MEDIA SCIENCES INTERNATIONAL INC
Form 10QSB
May 15, 2006

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

FORM 10-QSB

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2006

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

Commission file number: **1-16053**

MEDIA SCIENCES INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

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

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

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

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the 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 o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of May 4, 2006, the issuer had 11,114,529 shares of common stock outstanding.

Transitional Small Business Disclosure Format (check one): Yes o No x

MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES

FORM 10-QSB
FOR THE QUARTER ENDED MARCH 31, 2006

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

ASSETS	March 31, 2006 (Unaudited)	June 30, 2005 (Restate (Note 1)
CURRENT ASSETS :		
Cash	$ 1,070,575	$ 611,016
Accounts receivable, less allowance for doubtful accounts of $50,000 at March, $35,000 at June	2,329,076	2,175,512
Inventories	4,138,113	3,196,323
Deferred tax assets	582,778	959,910
Prepaid expenses and other current assets	422,121	308,822

Total Current Assets	8,542,663	7,251,583
PROPERTY AND EQUIPMENT, NET	2,541,899	2,058,251
OTHER ASSETS:		
Goodwill and other intangible assets, net	3,584,231	3,584,231
Other assets	78,201	63,911
	3,662,432	3,648,142
TOTAL ASSETS	$ 14,746,994	$ 12,957,976
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Bank line of credit	$ --	$ 1,620,233
Bank term loan	150,000	100,000
Accounts payable	1,542,408	1,254,921
Accrued compensation and benefits	535,996	128,413
Other accrued expenses and current liabilities	353,568	14,019
Income taxes payable	362,500	295
Accrued product warranty	256,060	291,733
Deferred revenue	699,179	526,853
Total Current Liabilities	3,899,711	3,936,467
OTHER LIABILITIES :		
Bank term loan, less current maturities	500,000	375,000
Deferred rent liability	311,946	341,988
Deferred revenue, less current portion	430,658	280,418
Deferred tax liabilities	443,556	404,099
Total Other Liabilities	1,686,160	1,401,505
TOTAL LIABILITIES	5,585,871	5,337,972
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 11,067,029 shares in March, 10,953,606 shares in June	11,067	10,954
Additional paid-in capital	9,802,729	9,753,405
Cost of common stock in treasury, none in March, 54,577 shares in June	--	(112,913
Accumulated deficit	(652,673)	(2,031,442
Total shareholders' equity	9,161,123	7,620,004
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 14,746,994	$ 12,957,976

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,		Nine
	2006	2005	2006
NET SALES	$ 5,371,581	$ 4,070,179	$ 15,247,7
COST OF GOODS SOLD:			
Cost of goods sold, excluding depreciation and amortization	2,182,348	1,981,371	6,260,1
Depreciation and amortization	128,979	66,629	380,7
Total cost of goods sold	2,311,327	2,048,000	6,640,9
GROSS PROFIT	3,060,254	2,022,179	8,606,8
OTHER COSTS AND EXPENSES:			
Selling, general and administrative, excluding depreciation and amortization, loss from sublease and moving expense, and impact of variable plan accounting	2,162,035	1,818,132	6,091,1
Depreciation and amortization	58,096	71,880	163,4
Loss from sublease and moving expenses	--	528,050	--
Impact of variable plan accounting	--	192,321	--
Total other costs and expenses	2,220,131	2,610,383	6,254,6
INCOME (LOSS) FROM OPERATIONS	840,123	(588,204)	2,352,2
Interest expense, net	4,283	44,533	54,2
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	835,840	(632,737)	2,297,9
Provision (benefit) for income taxes	334,336	(176,168)	919,1
INCOME (LOSS) FROM CONTINUING OPERATIONS	501,504	(456,569)	1,378,7
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	--	(82,740)	--
Provision (benefit) for income taxes	--	(27,783)	--
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	--	(54,957)	--
NET INCOME (LOSS)	$ 501,504	$ (511,526)	$ 1,378,7

BASIC EARNINGS (LOSS) PER SHARE			
Income (loss) from continuing operations	$ 0.05	$ (0.04)	$ 0.
Income (loss) from discontinued operations	$ --	$ (0.01)	$ --
Net Income (loss)	$ 0.05	$ (0.05)	$ 0.
DILUTED EARNINGS (LOSS) PER SHARE			
Income (loss) from continuing operations	$ 0.04	$ (0.04)	$ 0.
Income (loss) from discontinued operations	$ --	$ (0.01)	$ --
Net Income (loss)	$ 0.04	$ (0.05)	$ 0.
WEIGHTED AVERAGE SHARES USED TO COMPUTE NET EARNINGS (LOSS) PER SHARE			
Basic	11,002,426	10,288,450	10,983,3
Diluted	11,635,422	10,288,450	11,481,4

See accompanying notes to condensed consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
NINE MONTHS ENDED MARCH 31, 2006
(UNAUDITED)

	Common Stock		Additional Paid-in Capital	Treasury Stock
	Shares	Amount		
BALANCES, JUNE 30, 2005	10,953,606	$ 10,954	$ 9,753,405	$ (112,913)
Cumulative net increase in net loss - pre-2004	--	--	--	--
BALANCES, JUNE 30, 2005 (Restated)	10,953,606	$ 10,954	$ 9,753,405	$ (112,913)
Issuance of common stock for exercise of stock warrants	150,000	150	149,850	--
Issuance of common stock for exercise of stock options	18,000	18	12,332	--
Cancellation of shares held in treasury and returned to unissued status	(54,577)	(55)	(112,858)	112,913
Net income	--	--	--	--
BALANCES, MARCH 31, 2006	11,067,029	$ 11,067	$ 9,802,729	$ --

