MEDIA SCIENCES INTERNATIONAL INC
Form 10QSB
February 12, 2004

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

FORM 10-QSB

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended December 31, 2003

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________.

Commission file number: **0-21853**

MEDIA SCIENCES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**87-0475073** (I.R.S. Employer Identification No.)

40 Boroline Road, Allendale, New Jersey 07401
(Address of principal executive offices)

(201) 236-9311
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the 90 past days. YES [X] NO [ ]

As of February 12, 2004, the issuer had 8,602,210 shares of common stock outstanding.

Transitional Small Business Disclosure Format (check one): YES [ ] NO [X]

MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES

FORM 10-QSB
FOR THE QUARTER ENDED DECEMBER 31, 2003

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ITEM 1. FINANCIAL STATEMENTS

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS	December 31, 2003 (Unaudited)	June 30, 2003
CURRENT ASSETS :		
Cash and equivalents	$ 66,099	$ 66,467
Accounts receivable, less allowance for doubtful accounts of $35,000	2,248,953	1,841,060
Inventories	1,493,054	1,089,809
Deferred income taxes	649,881	1,000,000
Prepaid expenses and other current assets	120,764	173,050
Total Current Assets	4,578,751	4,170,386
PROPERTY AND EQUIPMENT, NET	1,056,014	1,362,734
OTHER ASSETS:		
Goodwill and other intangible assets, net	4,473,117	4,478,190
Deferred income taxes	--	47,315
Other assets	141,722	58,102
	4,614,839	4,583,607
TOTAL ASSETS	$ 10,249,604	$ 10,116,727

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Short-term debt	$ 2,381,630	$ 2,185,118
Accounts payable	1,471,314	1,340,257
Accrued expenses and other current liabilities	136,023	258,512
Income tax payable	77,796	131,425
Accrued product warranty	250,000	250,000
Accrued expense - supplier	214,663	448,952
Dividends payable	152,375	699,919
Loan from investors	--	200,000
Loan from officer	255,000	280,000
Deferred revenues	141,803	196,234
Total Current Liabilities	5,080,604	5,990,417
OTHER LIABILITIES :		
Long-term debt, less current maturities	17,625	39,081
Loan from investors	400,000	400,000
Loan from officer	195,000	195,000
	612,625	634,081
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY :		
Series A Convertible Preferred stock, $.001 par value, Authorized 1,000,000 shares; issued none in December; 547,500 in June	--	547
Common Stock, .001 par value, Authorized 20,000,000 shares; issued 8,602,210 shares in December, 3,577,210 shares in June	8,603	3,578
Additional paid-in capital	6,169,011	5,109,343
Cost of 10,564 shares of common stock in treasury	(20,832)	(20,832)
Retained earnings (deficit)	(1,600,407)	(1,600,407)
Total Shareholders' equity	4,556,375	3,492,229
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 10,249,604	$ 10,116,727

See accompanying notes to consolidated financial statements.

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MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31,		Six Months E[...] December 3[...]	
	2003	2002	2003	

NET SALES	$ 4,417,483	$ 4,023,556	$ 8,033,001	$
COST OF GOODS:				
Cost of sales, excluding depreciation	2,132,869	1,938,155	$ 3,747,506	
Depreciation	139,662	131,979	284,817	
Total cost of goods	2,272,531	2,070,134	4,032,324	
GROSS PROFIT	2,144,952	1,953,422	4,000,677	
OTHER COSTS AND EXPENSES:				
Selling, general and administrative	1,478,072	1,328,370	2,788,823	
Depreciation and amortization	67,139	68,076	129,586	
Total other costs and expenses	1,545,211	1,396,446	2,918,409	
INCOME FROM OPERATIONS	599,741	556,976	1,082,268	
INTEREST EXPENSE, NET	93,900	127,349	201,208	
INCOME BEFORE INCOME TAXES	505,841	429,627	881,060	
INCOME TAXES :				
Current	45,653	38,947	79,289	
Deferred	156,818	133,152	273,136	
	202,471	172,099	352,425	
NET INCOME	$ 303,370	$ 257,528	$ 528,635	$
PREFERRED STOCK DIVIDENDS	$ 1,913,824	$ 157,407	$ 2,071,230	$
INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	$(1,610,454)	$ 100,121	$(1,542,595)	$
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	3,577,210	3,577,210	3,577,210	
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	--	3,577,437	--	
BASIC NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	$ (0.45)	$ 0.03	$ (0.43)	$
DILUTED NET INCOME PER COMMON SHARE	$ --	$ 0.03	$ --	$

