MEDIA SCIENCES INTERNATIONAL INC
Form 10QSB/A
May 25, 2006

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

FORM 10-QSB/A

(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, 2005

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) 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 [ ]

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

As of November 7, 2005, the issuer had 10,981,106 shares of common stock outstanding.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

INTRODUCTORY NOTE

This Amendment on Form 10-QSB/A (the Form 10-QSB/A) to our previously filed Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005 is being filed to reflect the restatement of our condensed consolidated financial statements to correct the cumulative effect of errors related to our provision for income taxes arising from the years ended June 30, 2003 and prior, as discussed in Note 1A to the condensed consolidated financial statements included in Item 1 of Part I of this Form 10-QSB/A.

This Form 10-QSB/A amends and restates the previously filed Quarterly Report on Form 10-QSB, filed on November 9, 2005 (the Form 10-QSB), to: (i) amend Items 1 and 2 of Part I to reflect the restatement; (ii) amend Item 3 of Part I to reflect our revised evaluation of our disclosure controls and procedures as of September 30, 2005; and (iii) amend Item 6 of Part II.

Except as discussed above to reflect the restatement, we have not modified or updated disclosures presented in the Form 10-QSB. Accordingly, this Form 10-QSB/A does not reflect events occurring after the filing of the Form 10-QSB or modify or update those disclosures affected by subsequent events.

Please refer to Note 1A to the accompanying condensed consolidated financial statements at Part I, Item 1, for additional information regarding the restatement.

i

MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES

FORM 10-QSB/A
FOR THE QUARTER ENDED SEPTEMBER 30, 2005

TABLE OF CONTENTS

2

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

ASSETS	(Unaudited) September 30, 2005 (Note 1A)	June 30, 2005 (Notes 1 & 1A)
CURRENT ASSETS :		

Cash	$ 449,057	$ 611,016
Accounts receivable, less allowance for doubtful accounts of $35,000	2,347,165	2,175,512
Inventories	2,739,646	3,196,323
Deferred tax assets	743,446	959,910
Prepaid expenses and other current assets	510,735	308,822
Total Current Assets	6,790,049	7,251,583
PROPERTY AND EQUIPMENT, NET	2,006,325	2,058,251
OTHER ASSETS:		
Goodwill and other intangible assets, net	3,584,231	3,584,231
Other assets	63,911	63,911
	3,648,142	3,648,142
TOTAL ASSETS	$ 12,444,516	$ 12,957,976

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES :		
Bank line of credit	$ 1,081,418	$ 1,620,233
Bank term loan	100,000	100,000
Accounts payable	710,460	1,254,921
Accrued expenses and other current liabilities	285,733	142,432
Income taxes payable	--	295
Accrued product warranty	281,983	291,733
Deferred revenue	581,368	526,853
Total Current Liabilities	3,040,962	3,936,467
OTHER LIABILITIES :		
Bank term loan, less current maturities	350,000	375,000
Deferred rent liability	331,960	341,988
Deferred revenue, less current portion	215,714	280,418
Deferred tax liabilities	436,646	404,099
Total Other Liabilities	1,334,320	1,401,505
TOTAL LIABILITIES	4,375,282	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 10,981,106 shares in September, 10,953,606 in June	10,982	10,954
Additional paid-in capital	9,779,878	9,753,405
Cost of 10,564 shares of common stock in treasury	(112,913)	(112,913)
Accumulated deficit	(1,608,713)	(2,031,442)
Total Shareholders' equity	8,069,234	7,620,004