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended March 31, 2006	Nine Months Ended March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES :		
Income (loss) from continuing operations	$ 1,378,769	$ (32,281
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	544,219	398,395
Deferred income taxes	416,589	(238,013
Provision for bad debts	26,729	2,969
Impact of variable plan accounting	--	238,956
Cash provided by discontinued operations	--	10,981
Non-cash compensation expense	56,934	--
Changes in operating assets and liabilities :		
Accounts receivable	(180,293)	(931,662
Insurance claim receivable	--	500,000
Receivable from landlord	--	200,000
Inventories	(941,790)	(231,824
Prepaid expenses and other current assets	(113,299)	33,646
Other assets	(14,290)	(21,758
Accounts payable	287,487	(869,311
Accrued compensation and benefits	407,583	4,483
Other accrued expenses and current liabilities	303,876	10,100
Income taxes payable	362,205	294,490
Deferred rent liability	(30,042)	208,182
Deferred revenue	322,566	605,368
Net cash provided by operating activities	2,827,243	182,721
CASH FLOWS FROM INVESTING ACTIVITIES :		
Purchases of property and equipment	(1,084,801)	(1,327,064
Net cash used in investing activities	(1,084,801)	(1,327,064
CASH FLOWS FROM FINANCING ACTIVITIES :		
Bank line of credit, net	(1,620,233)	(871,054
Proceeds from bank term loan, net of repayments	175,000	500,000
Payments of other short-term debt	--	(31,749
Proceeds from issuance of common stock	162,350	1,575,654
Net cash provided by (used in) financing activities	(1,282,883)	1,172,851
NET INCREASE IN CASH	459,559	28,508
CASH, BEGINNING OF PERIOD	611,016	666,116
CASH, END OF PERIOD	$ 1,070,575	$ 694,624

SUPPLEMENTAL CASH FLOW INFORMATION :

Interest paid	$ 53,514	$ 149,651
Income taxes paid	$ 58,073	$ 52,775

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 included in our Annual Report on Form 10-KSB for the year ended June 30, 2005. The year-end consolidated balance sheet data was derived from audited financial statements 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 and nine months ended March 31, 2006 are not necessarily indicative of the results to be expected for the full year.

Reclassifications
Certain prior fiscal year balances were reclassified to conform to the current year presentation.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, accounts receivable, inventories, long-lived assets, warranty reserves, income taxes and contingencies. These estimates are based on historical facts and various other assumptions that we believe are reasonable.

NOTE 1A RESTATEMENT :

As a result of new processes and controls implemented during the quarter over tax compliance and tax accounting, the Company identified errors in previously filed tax returns, for which amended returns will be filed. These errors also contributed to errors in the Company s tax accounting for the year ended June 30, 2003 and prior years. For these periods, the Company s tax expense was understated by $161,956.

These errors had no effect on the Company s results of operations or cash flows for the current quarter, prior quarters in this fiscal year, or comparative periods presented for the prior fiscal year. The cumulative effect of these errors overstated the Company s deferred tax assets by $243,974, taxes payable by $82,018, and retained earnings by $161,956 on prior balance sheets presented this year and for the years ended June 30, 2005 and 2004 in our Form 10-KSB for the year ended June 30, 2005. The affected balances have been restated in the comparative balance sheet included in this Form 10-QSB. The Company will be filing amended Form 10-QSBs for its first and second fiscal quarters ended September 30 and December 31, 2005 and an amended Form 10-KSB for the year ended June 30, 2005 to reflect the restatement. Investors should look to the revised financial information regarding the restatement in this Form 10-QSB, until the above amendments are filed.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1A RESTATEMENT (CONTINUED) :

The following table reflects the effects of the errors on previously issued financial statements:

	1Q & 2Q 2006	2005	2004	2003 & Prior
Income tax expense	no effect	no effect	no effect	$161,956 understatement
Net income	no effect	no effect	no effect	$161,956 overstatement
Cash flows from operations	no effect	no effect	no effect	no effect
Ending Balance Sheet				
- Deferred tax assets	$243,974 overstatement	$243,974 overstatement	$243,974 overstatement	$243,974 overstatement
- Income taxes payable *	$82,018 overstatement *	$82,018 overstatement *	$82,018 overstatement	$82,018 overstatement
- Retained earnings	$161,956 overstatement	$161,956 overstatement	$161,956 overstatement	$161,956 overstatement

** In the June 30, 2005 and September 30, 2005 balance sheets, Taxes payable was overstated and/or Prepaid taxes, included in the Prepaid expenses and other current assets caption, was understated by the aggregate $82,018 error. In all other periods presented in this table, the Company had an Income taxes payable liability, which was overstated as shown.*

The following table reflects the effects of the restatement on the Company s accumulated deficit and total shareholders equity:

	Common Stock		Additional Paid-in Capital	Treasury Stock
	Shares	Amount		
BALANCES, JUNE 30, 2005	10,953,606	$ 10,954	$ 9,753,405	$ (112,913)
Cumulative net increase in net loss - pre-2004	--	--	--	--
BALANCES, JUNE 30, 2005 (Restated)	10,953,606	$ 10,954	$ 9,753,405	$ (112,913)

NOTE 2 NATURE OF BUSINESS :

Media Sciences International, Inc. and Subsidiaries, collectively referred to as the Company, manufactures and distributes supplies for workgroup 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 located in the United States through programs designed to foster our supplies business, such as our INKlusive free color printer program. In May 2005, we discontinued our electronic

pre-press sales and service operations conducted by our subsidiary, Cadapult Graphic Systems, Inc. (Cadapult) (see Note 10.) We have our corporate headquarters in New Jersey.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 STOCK-BASED COMPENSATION AND RELATED PRO FORMA DISCLOSURES :

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 (loss) and income (loss) per share disclosures as well as various other disclosures. As a result of amendments to SFAS 123, the Company will be required to expense the fair value of 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 at the time the options were granted.