See accompanying notes to consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
SIX MONTHS ENDED DECEMBER 31, 2003

	Common Stock Shares	Common Stock Amount	Preferred Stock Shares	Preferred Stock Amount	Treasury Stock	Additiona Paid-in Capital
BALANCES, JUNE 30, 2003	3,577,210	$3,578	547,500	$ 547	$(20,832)	$ 5,109,3
SIX MONTHS ENDED DECEMBER 31, 2003 (UNAUDITED)						
Issuance of common stock for Preferred Conversion	5,025,000	5,025	(547,500)	(547)	--	2,602,2
Preferred stock dividend, 11.5%	--	--	--	--	--	(1,542,5
Net Income	--	--	--	--	--	--
BALANCES, DECEMBER 31, 2003 (UNAUDITED)	8,602,210	$8,603	--	$ --	$(20,832)	$ 6,169,0

See accompanying notes to consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended December 31, 2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES :		
Net income	$ 528,635	$ 490,548
Adjustments to reconcile net Income to net cash flows from operating activities :		
Depreciation and amortization	414,403	393,520
Deferred income taxes	273,136	327,197
Provision for bad debts	23,989	9,174
Changes in operating assets and liabilities :		
Accounts receivable	(431,882)	(666,501)
Inventories	(403,245)	213,461
Prepaid expenses and other current assets	52,286	25,940
Other assets	(83,620)	(2,369)
Accounts payable	131,057	(414,703)
Accrued expenses and other current liabilities	(63,851)	(220,972)
Accrued expense - supplier	(234,289)	(128,755)
Deferred revenues	(54,432)	(106,356)
Net cash flows from operating activities	152,187	(79,816)
CASH FLOWS FROM INVESTING ACTIVITIES :		
Purchases of property and equipment	(102,610)	(112,895)

Purchase of intangible assets	--	(94,609)
Net cash flows from investing activities	(102,610)	(207,504)
CASH FLOWS FROM FINANCING ACTIVITIES :		
Note payable to bank, net	278,927	149,984
Payments/Proceeds on short term debt, net	(82,416)	146,276
Payments on long term debt	(21,456)	(103,870)
Net advances from officer	(25,000)	120,000
Payments, loans from investors	(200,000)	--
Net cash flows from financing activities	(49,945)	312,390
NET CHANGE IN CASH AND EQUIVALENTS	(368)	25,070
CASH AND EQUIVALENTS, BEGINNING OF YEAR	66,467	42,180
CASH AND EQUIVALENTS, END OF YEAR	$ 66,099	$ 67,250
SUPPLEMENTAL CASH FLOW INFORMATION :		
Interest paid	$ 217,589	$ 176,195
Issuance of common stock as dividend payment	$ 704,950	$ 43,556
Income taxes paid	$ 8,626	$ 248
Issuance of common stock for accrued interest on dividends	$ 11,851	$ --

See accompanying notes to consolidated financial statements.

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MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION :

Our accounting and reporting policies conform to generally accepted accounting principles. Except for the June 30, 2003 consolidated balance sheet, the financial statements presented herein are unaudited but reflect all adjustments which, in our opinion, are necessary for the fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods presented. All adjustments reflected in the interim financial statements are of a normal recurring nature. You should read these financial statements in conjunction with the financial statements and notes thereto and the report of independent accountants included in our Annual Report on Form 10-KSB for the year ended June 30, 2003. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. The results of operations for the three and six months ended December 31, 2003 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 NATURE OF BUSINESS :

We are engaged in the business of manufacturing and distributing supplies for workgroup, or business, color printers. Our products include solid ink sticks, color toner cartridges and other consumable items. We distribute our products through an international network of dealers and distributors. We also sell directly to end-users through programs designed to foster our supplies business.