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 12,444,516	$ 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 September 30, 2005	2004
NET SALES	$ 4,758,329	$ 4,411,9
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation and amortization	2,013,068	2,234,0
Depreciation and amortization	124,268	63,3
Total cost of goods sold	2,137,336	2,297,3
GROSS PROFIT	2,620,993	2,114,5
OTHER COSTS AND EXPENSES:		
Selling, general and administrative, excluding depreciation and amortization and impact of variable plan accounting	1,830,712	1,608,4
Depreciation and amortization	51,036	66,5
Impact of variable plan accounting	--	72,7
Total other costs and expenses	1,881,748	1,747,7
INCOME FROM OPERATIONS	739,245	366,7
INTEREST EXPENSE	34,697	52,5
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	704,548	314,2
PROVISION FOR INCOME TAXES	281,819	132,8
INCOME FROM CONTINUING OPERATIONS	422,729	181,4
INCOME FROM DISCONTINUED OPERATIONS BEFORE INCOME TAXES	--	55,9
PROVISION FOR INCOME TAXES	--	23,4
INCOME FROM DISCONTINUED OPERATIONS	--	32,4
NET INCOME	$ 422,729	$ 213,8

BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,965,967	9,913,9
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	11,387,000	10,482,4
INCOME PER COMMON SHARE FROM CONTINUING OPERATIONS :		
BASIC AND DILUTED	$ 0.04	$ 0.
INCOME PER COMMON SHARE FROM DISCONTINUED OPERATIONS :		
BASIC AND DILUTED	$ 0.00	$ 0.
NET INCOME PER COMMON SHARE :		
BASIC AND DILUTED	$ 0.04	$ 0.

See accompanying notes to condensed consolidated financial statements.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(RESTATED)
THREE MONTHS ENDED SEPTEMBER 30, 2005
(UNAUDITED)

	Common Stock		Additional	
	Shares	Amount	Paid-in Capital	Treasury Stock
BALANCES, JUNE 30, 2005, as originally reported	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	25,000	25	24,975	--
Issuance of common stock for exercise of stock options	2,500	3	1,498	--
Net income	--	--	--	--
BALANCES, SEPTEMBER 30, 2005 (Restated)	10,981,106	$ 10,982	$ 9,779,878	$ (112,913)

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ende	
	September 30,	
	2005	200
CASH FLOWS FROM OPERATING ACTIVITIES :		
Income from continuing operations	$ 422,729	$ 181,
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	175,304	129,
Deferred income taxes	249,011	136,
Provision for bad debts	9,971	2,
Impact of variable plan accounting	--	75,
Cash provided by discontinued operations	--	32,
Changes in operating assets and liabilities :		
Accounts receivable	(181,624)	(978,
Insurance claim receivable	--	500,
Deferred rent liability	(10,028)	-
Inventories	456,677	(69,
Prepaid expenses and other current assets	(201,913)	(193,
Other assets	--	(21,
Accounts payable	(544,461)	(265,
Accrued expenses and other current liabilities	133,551	(40,
Income taxes payable	(295)	(21,
Deferred revenue	(10,189)	180,
Net cash provided by (used in) operating activities	498,733	(352,
CASH FLOWS FROM INVESTING ACTIVITIES :		
Purchases of property and equipment	(123,378)	(252,
Net cash used in investing activities	(123,378)	(252,
CASH FLOWS FROM FINANCING ACTIVITIES :		
Bank line of credit, net	(538,815)	517,
Bank term loan	(25,000)	(100,
Payments of other short-term debt	--	(11,
Proceeds from issuance of common stock	26,501	77,
Net cash provided by (used in) financing activities	(537,314)	483,
NET DECREASE IN CASH	(161,959)	(120,
CASH, BEGINNING OF PERIOD	611,016	666,
CASH, END OF PERIOD	$ 449,057	$ 545,
SUPPLEMENTAL CASH FLOW INFORMATION :		
Interest paid	$ 34,697	$ 50,
Income taxes paid	$ 3,369	$ 45,

See accompanying notes to condensed consolidated financial statements.

6

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, 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 months ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year.

NOTE 1A RESTATEMENT :

As a result of new processes and controls implemented during the Company s third fiscal quarter ended March 31, 2006 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 cumulative tax expense was understated by $161,956.