Prior to May 10, 2005, certain stock options permitted cashless exercise and were accounted for pursuant to variable plan accounting treatment. Under variable plan accounting treatment, non-cash compensation expense is increased or decreased as a result of changes in the market price of the Company s common stock. For the three months ended March 31, 2006 there was no non-cash compensation expense or benefit and for the three months ended March 31, 2005, we recognized non-cash compensation expense of $205,601 including a $13,280 non-cash compensation expense which was included in the loss from discontinued operations. For the nine months ended March 31, 2006 there was no non-cash compensation expense or benefit and for the nine months ended March 31, 2005, non-cash compensation expense was $255,244, of which $16,288 was included in the income from discontinued operations.

On May 10, 2005, our 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 were no longer subject to variable plan accounting treatment after the fiscal year ended June 30, 2005.

Pro forma information regarding net income (loss) and income (loss) per common share 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 values of options granted in the three and nine months ended March 31, 2006 and 2005 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions, respectively:

	Three and Nine Months Ended March 31,	
	2006	2005
Risk-free interest rate	4.72%	4-4.5%
Dividend yield	0.0%	0.0%
Expected common stock market price volatility factor	50-75%	9-15%
Average expected life of stock options	9 years	10 years

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 STOCK-BASED COMPENSATION AND RELATED PRO FORMA DISCLOSURES (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 March 31, 2006	Three Months Ended March 31, 2005	Nine Months March 3 2006
Net income (loss) as reported	$ 501,504	$(511,526)	$ 1,378,769
Impact of variable plan accounting, net of related tax effects	--	159,001	--
Stock-based employee compensation expense under fair value method, net of related tax effects	(7,157)	(14,126)	(30,269)
Pro forma net income (loss)	$ 494,347	$(366,651)	$ 1,348,500
Net income (loss) per common share:			
Basic, as reported	$0.05	$(0.05)	$0.13
Diluted, as reported	$0.04	$(0.05)	$0.12
Basic and diluted, pro forma	$0.04	$(0.04)	$0.12

NOTE 4 INVENTORIES :

Inventories are summarized as follows:

	March 31, 2006	June 30, 2005
Raw materials	$1,589,939	$1,040,390
Finished goods	2,548,174	2,155,933
	$4,138,113	$3,196,323

NOTE 5 DEBT :

The Company s borrowings consisted of the following:

	March 31, 2006	June 30, 2005
Short-term debt:		
Revolving line-of-credit with bank	$ --	$1,620,233

Current maturities of note payable to bank	150,000	100,000
	$ 150,000	$1,720,233
Long-term debt:		
Note payable to bank, less current maturities	$ 500,000	$ 375,000

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 DEBT (CONTINUED) :

We have a revolving line of credit which provides for maximum borrowings of $3 million. As of March 31, 2006, we had no outstanding balance under this line. In connection with the negotiation of this facility during 2004, we granted a security interest in all of our assets. Borrowings through January 23, 2006 bore interest at a rate of 0.75% over the bank s Prime Rate. On January 23, 2006, we entered into an Amended and Restated Committed Line of Credit Note, and an Amendment to Loan Documents (collectively, the Amendments). The Amendments reduced the interest rate by 0.75% to the bank s Prime Rate, and extended the maturity date by one year to November 30, 2007. The Amendments also modified certain financial covenants, which are described below.

On March 17, 2006, we entered into a five-year term note with our bank in the amount of $0.25 million that bears interest at a fixed rate of 7.75%, and requires monthly repayments of principal of $4,167. The proceeds were used to finance the purchase of certain long-lived manufacturing property and equipment. The note is cross collateralized and contains cross default provisions with the revolving line of credit.

On July 27, 2005, we entered into an equipment lease line of credit with $1 million in availability with the bank. Borrowings bear interest at a rate of approximately 1% over the bank s Prime Rate, with terms of three to seven years. The bank will hold title to the equipment leased under the line of credit. Any unutilized balance on the line of credit expires on November 30, 2006. In December 2005, we entered into an operating lease under this line, reducing the availability under the line by $228,682. This lease requires monthly rent payments of $3,453, for 72 months.

In March 2005, we entered into a five-year term note with our bank in the amount of $0.5 million that bears interest at a fixed rate of 6.5%, and requires monthly repayments of principal of $8,333. At March 31, 2006, this note had a remaining principal balance of $0.4 million. The proceeds were used to finance the leasehold improvements to our Oakland facility. The note is cross collateralized and contains cross default provisions with the revolving line of credit.

Both the amended revolving line-of-credit and the five-year term notes with the bank are subject to two amended financial covenants as follows :

(a) The Company will maintain, as of the end of each fiscal quarter, a ratio of Funded Debt to EBITDA of not more than 2.50 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2005.