NOTE 3 STOCK BASED COMPENSATION PROFORMA DISCLOSURE :

The Company follows the intrinsic method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations in accounting for its employee stock options because, as discussed below, Financial Accounting Standards Board Statement No. 123, Accounting for Stock-Based Compensation (FAS 123) requires use of option valuation models that were not developed for use in valuing employee stock options. FAS 123 permits a company to elect to follow the intrinsic method of APB 25 rather than the alternative fair value accounting provided under FAS 123, but requires pro forma net income and earnings per share disclosures as well as various other disclosures not required under FAS 123 for companies following APB 25. The Company has adopted the disclosure provisions required under Financial Accounting Standards Board Statement No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (FAS 148). Under APB 25, because the exercise price of the Company s stock options equals the market price of the underlying stock on the date of grant, no compensation expense was recognized.

Pro forma information regarding net income and earnings per share is required by FAS 123 and FAS 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement.

The fair value of options granted in 2003 and 2002 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions, respectively: risk-free interest rates of 6.0%, dividend yield of 0.0%, volatility factors of the expected market price of the Company s common stock of 74% in 2003 and 72% in 2002, and a weighted-average expected life of the options of five years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective input assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the options vesting period. The Company s pro forma information follows:

	Three Months Ended December 31,		Six Months End December 31	
	2003	2002	2003	
Net income as reported	$ 303,370	$ 257,528	$ 528,635	$

Less Preferred Stock Dividends	1,913,824	157,407	2,071,230	
Income(loss) applicable to common shareholders	$(1,610,454)	$ 100,121	$(1,542,595)	$
Stock-based employee compensation expense under fair value method, net of related tax effects	$ (19,006)	$ (533)	$ (27,937)	$
Pro forma net income (loss)	$(1,629,460)	$ 99,588	$(1,570,532)	$
Income (loss) per share:				
Basic, as reported	$ (0.45)	$ 0.03	$ (0.43)	$
Basic, pro forma	$ (0.46)	$ 0.03	$ (0.44)	$
Diluted per share, as reported	$ --	$ 0.03	$ --	$
Diluted per share, pro forma	$ --	$ 0.03	$ --	$

NOTE 4 NOTE PAYABLE TO BANK :

We have an agreement with a lender under which we can borrow up to $3,000,000 under a revolving line of credit, subject to availability of collateral. Borrowings bear interest at 1.75% over the lender s base rate, are payable on demand and are collateralized by all assets of the company. As of December 31, 2003, $2,176,943 was outstanding under this line and the interest rate was 5.75%. The line of credit expires on October 31, 2006.

NOTE 5 PREFERRED STOCK CONVERSION :

In November 2003, we initiated a voluntary Offer of Conversion, whereby preferred shareholders who accepted the offer waived their rights to unpaid dividends and interest on their preferred stock and they received ten shares of common stock for each preferred share tendered. 86% of the preferred shareholders tendered a total of 457,500 or 84% of the outstanding Series A preferred shares. The balance of the Series A preferred shares (90,000) were automatically converted to common stock at a rate of five shares of common stock for each preferred share, pursuant to the terms of the amended Certificate of Designation, which amendment was approved by a majority of the preferred shareholders. Those preferred shareholders whose preferred shares were converted at a rate of five to one will be paid their accrued and unpaid dividends.

The conversion of the preferred stock was accounted for according to EITF Topic No. D-42 as an Induced Conversion of Preferred Stock. Consequently, the fair value of the securities (ten shares of common stock) issued over the fair value of the securities issuable pursuant to the original conversion terms (five shares of common stock) less the accrued dividends and interest given up by the shareholders was subtracted from net earnings to arrive at net earnings available to common shareholders. The non-cash dividend for the three months ended December 31, 2003 was calculated as follows :

Fair value of securities issued (5,025,000 x $1.15)	$ 5,778,750
Less :	

Fair value of securities issuable pursuant to the original conversion terms (547,000 x 5 x $1.15)	(3,148,125)
Value of accrued dividends waived	(704,950)
Value of accrued interest waived	(11,851)
Non-cash preferred stock dividend	$ 1,913,824

NOTE 6 EARNINGS PER SHARE

Basic earnings per share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding options and warrants to purchase common stock, and other potentially dilutive securities.