These errors had no effect on the Company s results of operations or net cash flows for any of the comparative periods presented in this Form 10-QSB/A. The cumulative effect of these errors did overstate the Company s deferred tax assets by $243,974, taxes payable by $82,018, and retained earnings by $161,956 in the Form 10-QSB for the quarter ended September 30, 2005, filed on November 9, 2005. The cumulative effects of these errors have been corrected in the accompanying condensed consolidated financial statements included in this Form 10-QSB/A.

The following table reflects the effects of the errors on previously issued financial statements, prior to any restatement:

	1Q & 2Q 2006	2005	2004	2003 & Pr
Income tax expense	no effect	no effect	no effect	$161,956 understat
Net income	no effect	no effect	no effect	$161,956 overstate
Cash flows from operating activities	no net effect	no net effect	no net effect	no net ef
Ending Balance Sheet				
- Deferred tax assets	$243,974 overstatement	$243,974 overstatement	$243,974 overstatement	$243,974 overstate
- Income taxes payable *	$82,018 overstatement *	$82,018 overstatement *	$82,018 overstatement	$82,018 overstate
- Retained earnings	$161,956 overstatement	$161,956 overstatement	$161,956 overstatement	$161,956 overstate

** 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.*

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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.

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 and income 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 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 September 30, 2005 there was no non-cash compensation expenses and for the three months ended September 30, 2004, non-cash compensation expense was $75,509, of which $2,748 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 are no longer subject to variable plan accounting treatment after the fiscal year ended June 30, 2005.

Pro forma information regarding net income and income 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.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 STOCK-BASED COMPENSATION AND RELATED PROFORMA DISCLOSURES (CONTINUED)

The fair values of options granted in three months ending September 30, 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, 2005	2004
Risk-free interest rate	4%	4%
Dividend yield	0.0%	0.0%
Expected common stock market price volatility factor	12%	9%
Expected life of stock options	10 years	10 years

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, 2005	2004
Net income, as reported	$422,729	$213,894
Impact of variable plan accounting, net of related tax effects	--	53,529
Stock-based employee compensation expense under fair value method, net of related tax effects	(9,472)	(16,746)
Pro forma net income	$413,257	$250,677
Net income per common share:		
Basic and diluted, as reported	$0.04	$0.02
Basic, pro forma	$0.04	$0.03
Diluted, pro forma	$0.04	$0.02

NOTE 4 INVENTORIES :

Inventories are summarized as follows:

	September 30, 2005	2004
Raw materials	$ 946,739	$1,040,390
Finished goods	1,792,907	2,155,933
	$2,739,646	$3,196,323

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 DEBT :

The Company s borrowings consisted of the following:

	September 30, 2005	September 30, 2004
Short-term debt:		
Revolving line-of-credit with bank	$1,081,418	$1,620,233
Current maturities of note payable to bank	100,000	100,000
	$1,181,418	$1,720,233
Long-term debt:		
Note payable to bank, less current maturities	$ 350,000	$ 375,000

We have a revolving line of credit which provides for maximum borrowings of $3 million. In connection with the negotiation of this facility during 2004, we granted a security interest in all of our assets. Borrowings bear interest at a rate of 0.75% over the bank s Prime Rate. As of September 30, 2005, we had $1.1 million outstanding under this line and the interest rate was 7.5%. The line of credit expires on November 30, 2006.

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.

On July 27, 2005, we entered into an equipment lease line of credit with $1 million in availability with the bank, which we have not used. 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 July 26, 2006.

Both the revolving line-of-credit and the five-year term note with the bank are subject to two financial covenants including a ratio of Funded Debt to EBITDA, both as defined, of not more than 2.50 to 1.00 and a ratio of Cash Flow to Cash Uses, both as defined, of not less than 1.0, measured on a rolling four quarter basis. At no time have we been in violation of these covenants.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 INCOME PER SHARE :

Basic income per common share is computed using the weighted average number of common shares outstanding. Diluted income 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 income per common share from continuing operations:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004
Numerator:		
Income from continuing operations - basic and diluted	$ 422,729	$ 181,414
Denominator:		
Denominator for basic income per common share:		
Weighted average shares	10,965,967	9,913,916
Effect of dilutive securities - stock options and warrants	421,033	568,516
Denominator for diluted income per common share	11,387,000	10,482,432
Income per common share, basic and diluted	$ 0.04	$ 0.02