(b) The Company will maintain, as of the end of each fiscal quarter, a ratio of EBITDA to Fixed Charge (EBITDA to Fixed Charge) of more than 1.00 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2006. (Measurement will be on a six month basis for quarter ended March 31, 2006 and a nine month basis for quarter ending March 31, 2006).

As used herein:

CPLTD means the scheduled payments of principal on all indebtedness for borrowed money having an original term of more than one year (including but not limited to amortization of capitalized lease obligations), as shown on the Company s financial statements as of one year prior to the date of determination.

EBITDA means net income plus interest expense plus income tax expense plus depreciation plus amortization.

EBITDA to Fixed Charge means (i) EBITDA minus Unfunded Capital Expenditures divided by (ii) taxes actually paid plus CPLTD and interest expense.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 DEBT (CONTINUED) :

Funded Debt means all borrowed debt including senior borrowed debt and subordinated debt.

Unfunded Capital Expenditures represents the difference between actual capital expenditures and term financing, the proceeds of which were used to purchase such capital expenditures. In effect, this represents capital expenditures which were purchased with operating cash flow.

At no time since the inception of this loan agreement has the Company been in violation of these covenants.

NOTE 6 EARNINGS (LOSS) PER SHARE :

Basic earnings (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted earnings (loss) per common share is computed using the weighted average number of common shares outstanding as 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 the basic and diluted earnings (loss) per common share from continuing operations, discontinued operations, and net income (loss):

	Three Months Ended March 31,		Nine Months E March 31,	
	2006	2005	2006	
Numerator for basic and diluted:				
Income (loss) from continuing operations	$ 501,504	$ (456,569)	$ 1,378,769	$
Income (loss) from discontinued operations	--	(54,957)	--	
Net Income (loss)	$ 501,504	$ (511,526)	$ 1,378,769	$
Denominator :				
Denominator for basic earnings (loss) per common share - weighted average shares	11,002,426	10,288,450	10,983,361	1
Effect of dilutive securities - stock options and warrants	632,996	--	498,114	
Denominator for diluted earnings (loss) per common share - adjusted weighted average shares and assumed conversions	11,635,422	10,288,450	11,481,475	1
Basic earnings (loss) per share				
Income (loss) from continuing operations	$ 0.05	$ (0.04)	$ 0.13	$
Income (loss) from discontinued operations	$ --	$ (0.01)	$ --	$

Net Income (loss)	$ 0.05	$ (0.05)	$ 0.13	$
Diluted earnings (loss) per share				
Income (loss) from continuing operations	$ 0.04	$ (0.04)	$ 0.12	$
Income (loss) from discontinued operations	$ --	$ (0.01)	$ --	$
Net Income (loss)	$ 0.04	$ (0.05)	$ 0.12	$

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 EARNINGS (LOSS) PER SHARE (CONTINUED) :

The following warrants and options to purchase common stock were excluded from the computation of diluted income (loss) per common share from continuing operations and net income per common share for the three and nine months ended March 31, 2006 and 2005 because they were anti-dilutive for those periods:

	Three Months Ended March 31,		Nine Months E March 31,	
	2006	2005	2006	
Anti-dilutive warrants and options	41,200	1,248,641	97,200	

NOTE 7 WARRANTY EXPENSES :

The Company provides a warranty for all of its consumable supply products and for its INKlusive printer program. The Company s warranty stipulates that it 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 the 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 and nine months ended March 31, 2006 and 2005 are as follows:

	Three Months Ended March 31,		Nine Mont March	
	2006	2005	2006	
Warranty reserve at the beginning of the period	$ 275,268	$ 339,382	$ 291,733	
Warranties accrued during the period	200,321	272,686	696,833	
Warranties settled during the period	(219,529)	(296,357)	(732,506)	
Net change in warranty reserve	(19,208)	(23,671)	(35,673)	
Warranty reserve at March 31,	$ 256,060	$ 315,711	$ 256,060	

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NOTE 8 ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES :

Engineering and product development costs, which consist of salaries and related benefit 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 March 31, 2006 and 2005, engineering and product development costs were approximately $0.19 million and $0.15 million, respectively. For the nine months ended March 31, 2006 and 2005, engineering and product development costs were approximately $0.54 million and $0.37 million, 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 March 31, 2006 and 2005 totaled approximately $0.01 million and $0.05 million, respectively. Advertising expense for the three months ended March 31, 2006 and 2005 amounted to approximately $0.17 million and $0.24 million, respectively. Advertising expense for the nine months ended March 31, 2006 and 2005 amounted to approximately $0.58 million and $0.69 million, respectively.

NOTE 10 DISCONTINUED OPERATIONS :

In a prior year (May 2005), a decision was made to cease certain sales and service operations under Cadapult. Specifically, the Company ceased all electronic pre-press sales and service operations and the service operations were sold on May 7, 2005. Accordingly, the results of operations of the electronic pre-press sales and service operations have been reclassified and are included in discontinued operations for the three and nine months ended March 31, 2005. Sales and service revenues from the discontinued operations for the three and nine months ended March 31, 2005 were $0.26 and $1.15 million, respectively. The pre-tax income (loss) from discontinued operations for the three and nine months ended March 31, 2005 was $(0.08) and $0.03 million, respectively.

Cadapult continues to sell Media Sciences supplies and the INKlusive free color printer program to end users. Since this is essentially the same business as the rest of the Company s continuing operations, and as a result of the presentation of Cadapult s electronic pre-press sales and service operations as discontinued operations, segment information is no longer presented.

