MEDIA SCIENCES INTERNATIONAL INC
Form 10QSB/A
August 15, 2005

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

FORM 10-QSB/A
(Amendment No. 2)

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2004

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
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.)

8 Allerman Road, Oakland, NJ 07436
(Address of principal executive offices)

(201) 677-9311
(Issuer's telephone number)

Check whether the issuer (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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

As of November 11, 2004, the issuer had 9,935,710 shares of common stock outstanding.

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

INTRODUCTORY NOTE

In this Amendment No. 2 to our Quarterly Report on Form 10-QSB/A (the Second Amendment) for the quarter ended September 30, 2004, we further amend the following items set forth in our Amendment No. 1 to our Quarterly Report on Form 10-QSB/A (the First Amendment) filed on July 22, 2005:

Part I. Financial Information, Item 3
Part II. Other Information, Item 6

The First Amendment restated our consolidated financial statements for the periods ended September 30, 2004 and 2003 and the related disclosures. The following items were amended in the First Amendment as a result of the restatement:

Part I. Financial Information, Items 1, 2 and 3
Part II. Other Information, Item 6

In connection with the preparation of the Quarterly Report on Form 10-QSB of the Company for the quarter ended March 31, 2005, the Company s current independent registered public accounting firm brought to the attention of the Company that certain of the Company s issued and outstanding stock options are subject to variable plan accounting treatment under the Financial Accounting Standards Board s Interpretation 44, Accounting for Certain Transactions Involving Stock Compensation an Interpretation of Accounting Principles Board Opinion No. 25 (APB 25) (Issue Date 3/00). Accordingly, certain previously unrecognized compensation expenses should have been recognized in certain of the Company s previously issued financial statements. After reviewing the matter with its current and former independent registered public accounting firms, the Company has identified certain non-cash adjustments that necessitated the restatement of its financial statements for each of the first two quarters in the fiscal year ending June 30, 2005 and for the fiscal year ended June 30, 2004 and for the quarters within the fiscal year ended June 30, 2004.

These non-cash adjustments reflect variable plan accounting treatment of the affected stock options for the relevant periods, resulting from cashless exercise provisions applicable to options held by employees and directors. Under variable plan option accounting, non-cash compensation expense is increased or decreased as a result of changes in the market price of the Company s common stock. The restatement adjustment for the three months ended September 30, 2004 and 2003 resulted in an increase in selling, general and administrative expenses of $75,509 and $110,575, respectively. Net income for the three months ended September 30, 2004 and 2003 decreased by $53,529 and $88,925, respectively. On May 10, 2005, the Board of Directors of the Company rescinded the cashless exercise provisions for all of the Company s outstanding option grants. Consequently, the Company s stock options will no longer be subject to variable plan accounting treatment after the fiscal year ended June 30, 2005.

Except as discussed above, we have not modified or updated disclosures presented in the original Quarterly Report on Form 10-QSB, filed on November 12, 2004, except as required to reflect the effects of the restatement, in this Second Amendment. Accordingly, this Second Amendment does not reflect events occurring after the filing of our original Form 10-QSB or modify or update those disclosures affected by subsequent events.

Please refer to Note 2 to the accompanying consolidated financial statements for additional information on the restatement.

MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES

FORM 10-QSB/A
FOR THE QUARTER ENDED SEPTEMBER 30, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	September 30, 2004 (Unaudited and Restated)	June 3 2004 (Resta (Notes 1
CURRENT ASSETS :		
Cash	$ 545,126	$ 666
Accounts receivable, less allowance for doubtful accounts of $35,000	2,602,303	1,626
Insurance claim receivable	--	500
Inventories	2,343,700	2,274
Deferred tax assets	1,086,528	1,222
Prepaid expenses and other current assets	474,262	280
Total Current Assets	7,051,919	6,569
PROPERTY AND EQUIPMENT, NET	1,196,859	1,072
OTHER ASSETS:		
Goodwill and other intangible assets, net	4,466,796	4,468
Other assets	69,859	48
	4,536,655	4,517
TOTAL ASSETS	$ 12,785,433	$ 12,159

LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Bank debt	$ 2,606,685	$ 2,189
Short-term debt and current maturities of long-term debt	27,668	39
Accounts payable	2,245,438	2,511
Accrued expenses and other current liabilities	209,830	248
Income taxes payable	70,999	92
Accrued product warranty	339,247	340
Deferred revenue	333,706	153
Total Current Liabilities	5,833,573	5,574