The following table sets forth the computation of basic and diluted earnings per share :

	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002	Six Months End[ed] December 3[1,] 2003	
Numerator :				
Income (loss) applicable to common shareholders - basic	$ (1,610,454)	$ 100,121	$ (1,542,595)	$
Income applicable to common shareholders - diluted	$ --	$ 100,121	$ --	$
Denominator :				
Denominator for basic earnings per share : Weighted average shares	3,577,210	3,577,210	3,577,210	3,
Effect of dilutive securities				
Conversion of preferred stock to common	--	--	--	
Stock options and warrants	--	227	--	
Denominator for diluted earnings per share	3,577,210	3,577,437	3,577,210	3,
Earnings (loss) per share :				
Basic	$ (0.45)	$ 0.03	$ (0.43)	$
Diluted	$ --	$ 0.03	$ --	$

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following warrants to purchase common stock were excluded from the computation of diluted earnings per share for the three and six months ended December 31, 2003 because the warrants exercise price was greater than the average market price of the common stock for those periods:

	Three Months Ended December 31,		Six Months End December 31,	
	2003	2002	2003	2
Anti-dilutive warrants and options	--	3,382,979	--	3,3

The conversion of the Class A convertible preferred stock has been excluded from the computation of diluted earnings per share for the three and six months ended December 31, 2003 and 2002. Such conversion when taking into account the additional net income generated by the elimination of the dividend would be anti-dilutive.

NOTE 7 RECALL AND WARRANTY EXPENSES:

Media Sciences provides a warranty for all of its consumable supply products. The Company s warranty stipulates that the Company will pay reasonable and customary charges for the repair of a printer needing service as a result of using the Company s products. The Company estimates the costs that may be incurred and records a liability in the amount of such costs at the time product revenue is recognized. Factors that may affect the warranty include the number of units shipped to customers, historical and anticipated rates of warranty claims and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. These expenses are classified as Selling, General and Administrative costs.

In January 2002, the Company recalled all solid ink products manufactured between May 2001 and January 2002. It was discovered that the use of the Company s solid ink sticks manufactured during that time period could cause printer reliability issues. Management believes that it has resolved the problem. In addition, two independent test laboratories have tested the reliability of the Company s solid ink and have found no reliability issues associated with the use of the Company s solid ink products.

Changes in accrued product warranty for the three and six months ended December 31, 2003 and 2002 are as follows:

	Three Months Ended December 31,		Six Months December 3	
	2003	2002	2003	
Warranty reserve at the beginning of the period	$ 250,000	$ 300,000	$ 250,000	$
Warranties accrued during the period	280,000	420,000	580,000	
Warranties settled during the period	(280,000)	(470,000)	(580,000)	(

Net change in warranty reserve	$ --	$ (50,000)	$ --	$
Warranty reserve at December 31,	$ 250,000	$ 250,000	$ 250,000	$

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company has filed a claim under its umbrella liability policy for the unreimbursed portion of the warranty expenses. The insurance carrier has denied coverage under the policy. We are evaluating all options available to us to appeal this decision.

Even though management believes that the recall is complete, the Company will continue to receive warranty claims associated with the recalled ink and other warranty expenses for products not sold under the recall. While the Company believes that the reserve should be adequate to resolve the remaining claims, it is possible that the warranty claims may exceed the accrual, and therefore differences, if any, will be expensed in future periods.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with the information set forth in the unaudited financial statements and notes thereto, included elsewhere herein, and the audited financial statements and the notes thereto, included in our Form 10-KSB filed September 15, 2003.

Results of Operations

For the Three and Six Months Ended December 31, 2003 and 2002

Sales. Our consolidated sales for the three months ended December 31, 2003, as compared to the same period in 2002, increased approximately 10% to $4,417,483 from $4,023,556. The net increase in sales resulted from an increase in Media Sciences supply sales of approximately 19%, offset by a decrease in Cadapult sales of approximately 13%. Our consolidated sales for the six months ended December 31, 2003, as compared to the same period in 2002, increased approximately 7% to $8,033,001 from $7,512,706. The net increase in sales resulted from an increase in Media Sciences supply sales of approximately 24%, offset by a decrease in Cadapult sales of approximately 28%. The shift in sales from Cadapult to Media Sciences is to be expected as we focus on the higher margin growth opportunity in Media Sciences supplies.

Cost of Sales. Our cost of sales for the three months ended December 31, 2003 were $2,132,869, as compared to $1,938,155 for the same period in 2002, both approximately 48% of sales. Our cost of sales for the six months ended December 31, 2003 were $3,747,506, as compared to $3,526,649 for the same period in 2002, again both approximately 47% of sales.