NOTE 11 RELATED PARTY TRANSACTION :

In the nine months ended March 31, 2006, pursuant to the employment contract with the Company s Chief Executive Officer, dated July 1, 2003, the Company incurred a non-cash compensation expense of $56,934.

NOTE 12 CANCELLATION OF TREASURY SHARES :

On February 7, 2006, the Board of Directors voted to cancel 54,577 shares of treasury stock. This action reduced the number of shares outstanding by 54,577 and had no impact on total shareholders equity. The treasury stock was cancelled and returned to unissued status.

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

FORWARD LOOKING STATEMENTS

Our disclosure and analysis in this report contain forward-looking information, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, about our financial results and estimates, business prospects and products in development that involve substantial risks and uncertainties. You can identify these statements by the fact that they do not relate strictly to historic or current facts. These forward-looking statements use terms such as believes, expects, may , will, should, anticipates, estimate, plan, or forecast or other words of similar meaning relating to future operating or financial performance or by discussions of strategy that involve risks and uncertainties. From time to time, we also may make oral or written forward-looking statements in other materials we release to the public. These forward-looking statements are based on many assumptions and factors, and are subject to many conditions, including, but not limited to, our continuing ability to obtain additional financing, dependence on contracts with suppliers and major customers, competitive pricing for our products, demand for our products, changing technology, our introduction of new products, industry conditions, anticipated future revenues and results of operations, retention of key officers, management or employees, prospective business ventures or combinations and their potential effects on our business. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements are made based upon management s current expectations and beliefs concerning future developments and their potential effects upon our business. We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. We cannot predict whether future developments affecting us will be those anticipated by management, and there are a number of factors that could adversely affect our future operating results or cause our actual results to differ materially from the estimates or expectations reflected in such forward-looking statements. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise.

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, 2005, filed September 13, 2005.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123(R) (revised 2004), Share-Based Payment , which amends FASB Statement No. 123 and will be effective for us for the fiscal year beginning July 1, 2006. The new standard will require us to expense employee stock options and other share-based payments over the service period. The new standard may be adopted in one of three ways the modified prospective transition method, a variation of the modified prospective transition method or the modified retrospective transition method. We are currently evaluating how we will adopt the standard and evaluating the effect that the adoption of SFAS 123(R) will have on our financial position and results of operations, although it is likely that we will have to recognize additional compensation expense in the periods after adoption.

RESULTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2006 AND 2005

Sales. Our consolidated sales from continuing operations for the three months ended March 31, 2006 compared to the same period in 2005, increased approximately 32% to $5.4 million from $4.1 million. Sales of solid ink sticks increased approximately 23%, while sales of color toner cartridges increased by approximately 68%. Our consolidated sales from continuing operations for the nine months ended March 31, 2006 compared to the same period in 2005, increased approximately 16% to $15.2 million from $13.1 million. Sales of solid ink sticks increased approximately 14%, while sales of color toner cartridges increased by approximately 36%. Direct sales of supplies through our Cadapult subsidiary for the three and nine months ended March 31, 2006 decreased by approximately 22% and 42%, respectively, as we focused on building our sales through our distribution channels.

In late September 2005, we started shipping color toner cartridges for the Oki 5000 series of color printers. In late December 2005, we started shipping solid ink sticks for the new Xerox Phaser 8500 and 8550, and color toner cartridges for the Ricoh 3800 and related engines. In mid-March 2006, we started shipping universal, high capacity cartridges for use in Xerox Phaser 7300, Oki 9300 and 9500, and Konica 7830 office color printers. In early April 2006, we started shipping high capacity cartridges for use in Xerox Phaser 6250, Konica Minolta magicolor 3300, Epson AcuLaser C4100 and Brother HL-4200CN office color printers, the first independently manufactured, new-build, office color toner cartridges featuring chip technology. As a result of these new products and current sales trends of existing products, we expect the growth of color toner cartridge sales to continue to outpace the growth of our solid inks for the remainder of fiscal 2006.

Gross Profit. The consolidated gross profit for the three months ended March 31, 2006 was $3.1 million, or approximately 57% of sales, as compared to $2.0 million, or approximately 50% of sales, for the three months ended March 31, 2005. The consolidated gross profit for the nine months ended March 31, 2006 was $8.6 million, or approximately 56% of sales, as compared to $6.4 million, or approximately 49% of sales, for the nine months ended March 31, 2005. We benefited from margin expansion in both our solid ink and color toner cartridge lines. Our solid ink margins increased due to manufacturing efficiencies, which more than offset certain increases in our raw material costs. Our color toner cartridge margins expanded significantly due to the mix of products making up our color toner cartridge sales. While our margins can and do vary due to sales product mix, we believe that they will remain fairly consistent with our current results throughout the remainder of fiscal 2006.

Selling, General and Administrative. Consolidated selling, general and administrative expenses for the three months ended March 31, 2006 increased to $2.2 million, or 40% of sales, from $1.8 million, or 45% of sales, exclusive of non-recurring charges, for the three months ended March 31, 2005. Consolidated selling, general and administrative expenses for the nine months ended March 31, 2006 increased to $6.1 million, or 40% of sales, from $5.2 million, or 40% of sales, exclusive of non-recurring charges, for the nine months ended March 31, 2005. These increases are attributed to additional compensation and benefits expense and research and development expense, partially offset by decreased warranty expense. For the three and nine months ended March 31, 2005, non-cash compensation expenses of $0.19 million and $0.24 million, respectively, were incurred to reflect the impact of variable plan accounting treatment. These have been shown as a separate line item on our income statement. Since our stock options are no longer subject to variable plan accounting treatment, we do not anticipate further non-cash compensation charges until our adoption of SFAS 123(R). While we intend to increase expenditures in advertising, marketing, research and development and general payroll costs, we expect our selling, general and administrative expenses to remain relatively consistent as a percentage of sales.