OTHER LIABILITIES :		
Deferred tax liabilities	543,880	543
Total Other Liabilities	543,880	543
TOTAL LIABILITIES	6,377,453	6,118
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY :		
Series A Convertible Preferred stock, $.001 par value Authorized 1,000,000 shares; none issued	--	
Common Stock, .001 par value Authorized 20,000,000 shares; issued 9,935,710 shares in September, 9,857,210 shares in June	9,937	9
Additional paid-in capital	7,991,129	7,837
Cost of 10,564 shares of common stock in treasury	(20,832)	(20
Accumulated deficit	(1,572,254)	(1,786
Total Shareholders' equity	6,407,980	6,040
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 12,785,433	$ 12,159

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2004 (Restated)	Three Months Ended September 30, 2003 (Restated)
NET SALES	$ 4,851,869	$ 3,615,518
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation	2,499,613	1,614,637
Depreciation	63,319	145,156
Total cost of goods sold	2,562,932	1,759,793
GROSS PROFIT	2,288,937	1,855,725

OTHER COSTS AND EXPENSES:		
Selling, general and administrative, excluding depreiciation and amortization and impact of variable plan accounting	1,724,162	1,310,751
Depreciation and amortization	66,549	62,447
Impact of variable plan accounting	75,509	110,575
Total other costs and expenses	1,866,220	1,483,773
INCOME FROM OPERATIONS	422,717	371,952
INTEREST EXPENSE	52,520	107,308
INCOME BEFORE INCOME TAXES	370,197	264,644
PROVISION FOR INCOME TAXES	156,303	128,304
NET INCOME	213,894	136,340
PREFERRED STOCK DIVIDENDS	--	157,406
NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	$ 213,894	$ (21,066)
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,913,916	3,577,210
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,482,432	3,577,210
BASIC AND DILUTED NET INCOME (LOSS) PER SHARE APPLICABLE TO COMMON SHAREHOLDERS	$ 0.02	$ (0.01)

See accompanying notes to condensed consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
THREE MONTHS ENDED SEPTEMBER 30, 2004
(UNAUDITED)

	Common Stock		Additional Paid-in	Treasury	Accumu
	Shares	Amount	Capital	Stock	Defi

BALANCES, JUNE 30, 2004 (RESTATED)	$ 9,857,210	$ 9,858	$ 7,837,948	$ (20,832)	$(1,78
Issuance of common stock for exercise of stock warrants	75,000	75	74,925	--	
Issuance of common stock for exercise of stock options	3,500	4	2,747	--	
Impact of variable plan accounting	--	--	75,509	--	
Net income	--	--	--	--	21
BALANCES, SEPTEMBER 30, 2004 (RESTATED)	9,935,710	9,937	7,991,129	(20,832)	(1,57

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2004 (Restated)	Three Months Ended September 30, 2003 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES :		
Net income	$ 213,894	$ 136,340
Adjustments to reconcile net Income to net cash provided by (used in) operating activities:		
Depreciation and amortization	129,868	207,603
Impact of variable plan accounting	75,509	110,575
Deferred income taxes	136,246	94,668
Provision for bad debts	2,778	17,259
Changes in operating assets and liabilities :		
Accounts receivable	(978,794)	86,223
Insurance claim receivable	500,000	--
Inventories	(69,612)	(38,584)
Prepaid expenses and other current assets	(193,732)	(1,940)
Other assets	(21,759)	(22,818)
Accounts payable	(265,679)	(144,461)
Income taxes payable	(21,652)	--
Accrued expenses and other current liabilities	(40,095)	(64,437)
Accrued expense - supplier	--	(107,952)
Deferred revenue	180,433	(23,722)
Net cash provided by (used in) operating activities	(352,595)	248,754
CASH FLOWS FROM INVESTING ACTIVITIES :		
Purchases of property and equipment	(252,364)	(47,809)
Net cash used in investing activities	(252,364)	(47,809)

CASH FLOWS FROM FINANCING ACTIVITIES :		
Bank debt	517,631	(148,701)
Bank term loan payments	(100,000)	--
Payments of debt	(11,413)	(64,786)
Proceeds from issuance of common stock	77,751	--
Net cash provided by (used in) financing activities	483,969	(213,487)
NET DECREASE IN CASH	(120,990)	(12,542)
CASH, BEGINNING OF PERIOD	666,116	66,467
CASH, END OF PERIOD	$ 545,126	$ 53,925
SUPPLEMENTAL CASH FLOW INFORMATION :		
Interest paid	$ 50,878	$ 100,976
Income taxes paid	$ 45,206	--