The following table sets forth the computation of the basic and diluted net income per common share:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004
Numerator:		
Net income - basic and diluted	$ 422,729	$ 213,894
Denominator:		
Denominator for basic income per common share:		
Weighted average shares	10,965,967	9,913,916
Effect of dilutive securities - stock options and warrants	421,033	568,516
Denominator for diluted net income per common share	11,387,000	10,482,432
Net income per common share, basic and diluted	$ 0.04	$ 0.02

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 INCOME PER SHARE (CONTINUED) :

The following warrants and options to purchase common stock were excluded from the computation of diluted net income per share as of September 30, 2005 and 2004 because they were anti-dilutive for those periods:

	September 30, 2005	September 30, 2004
Anti-dilutive warrants and options	122,150	1,850,650

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 months ended September 30, 2005 and 2004 are as follows:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004
Warranty reserve at the beginning of the period	$ 291,733	$ 340,592
Warranties accrued during the period	249,029	294,277
Warranties settled during the period	(258,779)	(295,622)
Net change in warranty reserve	(9,750)	(1,345)
Warranty reserve at September 30,	$ 281,983	$ 339,247

NOTE 8 ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES :

Engineering and product development costs, which consist of salaries 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, 2005 and 2004, engineering and product development costs were approximately $0.17 million and $0.11 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 September 30, 2005 and 2004 totaled approximately $0.057 million and $0.084 million, respectively. Advertising expense for the three months ended September 30, 2005 and 2004 amounted to approximately $0.16 million and $0.21 million, respectively.

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 DISCONTINUED OPERATIONS :

In May 2005, a decision was made to cease certain sales and service operations under Cadapult. Specifically we 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 months ended September 30, 2004. Sales and service revenues from the discontinued operations for the three months ended September 30, 2004 were $0.44 million. The pre-tax income from discontinued operations for the three months ended September 30, 2004 was $0.056 million. The restatement reflected in this Form 10-QSB/A had no effect on the income, net of tax, from discontinued operations or the net income for the three months ended September 30, 2004.

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.

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/A for the year ended June 30, 2005.

INTRODUCTION

As a result of new processes and controls implemented during the Company s third fiscal quarter ended March 31, 2006 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 cumulative tax expense was understated by $161,956.

These errors had no effect on the Company s results of operations or net cash flows for any of the comparative periods presented in this Form 10-QSB/A. The cumulative effect of these errors did overstate the Company s deferred tax assets by $243,974, taxes payable by $82,018, and retained earnings by $161,956 in the Form 10-QSB for the quarter ended September 30, 2005, filed on November 9, 2005. The cumulative effects of these errors have been corrected in the condensed consolidated financial statements included in this Form 10-QSB/A. For additional information regarding the restatement, please refer to Note 1A to the accompanying condensed consolidated financial statements.

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 ending June 30, 2007. The new standard will require us to expense employee stock options and other share-based payments over the vesting period. The FASB believes the use of a binomial lattice model for option valuation is capable of more fully reflecting certain characteristics of employee share options compared to the Black-Scholes options pricing model. 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.

RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004

Sales. Our consolidated sales from continuing operations for the three months ended September 30, 2005 compared to the same period in 2004, increased approximately 8% to $4.8 million from $4.4 million. Sales of solid ink sticks increased approximately 19%, while sales of color toner cartridges increased approximately 5%. Direct sales of supplies, through our Cadapult subsidiary, decreased by approximately 47% 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. We also announced color toner cartridges for the Oki 7000 and 9000 series color printers and related engines. We expect these cartridges to start shipping between December 2005 and January 2006. We also announced solid ink sticks for the new Xerox Phaser 8500 and 8550. We expect these inks to ship in November 2005. As a result of these new products and current sales trends of existing products, we expect the growth of color toner cartridge sales to outpace the growth of our solid inks in fiscal 2006.