For comparability, the non-recurring costs of moving the Company s operations and an impairment charge associated with vacating and subleasing the prior facility were excluded from the above analysis for the three and nine months ended March 31, 2005. These non-recurring charges, shown as separate line items, were approximately $0.53 million for both the three and nine month periods ended March 31, 2005.

Depreciation and Amortization. For the three months ended March 31, 2006 compared to the same period in 2005, our depreciation and amortization expense increased to $0.19 million, of which $0.13 million was included in cost of goods sold, from $0.14 million, of which $0.07 million was included in cost of goods sold. For the nine months ended March 31, 2006 compared to the same period in 2005, our depreciation and amortization expense increased to $0.54 million, of which $0.38 million was included in cost of goods sold, from $0.40 million, of which $0.20 million was included in cost of goods sold. The year-over-year increase in depreciation and amortization was primarily due to leasehold improvements related to our new facility, additions to our manufacturing equipment, and placing in service capitalized tool and die costs associated with the launch of new color toner cartridge models, discussed above in Sales. There was no amortization expense associated with intangibles for the three or nine months ended March 31, 2006. For the three and nine months ended March 31, 2005, amortization of intangibles was $1,062 and $4,750, respectively.

Interest Expense, Net. For the three months ended March 31, 2006 compared to the same period in 2005, our net interest expense decreased to $0.004 million from $0.045 million. For the nine months ended March 31, 2006 compared to the same period in 2005, our net interest expense decreased to $0.054 million from $0.150 million. The year-over-year decrease in net interest expense was due to year-over-year retirement of debt funded by cash flows generated from operations.

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Income Taxes. For the three months ended March 31, 2006, we recorded an income tax expense from continuing operations of $0.33 million as compared to an income tax benefit from continuing operations of $0.18 million for the three months ended March 31, 2005. For the nine months ended March 31, 2006, we recorded an income tax expense from continuing operations of $0.92 million as compared to an income tax expense from continuing operations of $0.12 million for the nine months ended March 31, 2005. An effective tax rate of 40% was used for the three and nine months ended March 31, 2006, and 28% and 118% was used for the three and nine months ended March 31, 2005, respectively. The effective aggregate state and federal tax rate for the periods ended March 31, 2005 differed from that for the periods ended March 31, 2006 due primarily to the impact of variable plan accounting in 2005.

Income (Loss) from Continuing Operations. For the three months ended March 31, 2006, we earned $0.5 million from continuing operations, or $0.05 per share basic and $0.04 per share diluted, as compared to the three months ended March 31, 2005, where we incurred a loss of $0.5 million from continuing operations, or $(0.04) per share basic and diluted. For the nine months ended March 31, 2006, we earned

$1.4 million from continuing operations, or $0.13 per share basic and $0.12 per share diluted, as compared to the nine months ended March 31, 2005, where we incurred a loss of $0.03 million, or $0.00 per share basic and diluted.

Income (Loss) from Discontinued Operations. In May 2005, we ceased and sold certain sales operations under Cadapult. Specifically, we ceased all electronic pre-press equipment sales and service operations. The results of operations for that line of business are classified as a discontinued operation.

Sales and service revenues from the discontinued operations for the three and nine months ended March 31, 2005 were $0.26 million and $1.15 million, respectively. Income (loss), net of tax from discontinued operations, for the three and nine months ended March 31, 2005 was $(0.055) million and $0.011 million, respectively.

LIQUIDITY AND CAPITAL RESOURCES

We experienced positive cash flows from operating activities for the nine months ended March 31, 2006. Cash flows from operating activities of $2.8 million resulted primarily from income from continuing operations of $1.4 million, non-cash charges of $1.0 million, an increase in accounts payable of $0.29 million, an increase in accrued expenses and other liabilities (including compensation and benefits) of $0.71 million, an increase in income taxes payable of $0.36 million, and an increase in deferred revenue of $0.32 million, offset by increases in accounts receivable of $0.18 million, inventories of $0.94 million, and an increase in prepaid expenses and other current assets of $0.11 million.

Accounts receivable increased over the levels at June 30, 2005 due to the noted increase in year-over-year sales. At March 31, 2006, 98% of gross receivables were aged at less than 60 days, and approximately $0.06 million (2%) of gross receivables were aged at greater than 90 days.

Under the Company s INKlusive program, a customer commits to purchase a fixed quantity of supplies from the Company over a two or three year period. These supplies are automatically shipped to the customer on a regular basis. In exchange, and through a financing partner, the Company provides the customer with a color printer at no additional charge. Under our agreement with the financing company, at the time of placement of the INKlusive printer, we are paid in full for the printer and the two or three years of supplies. The Company recognizes the revenue from the supplies as they are shipped over the term of the INKlusive agreement. Deferred revenue consists principally of billings on INKlusive contracts prior to shipping supplies to fulfill those contracts.

Cash flow generated by the INKlusive program is a function of the net number of printer placements in the program. During the three and nine months ended March 31, 2006, there was an increase in the net number of printers placed in the program. This resulted in an increase in deferred revenues during those periods, and therefore contributed positively to our cash flow.