Selling, General and Administrative. For the three months ended December 31, 2003 as compared to the same period in 2002, our selling, general and administrative expenses increased to $1,478,072 from $1,328,370, thus remaining at 33% of sales. For the six months ended December 31, 2003 as compared to the same period in 2002, our selling, general and administrative expenses increased to $2,788,823 from $2,533,851, or slightly up to 35% of sales from 34% of sales.

Depreciation and Amortization. For the three months ended December 31, 2003 as compared to the same period in 2002, our depreciation expense increased slightly to $204,484 from $195,139. Amortization expense was $2,317 and $4,916 for the two periods respectively. For the six months ended December 31, 2003 as compared to the same period in 2002, our depreciation expense increased slightly to $409,770 from $383,688. Amortization of intangibles for the six months ending December 31, 2003 and 2002 was $4,633 and $9,832, respectively.

Interest Expense. For the three months ended December 31, 2003 as compared to the same period in 2002, our interest expense decreased to $93,900 from $127,349. For the six months ended December 31, 2003 as compared to the same period in 2002, our interest expense decreased to $201,208 from $240,693. The decrease in interest expense can be attributed to the repayment of certain notes and the expiration of certain capital leases.

Income Taxes. For the three months ended December 31, 2003, we recorded a current income tax expense of $45,653 and a deferred income tax expense of $156,818, as compared to a current income tax expense of $38,947 and a deferred income tax expense of $133,152 in 2002. For the six months ended December 31, 2003, we recorded a current income tax expense of $79,289 and a deferred income tax expense of $273,136, as compared to a current income tax expense of $73,867 and a deferred income tax expense of $253,578 in 2002. For all periods, we recorded the current income tax expense because of New Jersey s two-year suspension of the use of net operating loss carry forwards.

Dividends. For the three months ending December 31, 2003, we incurred a non-cash preferred stock dividend charge of $1,913,824 associated with the induced conversion of our preferred stock as described in Note 5 to the Financial Statements. For the six months ended December 31, 2003, we incurred a preferred stock dividend charge of $2,071,230.

Net Income (loss). For the three month period ended December 31, 2003, we incurred a loss of $1,610,454, or $(0.45) per share, as compared to earning $100,121, or $0.03 per share basic and diluted, for the corresponding three month period ended December 31, 2002. For the six month period ended December 31, 2003, we incurred a loss of $1,542,595, or $(0.43) per share, as compared to earning $175,735, or $0.05 per share basic and diluted, for the corresponding six month period ended December 31, 2002. The losses for the three and six months ended December 31, 2003 are due to the non-cash dividend as described more fully in Note 5 to the Financial Statements.

Liquidity and Capital Resources

We experienced neutral cash flow for the six months ended December 31, 2003. Cash flows from operating activities resulted in positive cash flows of $152,187, primarily due to net income of $528,635, a non-cash charge of $414,403 for depreciation and amortization, $273,136 for deferred income taxes and an increase in accounts payable of $131,057, offset by an increase in accounts receivables of $431,882 and in inventories of $403,245 and a decrease in accrued supplier, deferred revenues and other accrued expenses and current liabilities of $352,572.

The cash we used in investing activities included the purchase of equipment in the amount of $102,610.

Cash used by financing activities included net debt payments of $49,945. We have an agreement with a lender under which we can borrow up to $3,000,000 under a revolving line of credit, subject to availability of collateral. Borrowings bear interest at 1.75% over the lender s base rate, are payable on demand and are collateralized by all assets of the Company. As of December 31, 2003, $2,176,943 was outstanding under this line. In December 2003, we repaid an aggregate of $225,000 to several individuals upon the maturation of one year notes carrying interest rates of 20-23%.

Inflation

We have historically offset any inflation in operating costs by a combination of increased productivity and price increases, where appropriate. We do not expect inflation to have a significant impact on its business in the future.

Seasonality

We anticipate that our cash flow from operations will be slightly better in the fall and winter months than in the spring and summer months due to the sales cycles associated with our Cadapult Graphic Systems subsidiary business. In the event that we are unable to generate sufficient cash flows from operations, we may be required to utilize other cash reserves, if any, or seek additional equity or debt financing to meet operating expenses, and there can be no assurance that there will be any other cash reserves or that additional financing will be available or, if available, on reasonable terms.