Gross Profit. The consolidated gross profit for the three months ended September 30, 2005 was $2.6 million, or approximately 55% of sales, as compared to $2.1 million, or approximately 48% of sales, for the three months ended September 30, 2004. 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 fiscal 2006.

Selling, General and Administrative. Consolidated selling, general and administrative expenses for the three months ended September 30, 2005 increased to $1.88 million, or 40% of sales, from $1.75 million, also 40% of sales, for the three months ended September 30, 2004. Selling, general and administrative expenses for the three months ended September 30, 2004 include $0.073 million in non-cash compensation, as a result of variable plan accounting treatment. 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 consistent as a percentage of sales.

Depreciation and Amortization. For the three months ended September 30, 2005 compared to the same period in 2004, our depreciation and amortization expense increased to $0.18 million, of which $0.12 million was included in cost of goods sold, from $0.13 million, of which $0.06 million was included in cost of goods sold. The increase in depreciation and amortization was primarily due to the depreciation of tooling related to new color toner cartridge lines introduced over the last six months and to leasehold improvements related to our move in February 2005. There were no expenses related to the amortization of intangibles for the three months ended September 30, 2005 as all intangible assets have been fully amortized. For the three months ended September 30, 2004, amortization of intangibles was $2,177.

Interest Expense. For the three months ended September 30, 2005 compared to the same period in 2004, our interest expense decreased to $0.035 million from $0.053. The decrease in interest expense was due to decreased borrowings. We anticipate continued decreased borrowings as we generate cash from operations, which should result in decreased interest expense, despite an increasing interest rate environment.

Income Taxes. For the three months ended September 30, 2005, we recorded an income tax expense from continuing operations of $0.28 million as compared to an income tax expense from continuing operations of $0.13 million for the three months ended September 30, 2004. An effective tax rate of 40% was used for the three months ended September 30, 2005 and 42% for the three months ended September 30, 2004. The effective aggregate state and federal tax rate for the period ended September 30, 2004 differed from that for the period ended September 30, 2005 due to the impact of variable plan accounting in 2004. The restatement reflected in this Form 10-QSB/A had no effect on the income tax expense for either of the presented 2005 or 2004 periods.

Income from Continuing Operations. For the three months ended September 30, 2005, we earned $0.42 million from continuing operations or $0.04 per share basic and diluted, as compared to the three months ended September 30, 2004, where we earned $0.18 million from continuing operations or $0.02 per share basic and diluted. The restatement reflected in this Form 10-QSB/A had no effect on the income from continuing operations or the net income for either of the presented 2005 or 2004 periods.

Income 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 months ended September 30, 2004 were $0.44 million. Income, net of tax from discontinued operations, for the three months ended September 30, 2004 was $0.032 million. The restatement reflected in this Form 10-QSB/A had no effect on the income, net of tax, from discontinued operations or the net income for the three months ended September 30, 2004.

LIQUIDITY AND CAPITAL RESOURCES

We experienced positive cash flows from operating activities for the three months ended September 30, 2005. Cash flows from operating activities of $0.50 million resulted primarily from income from continuing operations of $0.42 million, non-cash charges of $0.42 million, a decrease in inventories of $0.46 million and an increase in accrued expenses and other current liabilities of $0.13 million, offset by increases in accounts receivable of $0.18 million and a decrease in accounts payable of $0.54 million and a decrease in prepaid expenses and other current assets of $0.23 million. The restatement reflected in this Form 10-QSB/A had no effect on the net cash provided by operating activities, net cash used in investing activities, or net cash provided by financing activities for either of the comparative periods presented.

Accounts receivable increased over the levels at June 30, 2005 as shipments were skewed towards the end of the quarter, due to the shipment of the Oki 5000 cartridges late in September, and to normal seasonality within the quarter.