The cash we used in investing activities for the nine months ended March 31, 2006 included the purchase of equipment and tooling in the amount of $1.08 million. In addition to these expenditures, we plan additional capital expenditures of approximately $0.25 million through June 30, 2006, which we plan to finance through internal cash generation. We plan to rent additional equipment through operating leases, under our equipment lease line of credit.

We have a revolving line of credit which provides for maximum borrowings of $3 million. As of March 31, 2006, we had no outstanding balance under this line. In connection with the negotiation of this facility during 2004, we granted a security interest in all of our assets. Borrowings through January 23, 2006 bore interest at a rate of 0.75% over the bank s Prime Rate. On January 23, 2006, we entered into an Amended and Restated Committed Line of Credit Note, and an Amendment to Loan Documents (collectively, the Amendments). The Amendments reduced the interest rate by 0.75% to the bank s Prime Rate, and extended the maturity date by one year to November 30, 2007. The Amendments also modified certain financial covenants, which are described below.

On March 17, 2006, we entered into a five-year term note with our bank in the amount of $0.25 million that bears interest at a fixed rate of 7.75%, and requires monthly repayments of principal of $4,167. The proceeds were used to finance the purchase of certain long-lived manufacturing property and equipment. The note is cross collateralized and contains cross default provisions with the revolving line of credit.

On July 27, 2005, we entered into an equipment lease line of credit with $1 million in availability with the bank. Borrowings bear interest at a rate of approximately 1% over the bank s Prime Rate, with terms of three to seven years. The bank will hold title to the equipment leased under the line of credit. Any unutilized balance on the line of credit expires on November 30, 2006. In December 2005, we entered into an operating lease under this line, reducing the availability under the line by $228,682. This lease requires monthly rent payments of $3,453, for 72 months.

In March 2005, we entered into a five-year term note with our bank in the amount of $0.5 million that bears interest at a fixed rate of 6.5%, and requires monthly repayments of principal of $8,333. The proceeds were used to finance the leasehold improvements to our new facility. The note is cross collateralized and contains cross default provisions with the revolving line of credit.

Both the amended revolving line-of-credit and the five-year term notes with the bank are subject to two amended financial covenants as follows :

(a) The Company will maintain, as of the end of each fiscal quarter, a ratio of Funded Debt to EBITDA of not more than 2.50 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2005.

(b) The Company will maintain, as of the end of each fiscal quarter, a ratio of EBITDA to Fixed Charge (EBITDA to Fixed Charge) of more than 1.00 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2006. (Measurement will be on a six month basis for quarter ended March 31, 2006 and a nine month basis for quarter ending March 31, 2006).

As used herein:

CPLTD means the scheduled payments of principal on all indebtedness for borrowed money having an original term of more than one year (including but not limited to amortization of capitalized lease obligations), as shown on the Company s financial statements as of one year prior to the date of determination.

EBITDA means net income plus interest expense plus income tax expense plus depreciation plus amortization.

EBITDA to Fixed Charge means (i) EBITDA minus Unfunded Capital Expenditures divided by (ii) taxes actually paid plus CPLTD and interest expense.

Funded Debt means all borrowed debt including senior borrowed debt and subordinated debt.

Unfunded Capital Expenditures represents the difference between actual capital expenditures and term financing, the proceeds of which were used to purchase such capital expenditures. In effect, this represents capital expenditures which were purchased with operating cash flow.

At no time since the inception of this loan agreement has the Company been in violation of these covenants.

We believe that we will be able to fund our cash requirements for the foreseeable future through a combination of internal cash generation, the revolving line of credit and the lease line of credit.

INFLATION

We have been subject to several significant increases in raw materials costs over the last 18 months, primarily resulting from increases in energy costs. We have embarked on a program to improve our procurement of raw materials and to optimize our processes to increase our manufacturing yields. Through these efforts we have been able to offset the increases in raw material costs. We believe we will be able to offset any near-term inflation in operating costs through increased productivity.

SEASONALITY

While we do not experience any significant quarter to quarter seasonality, we do experience some seasonality within certain quarters.

ITEM 3. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company s management, with the participation of our Chief Executive Officer and Chief 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 Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company s disclosure controls and procedures are effective.

There have not been any changes, except as described below, in the Company s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

The Company s management, including its Chief Executive Officer and its Chief 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.

Because of the inherent limitations of a cost-effective control system, misstatements due to error or fraud may occur and not be detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls.

On March 15, 2006, the Company hired a Chief Financial Officer, with substantial Sarbanes-Oxley compliance experience. With the hiring of its Chief Financial Officer, the Company is developing a detailed plan to address compliance with Section 404 of the Sarbanes-Oxley Act of 2002. In mid-March, the Company initiated and since then has made progress on several projects focused on assessing potential risks, better understanding and documenting its processes, and implementing certain preventative or detective controls to address key risks. These are important first steps toward designing and implementing an effective compliance plan. As a non-accelerated filer with a fiscal year end of June 30, the Company must first begin to comply with the requirements of Section 404 for the fiscal year ending June 30, 2008.

As part of its risk assessment, the Company undertook an extensive review of its tax compliance efforts and the controls associated with its tax accounting process. As a result of new processes and controls implemented during the quarter, the Company identified errors in previously filed tax returns that contributed to errors in the Company s tax accounting for the years ended June 30, 2003 and prior years. These errors and their effects are discussed further in Note 1A to the condensed consolidated financial statements contained in Item 1 of Part 1 of this quarterly report on Form 10-QSB. In order to ensure continued independence with its registered public accounting firm, the Company on April 10, 2006 engaged Cipolla Sziklay, LLC (an accounting firm not affiliated with the Company s independent registered public accounting firm) to provide tax services.