See accompanying notes to condensed consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION :

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America. The condensed consolidated 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 consolidated financial statements are of a normal recurring nature. You should read these condensed consolidated financial statements in conjunction with the consolidated financial statements and notes thereto and the report of our independent registered public accounting firm included in our Annual Report on Form 10-KSB/A for the year ended June 30, 2004 and in conjunction with the information set forth in our Form 8-K filed on May 11, 2005. The year-end consolidated balance sheet data was derived from audited financial statements and includes adjustments as required in Note 2 below, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the three months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 RESTATEMENT OF FINANCIAL STATEMENTS :

In connection with the preparation of the Quarterly Report on Form 10-QSB of the Company for the quarter ended March 31, 2005, the Company s current independent registered public accounting firm brought to the attention of the Company that certain of the Company s issued and outstanding stock options are subject to variable plan accounting treatment under the Financial Accounting Standards Board s Interpretation 44, Accounting for Certain Transactions Involving Stock Compensation an Interpretation of Accounting Principles Board Opinion No. 25 (APB

25) (Issue Date 3/00). Accordingly, certain previously unrecognized compensation expenses should have been recognized in certain of the Company s previously issued financial statements. After reviewing the matter with its current and former independent registered public accounting firms, the Company has identified certain non-cash adjustments that necessitate the restatement of its financial statements for each of the first two quarters in the fiscal year ending June 30, 2005 and for the fiscal year ended June 30, 2004 and for the quarters within the fiscal year ended June 30, 2004.

These non-cash adjustments reflect variable plan accounting treatment of the affected stock options for the relevant periods, resulting from cashless exercise provisions applicable to options held by employees and directors. Under variable plan option accounting, non-cash compensation expense is increased or decreased as a result of changes in the market price of the Company s common stock. The restatement adjustment for the three months ended September 30, 2004 and 2003 resulted in an increase in selling, general and administrative expenses of $75,509 and $110,575, respectively. Net income for the three months ended September 30, 2004 and 2003 decreased by $53,529 and $88,925, respectively. On May 10, 2005, the Board of Directors of the Company rescinded the cashless exercise provisions for all of the Company s outstanding option grants. Consequently, the Company s stock options will no longer be subject to variable plan accounting treatment after the fiscal year ended June 30, 2005.

NOTE 3 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.

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MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 STOCK-BASED COMPENSATION :

The Company follows the intrinsic value 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. Financial Accounting Standards Board Statement No. 123 Accounting for Stock-Based Compensation (SFAS 123) permits the Company to elect to follow the intrinsic value method of APB 25 rather than the alternative fair value accounting provided under SFAS 123, but requires pro forma net income and earnings per share disclosures as well as various other disclosures. As a result of amendments to SFAS 123, the Company will be required to expense employee stock options over the vesting period beginning with its quarter ending September 30, 2006. The Company has also adopted the disclosure provisions required under Financial Accounting Standards Board Statement No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148). Under APB 25, because the exercise price of all of the Company s stock options has equaled the market price of the underlying stock on the date of grant, no compensation expense was recognized as of that date.

The Company, its Audit Committee and its current and former independent registered public accounting firms have agreed that certain of the Company s issued and outstanding stock options that permit cashless exercise should be subject to variable plan accounting treatment under applicable accounting standards, and, accordingly, previously unrecognized compensation expenses should have been recognized in certain of the Company s previously issued financial statements under the Financial Accounting Standards Board s Interpretation 44, Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB No. 25 (Issue Date 3/00). Accordingly, management will restate the Company s financial statements for the first two quarters of the fiscal year ending June 30, 2005 and for the fiscal year ended June 30, 2004, and for the quarters within the fiscal year ended June 30, 2004.

Pro forma information regarding net income (loss) and income (loss) per share applicable to common shareholders is required by SFAS 123 and SFAS 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of those statements.