Forward Looking Statements

The foregoing management discussion and analysis contains forward-looking statements and information that are based on our management s beliefs, as well as assumptions made by, and information currently available to, our management. These forward-looking statements are based on many assumptions and factors, and are subject to many conditions, including our continuing ability to obtain additional financing, dependence on contracts with suppliers, competitive pricing for our products, demand for our products which depends upon the condition of the computer industry, and the effects of increased indebtedness as a result of our business acquisitions. Except for the historical information contained in this new release, all forward-looking information are estimates by our management and are subject to various risks, uncertainties and other factors that may be beyond our control and may cause results to differ from management s current expectations, which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

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ITEM 3. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company s management, with the participation of the Company s Chief Executive Officer and Principal Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, the Company s Chief Executive Officer and Principal Financial Officer have concluded that, as of the end of such period, the Company s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

Internal Control Over Financial Reporting

There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES

In March 2000, we completed a private placement of 550,000 units of our securities, which included shares of preferred stock, to accredited investors in transactions deemed to be exempt under Section 4(2) of the Securities Act and under Rule 506 of Regulation D promulgated under the Securities Act. On December 31, 2003, we concluded an exchange offer with our preferred stockholders through which they had an opportunity to exchange each of their preferred shares for 10 shares of our common stock. Preferred shareholders who accepted the offer waived their rights to unpaid dividends and interest on their preferred stock. Preferred shareholders tendered a total of 457,500 preferred shares, representing 84% of the outstanding preferred shares, in exchange for a total of 4,575,000 shares of common stock. Pursuant to the terms of the certificate of designation for our preferred stock, the other 90,000 preferred shares outstanding were converted into 450,000 shares of common stock.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our annual meeting of stockholders on December 11, 2003. Stockholders of record of our common stock as of the close of business on October 24, 2003 were entitled to vote. On the record date, there were 3,577,210 shares of common stock outstanding. The matters voted upon at the meeting and the voting results were:

- Proposal 1 the election of seven members to the Board of Directors, Michael W. Levin, Frances Blanco, Paul C. Baker, Edwin Ruzinsky, Donald Gunn, Henry Royer, and Sagiv Shiv, to serve until the next annual meeting: 2,878,072 votes were cast for the proposal, with no votes against and 5,500 votes withheld. 5,650 eligible votes did not cast a vote on the proposal.

- o Proposal 2 the ratification of the selection of Wiss & Company, LLP as our independent certified public accountants for the fiscal year ending June 30, 2004 until new accountants are selected: 2,887,222 votes were cast for the proposal, with no votes against and 2,000 votes abstained.
- o Proposal 3 the ratification of the issuance of up to an additional 4,022,522 shares of common stock underlying series A preferred stock, for AMEX additional share listing purposes: 2,190,742 votes were cast for the proposal, with 60,463 votes against and 2,100 votes abstained. 635,719 eligible votes did not cast a vote on the proposal.
- o Proposal 4 the ratification of the issuances of employment-issued stock options for 925,000 shares of common stock, for AMEX additional share listing purposes: 2,167,351 votes were cast for the proposal, with 62,913 votes against and 23,041 votes abstained. 635,719 eligible votes did not cast a vote on the proposal.

In December 2003, we filed a certificate of amendment to our preferred share certificate of designation, approved by a majority of our preferred shareholders, which provides for automatic conversion of preferred shares into common shares if less than a majority of the originally issued preferred shares becomes outstanding.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

The following exhibits are filed with this report:

Exhibit Number	Description of Exhibit
Exhibit 3(i)	Certificate of Amendment of Certificate of Designation of Series A Preferred Stock
Exhibit 11*	Statement re: computation of per share earnings is hereby incorporated by reference to Financial Statements of Part I - Financial Information, Item 1 Financial Statements, contained in this Form 10-QSB.
Exhibit 31.1*	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
Exhibit 31.2*	Certification of Principal Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
Exhibit 32*	Certifications Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350

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* Filed herewith.

(b) Reports on Form 8-K.

On November 4, 2003, Media Sciences filed a Current Report on Form 8-K, dated November 4, 2003, regarding an issuer tender offer for the exchange of outstanding Series A preferred stock for shares of common stock and a consent solicitation to amend the certificate of designation for the series A preferred stock.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MEDIA SCIENCES INTERNATIONAL, INC.

Dated: February 12, 2004	By: /s/ Michael W. Levin Michael W. Levin Chief Executive Officer and President
Dated: February 12, 2004	By: /s/ Denise Hawkins Denise Hawkins Vice President and Controller (Principal Financial Officer)