In the period up to and following March 31, the Company has implemented additional procedures and controls in purchasing, receiving, and inventory management. The Company is in the process of recruiting additional personnel to further segregate certain duties. We will continue to conduct a thorough risk assessment, document our processes, and where necessary, enhance our system of internal controls. The Company is committed to the continued improvement of its control systems and financial reporting process.

PART II. OTHER INFORMATION

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

The shareholders of the Company voted on four items at the Annual Meeting of Shareholders held on January 19, 2006:

1. the election of seven directors to serve until the next annual meeting and until their successors have been duly elected and qualified;
2.

ratification of a proposal to amend the Company s 1998 Incentive Plan to increase the number of shares of common stock reserved for issuance from 500,000 to 1,000,000;

3. the ratification of the issuances of employment-issued stock options for 200,000 shares of common stock; and
4. the ratification of the selection of J.H. Cohn LLP as our independent registered public accounting firm for the fiscal year ending June 30, 2006.

The total shares voted at the meeting was 7,565,515. The nominees for directors were elected based upon the following votes:

		For	Withheld Authority
1.	Election of directors		
	Michael W. Levin	7,563,015	2,500
	Frances Blanco	7,459,815	105,700
	Paul C. Baker	7,562,615	2,900
	Edwin Ruzinsky	7,562,615	2,900
	Donald Gunn	7,459,815	105,700
	Henry Royer	7,562,615	2,900
	Alan Bazaar	7,563,015	2,500

The voting results on the other proposals were:

		For	Against	Abstent
2.	Ratification of amendment to 1998 Incentive Plan	4,563,347	128,966	
3.	Ratification of stock option issuances	4,608,426	83,650	1
4.	Ratification of independent registered public accounting firm	7,559,220	5,800	

ITEM 5. OTHER INFORMATION

On March 17, 2006, we entered into a five-year term note with our bank in the amount of $0.25 million that bears interest at a fixed rate of 7.75%, and requires monthly repayments of principal of $4,167. The proceeds were used to finance the purchase of certain long-lived manufacturing property and equipment. The note is cross collateralized and contains cross default provisions with the revolving line of credit.

We have a revolving line of credit which provides for maximum borrowings of $3 million. On January 23, 2006, we entered into an Amended and Restated Committed Line of Credit Note, and an Amendment to Loan Documents (collectively, the Amendments). The Amendments reduced the interest rate by 0.75% to the bank s Prime Rate, and extended the maturity date by one year to November 30, 2007. The Amendments also modified certain financial covenants, which are described below.

Both the amended revolving line-of-credit and the five-year term note with the bank entered in March 2005 are subject to two amended financial covenants as follows :

(a) The Company will maintain, as of the end of each fiscal quarter, a ratio of Funded Debt to EBITDA of not more than 2.50 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2005.

(b) The Company will maintain, as of the end of each fiscal quarter, a ratio of EBITDA to Fixed Charge (EBITDA to Fixed Charge) of more than 1.00 to 1.00, measured on a rolling four quarter basis commencing with quarter ending June 30, 2006. (Measurement will be on a six month basis for quarter ended March 31, 2006 and a nine month basis for quarter ending March 31, 2006).

As used herein:

CPLTD means the scheduled payments of principal on all indebtedness for borrowed money having an original term of more than one year (including but not limited to amortization of capitalized lease obligations), as shown on the Company s financial statements as of one year prior to the date of determination.

EBITDA means net income plus interest expense plus income tax expense plus depreciation plus amortization.

EBITDA to Fixed Charge means (i) EBITDA minus Unfunded Capital Expenditures divided by (ii) taxes actually paid plus CPLTD and interest expense.

EBITDA Funded Debt means all borrowed debt including senior borrowed debt and subordinated debt.

Unfunded Capital Expenditures represents the difference between actual capital expenditures and term financing, the proceeds of which were used to purchase such capital expenditures. In effect, this represents capital expenditures which were purchased with operating cash flow.

On February 7, 2006, the Board of Directors voted to cancel 54,577 shares of treasury stock. This action reduces the number of shares outstanding by 54,577 and has no impact on total shareholders equity. The treasury stock was cancelled and returned to unissued status.

ITEM 6. EXHIBITS

The following exhibits are filed with this report:

Exhibit Number	Description of Exhibit
Exhibit 10.1	Amendment to Loan Documents, dated as of January 23, 2006 (Incorporated by reference to Exhibit 10.1 of Form 10-QSB filed on February 9, 2006)
Exhibit 10.2	Amended and Restated Committed Line of Credit Note, dated January 23, 2006 (Incorporated by reference to Exhibit 10.2 of Form 10-QSB filed on February 9, 2006)
Exhibit 10.3	Guaranty and Suretyship Agreement, dated January 23, 2006 (Incorporated by reference to Exhibit 10.3 of Form 10-QSB filed on February 9, 2006)
Exhibit 10.4*	Term Note with PNC Bank, dated March 17, 2006, with Security Agreement and Guarantee
Exhibit 10.5	Agreement with Donald Gunn, dated March 31, 2006 (Incorporated by reference to Exhibit 10.1 of Form 8-K/A filed on April 24, 2006)
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 Chief 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 Chief 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: May 15, 2006

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

Dated: May 15, 2006

By: /s/ Kevan D. Bloomgren
Kevan D. Bloomgren
Chief Financial Officer