The fair value of options granted in 2005 and 2004 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions, respectively:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003
Risk-free interest rate	4%	6%
Dividend yield	0.0%	0.0%
Expected common stock market price volatility factor	9%	74%
Expected life of stock options	10 years	10 years

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 STOCK-BASED COMPENSATION (CONTINUED):

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

	Three Months Ended September 30, 2004 (Restated)	Three Months Ended September 30, 2003 (Restated)
Net income as reported	$ 213,894	$ 136,340
Less preferred stock dividends	--	157,406
Income (loss) applicable to common shareholders	213,894	(21,066)
Impact of variable plan accounting net of tax effect	53,529	88,925
Stock-based employee compensation expense under fair value method, net of related tax effects	(16,746)	(8,931)
Pro forma net income applicable to common shareholders	$ 250,677	$ 58,928
Income (loss) per share applicable to common shareholders :		
Basic and diluted, as reported	$ 0.02	$(0.01)
Basic, pro forma	$ 0.03	$ 0.02
Diluted, pro forma	$ 0.02	$ 0.02

NOTE 5 BANK DEBT :

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 of the assets of the Company. As of September 30, 2004, $2.3 million was outstanding under this line and included in the bank debt in the accompanying condensed consolidated balance sheet. The interest rate was 6.5%. The line of credit expires on October 31, 2006.

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MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 INCOME (LOSS) PER SHARE

Basic income (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted income (loss) per common share is computed using the weighted average number of common shares outstanding adjusted for the incremental dilutive 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 income (loss) per share :

	Three Months Ended September 30, 2004 (Restated)	Three Months Ended September 30, 2003 (Restate
Numerator :		
Income (loss) applicable to common shareholders	$ 213,894	$ (21,0
Denominator :		
Denominator for basic income (loss) per share :		
Weighted average shares	9,913,916	3,577,2
Effect of dilutive securities - stock options and warrants	568,516	--
Denominator for diluted income (loss) per share	10,482,432	3,577,2
Net income (loss) per share :		
Basic and diluted	$0.02	$(0.

The following warrants and options to purchase common stock were excluded from the computation of diluted net income (loss) per share as of September 30, 2004 and 2003 because they were anti-dilutive for those periods:

	September 30, 2004	September 30, 2003
Anti-dilutive warrants and options	1,850,650	3,189,4

The assumed conversion of the Class A convertible preferred stock has been excluded from the computation of diluted net income per share for the three months ended September 30, 2003. Such conversion, when taking into account the additional income applicable to common shareholders generated by the elimination of the dividend, would be anti-dilutive.

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MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 RECALL AND WARRANTY EXPENSES:

The Company provides a warranty for all of its consumable supply products and for its INKlusive free printer program. 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.

Changes in accrued product warranty for the three months ended September 30, 2004 and 2003 are as follows:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003
Warranty reserve at the beginning of the period	$ 340,592	$ 250,000
Warranty expenses accrued during the period	294,277	302,000
Warranty claims settled during the period	(295,622)	(302,000)
Net change in warranty reserve	(1,345)	--
Warranty reserve at end of period	$ 339,247	$ 250,000

NOTE 8 ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES :

Engineering and product development costs, which consist of salary and related benefits costs of our technical staff, as well as product development costs, including conceptual formulation, design and testing of product alternatives, and construction of prototypes, are expensed as incurred. For the three months ended September 30, 2004 and 2003, engineering and product development costs were approximately $106,000 and $8,000, respectively.

NOTE 9 ADVERTISING EXPENSES :

The Company accounts for advertising costs in accordance with Statement of Position 93-7, Reporting on Advertising Costs. Advertising expenses are deferred until first use of the advertising. Deferred advertising costs at September 30, 2004 and 2003 totaled approximately $84,000 and $69,000, respectively. Advertising expense for the three months ended September 30, 2004 and 2003 amounted to approximately

$215,000 and $105,000, respectively.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 SEGMENT INFORMATION:

The Company has adopted the provisions of Statements of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). Pursuant to the provisions of SFAS 131, the Company is reporting segment sales, cost of goods sold, gross margins and operating income in the same format reviewed by the Company s chief operating decision maker (the management approach). The Company has two reporting segments: Media Sciences and Cadapult. The Media Sciences segment is comprised of the operations connected with manufacturing and distributing color printer supplies, including ink sticks and toner cartridges through distributors. The Cadapult segment is comprised of selling supplies, including Media Sciences supplies, directly to certain end users and the sale and support of other computer graphics systems.

The Company assesses and measures segment operating results based on operating income. Asset information is not reported since the Company does not use this measure to assess performance.

