of contingent liabilities. We base our estimates on historical experience and other assumptions that we believe are reasonable in the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements.

- The consolidated financial statements have been prepared on the going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of operations.  
If we were not to continue as a going concern, we would likely not be able to realize on our assets at values comparable to the carrying value or the fair value estimates reflected in the balances set out in the preparation of the consolidated financial statements. There can be no assurances that we will be successful in generating additional cash from equity or other sources to be used for operations. The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.
- We recognize revenue when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, collection is reasonably assured, and there are no substantive performance obligations remaining. Our revenue recognition policies are in conformity with AICPA's Statement of Position No. 97-2, "Software Revenue Recognition", as amended ("SOP 97-2). We generate revenue from software arrangements involving multiple element sales arrangements. Revenue is allocated to each element of the arrangement based on the relative fair value of the elements and is recognized as each element is delivered and we have no significant remaining performance obligations. If evidence of fair value for each element does not exist, all revenue from the arrangement is recognized over the term of the arrangement.
- Costs incurred internally to develop computer software products and the costs to acquire externally developed software products (which have no alternative future use) to be sold, leased or otherwise marketed are charged to expense until the technological feasibility of the product has been established. After technological feasibility is established and until the product is available for general release, software development, product enhancements and acquisition costs are capitalized and amortized on a product-by-product basis.
- We account for stock-based employee compensation arrangements using the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and comply with the disclosure provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("FAS 123") as amended by Statement of Financial Accounting Standards No. 148 "Accounting for Stock-Based Compensation Transition and Disclosure – an amendment of FASB Statement No. 123". The pro forma disclosure of stock-based compensation is included in Note 1 our audited consolidated financial statements for the year ended August 31, 2004. Under APB 25, compensation expense for employees is based on the difference between the fair value of our stock and the exercise price if any, on the date of the grant. We account for stock issued to non-employees at fair value in accordance with FAS 123. We use the Black-Scholes option pricing model to determine the fair value of stock options granted to non-employees.

**ITEM 3. CONTROLS AND PROCEDURES.**

As required by Rule 13a-15 under the Exchange Act, we have carried out an evaluation of the effectiveness of the design and operation of our company's disclosure controls and procedures as of the end of the period covered by this quarterly report, being May 31, 2005. This evaluation was carried out under the supervision and with the participation of our company's management, including our company's chief financial officer and chief executive officer. Based upon that evaluation, our company's chief financial officer and chief executive officer concluded that our company's disclosure controls and procedures are effective. There have been no significant changes in our company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date we carried out our evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our company's reports filed under the Exchange Act is accumulated and communicated to management, including our company's president and chief executive officer as appropriate, to allow timely decisions regarding required disclosure.

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings**

The were no material developments in any of the legal proceedings to which we are a party, as disclosed in our Annual Report on Form 10-KSB for the year ended August 31, 2004, during the quarters ended November 30, 2004 or February 28, 2005 or May 31, 2005.

**Item 2. Changes in Securities and Use of Proceeds**

During our fiscal quarter ended May 31, 2005, there were no sales of securities that were not registered pursuant to the Securities Act of 1933 (the “Securities Act”).

**Item 3. Default Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Securities Holders**

No matters were submitted to a vote of securities holders during the quarter ended May 31, 2005

**Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8-K**

**(a) Exhibits.**

**EXHIBIT  
NUMBER**

**DESCRIPTION**

31                      Certification 302 of Steve Vestergaard, Chief Executive Officer and Chief Financial Officer (1)

32                      Certification 906 of Steve Vestergaard, Chief Executive Officer and Chief Financial Officer (1)

(1) Filed as an exhibit to this Quarterly Report on Form 10-QSB

**(b) Reports on Form 8-K.**

No reports on Form 8-K were filed during the quarter ended May 31, 2005.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**DESTINY MEDIA TECHNOLOGIES INC.**

Dated: July 15, 2005

/s/ Steven Vestergaard

Steven Vestergaard, Chief Executive Officer  
and Chief Financial Officer

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