Net sales, cost of goods sold and other related segment information follows:

	September 30, 2004 (Restated)	September 30, 2003 (Restated)
Net sales:		
Media Sciences	$ 4,126,499	$ 2,891,116
Cadapult	829,315	860,070
Elimination	(103,945)	(135,668
Totals	$ 4,851,869	$ 3,615,518
Cost of goods sold:		
Media Sciences	$ 2,109,350	$ 1,360,267
Cadapult	550,116	552,670
Elimination	(96,534)	(153,144
Totals	$ 2,562,932	$ 1,759,793
Gross profit:		
Media Sciences	$ 2,017,149	$ 1,530,849
Cadapult	279,199	307,400
Elimination	(7,411)	17,476
Totals	$ 2,288,937	$ 1,855,725
Selling, general, administrative and other expenses:		
Media Sciences	$ 1,637,522	$ 1,123,819
Cadapult	228,698	359,954
Elimination	--	--

Totals	$ 1,866,220	$ 1,483,773
Income from operations:		
Media Sciences	$ 379,627	$ 407,030
Cadapult	50,501	(52,554
Elimination	(7,411)	17,476
Totals	$ 422,717	$ 371,952
Reconciliation to consolidated net income:		
Segment income from operations	$ 422,717	$ 371,952
Non-operating items	(52,520)	(107,308
Income taxes	(156,303)	(128,304
Net income	$ 213,894	$ 136,340

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 for the year ended June 30, 2004, filed September 28, 2004, which Form 10-KSB will be amended pursuant to Note 2 of the Notes to Condensed Consolidated Financial Statements and the information set forth in our Form 8-K filed on May 11, 2005. As explained in Note 2 of the Notes to Condensed Consolidated Financial Statements, certain amounts in the condensed consolidated financial statements as of and for the three months ended September 30, 2003 have been restated to reflect the effects of variable plan accounting for certain stock options.

RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

Sales. Our consolidated sales for the three months ended September 30, 2004 compared to the same period in 2003, increased approximately 34% to $4.9 million from $3.6 million. Media Sciences sales increased approximately 43% to $4.1 million from $2.9 million. Cadapult sales decreased approximately 4% to $0.83 million from $0.86 million. Approximately 60% of the increase in Media Sciences sales was due to the shipment of new products, while 40% of the increase was due to increased sales of existing products.

Gross Profit. The consolidated gross profit for the three months ended September 30, 2004 was $2.3 million, or approximately 47% of sales, as compared to $1.9 million, or approximately 51% of sales for the three months ended September 30, 2003. Media Sciences gross profit margins decreased to 49% from 53% in the prior year. Cadapult s gross profit margins decreased slightly to 34% from 36%. The decrease in Media Sciences gross profit margins was due to a shift in the mix of toner product sales and to a temporary increase in our solid ink manufacturing costs.

Selling, General and Administrative. Consolidated selling, general and administrative expenses for the three months ended September 30, 2004 decreased to $1.9 million or 38% of sales, from $1.5 million or 41% of sales for the three months ended September 30, 2003. Media Sciences selling, general and administrative expenses increased slightly to 40% of sales from 39% of sales. The increase in Media Sciences selling, general and administrative expenses was primarily due to increased sales, marketing and new product development costs. Cadapult s selling, general and administrative expenses decreased to 28% of sales from 42% of sales primarily due to a shift in the allocation of overhead from Cadapult to Media Sciences. The allocation of overhead has shifted from Cadapult to Media Sciences due to the relative increases in management time, financial resources, and space resulting from the focus on growing the Media Sciences business.

Depreciation and Amortization. For the three months ended September 30, 2004 compared to the same period in 2003, our depreciation and amortization expense decreased to $0.13 million, of which $0.06 million was included in cost of goods sold, from $0.2 million of which $0.15 million was included in cost of goods sold. The decrease in depreciation was due to substantially all of the No-Cap Color printer assets and one Media Sciences tooling investment being fully depreciated in our last fiscal year. Amortization of intangibles for the three months ended

September 30, 2004 was $2,177 and for the three months ended September 30, 2003 was $2,317.

Interest Expense. For the three months ended September 30, 2004 compared to the same period in 2003, our interest expense decreased to $0.05 million from $0.1 million due to the retirement of high interest rate debt during our fiscal 2004 year.

Income Taxes. For the three months ended September 30, 2004, we recorded an income tax expense of $0.16 million as compared to an income tax expense of $0.13 million in 2003. For the three months ended September 30, 2004, we recorded the current income tax expense because of New Jersey s suspension of the use of 50% of net operating loss carry forwards. For the three months ended September 30, 2003, we recorded the current income tax expense because of New Jersey s full suspension of the use of net operating loss carry forwards. An effective aggregate state and federal tax rate of 43% was used for the three months ended September 30, 2004 and 49% was used for the three months ended September 30, 2003. The effective aggregate state and federal taxes varies due to the impact of variable plan accounting.

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Dividends. There were no dividends for the three months ended September 30, 2004. For the three months ended September 30, 2003, we accrued $0.16 million of stock dividends to our preferred shareholders.

Net Income (Loss) Applicable to Common Shareholders. For the three month period ended September 30, 2004 (restated), we earned $0.21 million or $0.02 per share basic and diluted as compared to incurring a net loss of $0.02 million or $(0.01) per share basic and diluted for the corresponding three month period ended September 30, 2003 (restated).

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LIQUIDITY AND CAPITAL RESOURCES

For the three months ended September 30, 2004, we experienced negative cash flows of $0.12 million. Cash flows from operating activities resulted in negative cash flows of $0.35 million primarily due to net income of $0.21 million, non-cash charges of $0.13 million for depreciation and amortization, $0.08 million for the impact of variable plan accounting, $0.14 million for deferred income taxes, the receipt of the insurance claim receivable of $0.5 million and an increase in deferred revenue of $0.18 million, offset by an increase in accounts receivable of $1 million, an increase in prepaid expenses of $0.19 million and a decrease in accounts payable of $0.27 million.

The cash we used in investing activities included the purchase of equipment and tooling in the amount of $0.25 million.

Cash provided by financing activities was $0.48 million, comprised primarily of advances from our credit facility of $0.52 million and proceeds from stock option and warrant exercises of $0.08 million, offset by term loan payments of $0.1 million.

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 September 30, 2004, $2.3 million was outstanding under this line.

We anticipate that our cash requirements over the next twelve months which will include increases in inventory associated with new product launches and capital expenditures associated with new product launches, the move to new facilities, and the acquisition of certain manufacturing equipment to scale our solid ink manufacturing, will be met through internal cash generated by increased sales and profitability, the use of our revolving line of credit and where appropriate operating leases.

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 our 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. 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 our 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 September 30, 2004. Based on such evaluation, the Company s Chief Executive Officer and Principal Financial Officer have concluded that, as of such date, the Company s disclosure controls and procedures were not effective.

There have not been any changes in the Company s internal control over financial reporting during the quarter ended September 30, 2004 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

In connection with its review of the Company s financial statements for the quarter ended March 31, 2005, J.H. Cohn LLP, the Company s independent registered public accounting firm, brought to the attention of the Company that certain issued and outstanding options that permitted cashless exercise were subject to variable plan accounting treatment under the Financial Accounting Standards Board s Interpretation 44, Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB Opinion No. 25 (Issue Date 3/00). Accordingly, certain previously unrecognized compensation expense should have been recognized as compensation expense in certain of the financial statements previously issued by the Company.

Consequently, J.H. Cohn LLP also advised the Audit Committee and management of certain material weaknesses, including the inability to prepare financial statements and footnotes in accordance with U.S. generally accepted accounting principles and SEC rules, and improper accounting procedures for grants with cashless exercise provisions per Financial Accounting Standards Board s Interpretation 44, Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB Opinion No. 25". J.H. Cohn LLP indicated that they considered these deficiencies to be material weaknesses as that term is defined under standards established by the Public Company Accounting Oversight Board (United States).

In light of the need for a restatement and the material weaknesses in the Company s internal controls, commencing in the fourth quarter of the Company s 2005 fiscal year, the Company has begun undertaking a review of the Company s disclosure, financial information and internal controls and procedures. This review includes increased diligence by the Company s management and directors, as well as the use of additional outside resources. Further, the Company has accelerated its timetable to hire a Chief Financial Officer and has initiated the search process. The Company is committed to addressing its control environment and reporting procedures.

On May 10, 2005, the Board of Directors of the Company rescinded the cashless exercise provision for all of the Company s outstanding option grants. Thus, variable accounting relating to the cashless exercise feature will no longer required after the Company s fiscal quarter ended June 30, 2005.

The Company s management, including its Chief Executive Officer and its Principal Financial Officer, does not expect that disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud, even as the same are improved to address any deficiencies. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

The following exhibits are filed with this report:

Exhibit Number	Description of Exhibit
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 32.1*	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350
Exhibit 32.2*	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350

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* Filed herewith.

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: August 15, 2005

By: /s/ Michael W. Levin
Michael W. Levin
Chief Executive Officer and President

Dated: August 15, 2005

By: /s/ Denise Hawkins
Denise Hawkins
Vice President and Controller
(Principal Financial Officer)