Under the Company s INKlusive program, a customer commits to purchase a fixed quantity of supplies from the Company, typically over a two 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 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 months ended September 30, 2005, there was a reduction in the net number of printers placed in the program, as we transitioned the program from the Phaser 8400 to the Phaser 8500/8550, Oki 5000 and WorkCentre C2424. This resulted in a small reduction in deferred revenues during that period. With our shipment of solid ink for the Phaser 8500 and 8550 in November 2005, we expect that the net number of printers placed in the program will increase, and therefore the program will generate positive cash flow as deferred revenue increases.

The cash we used in investing activities for the three months ended September 30, 2005 included the purchase of equipment and tooling in the amount of $0.12 million. We plan additional capital expenditures of approximately $0.75 million through June 30, 2006, which we plan to finance through internal cash generation. We may use additional equipment acquired through operating leases.

We have a revolving line of credit which provides for maximum borrowings of $3 million. In connection with the negotiation of this facility during 2004, we granted a security interest in all of our assets. Borrowings bear interest at a rate of 0.75% over the bank s Prime Rate. As of September 30, 2005, we had $1.1 million outstanding under this line and the interest rate was 7.5%. The line of credit expires on November 30, 2006.

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 revolving line of credit and the five-year term note with the bank are subject to two financial covenants including a ratio of Funded Debt (defined as all borrowed debt including senior borrowed debt and subordinated debt) to EBITDA (defined as net income plus interest expense plus income tax expense plus depreciation plus amortization), of not more than 2.50 to 1.00 and a ratio of Cash Flow (defined as net income after taxes plus depreciation, plus interest expense, minus nonrecurring gains, plus nonrecurring losses, plus non-cash expenses, minus dividend distributions, plus capital contributions) to cash uses (defined as prior year s current maturities of long term debt including capital lease payments, plus current year s interest expense, plus unfunded capital expenditures), of not less than 1.0, measured on a rolling four quarter basis. At no time have we been in violation of these covenants.

On July 27, 2005, we entered into an equipment lease line of credit with $1 million in availability with the bank, which we have not used. 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 line of credit expires on July 26, 2006.

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.

16

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 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.

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.

17

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 re-evaluated the effectiveness of the Company s disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of September 30, 2005, the end of the period covered by this report. Based on that re-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 not effective. As further discussed below, in 2006, the Company s management identified that a deficiency existed as of

September 30, 2005 in the controls associated with the Company s tax accounting and its provision to actual reconciliation process. In accordance with Auditing Standard No. 2 and consistent with PCAOB Release No. 2005-023 issued in November 2005, in determining whether a control deficiency existed at September 30, 2005, professional judgment must be applied to identify the cause of the misstatement, rather than merely attributing it to the period(s) affected. In this case, a cumulative error originated with respect to the Company s tax provision in or before its fiscal year ended June 30, 2003. Accordingly, the Company s management deems such control deficiency to be a material weakness in its controls and procedures. A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

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.

Because of the inherent limitation 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.

Restatement and Remediation of Internal Control Weaknesses

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 has been developing a detailed plan to address compliance with Section 404 of the Sarbanes-Oxley Act of 2002. In mid-March 2006, 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 ended March 31, 2006, the Company identified errors in previously filed tax returns that 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 cumulative tax expense was understated by $161,956. In order to ensure the continued independence of 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.

These errors had no effect on the Company s results of operations or net cash flows for the quarter ended September 30, 2005 or for the years ended June 30, 2005 and 2004. 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 balance sheets presented in the Company s Form 10-QSB for the quarter ended September 30, 2005, filed on November 9, 2005.

Corrections to properly reflect the carrying values of the Company s deferred tax assets, income taxes payable, and retained earnings for the quarter ended September 30, 2005 are reflected in this Form 10-QSB/A, as further discussed in Note 1A to the condensed consolidated financial statements. Corresponding corrections to the Company s condensed consolidated financial statements for the quarter ended December 31, 2005 will be filed on Form 10-QSB/A (Amendment No. 2). Corresponding corrections to the Company s consolidated financial statements for the fiscal years ended June 30, 2005 and 2004 have been filed on Form 10-KSB/A on May 25, 2006.

In the quarter ended March 31, 2006, the Company implemented additional procedures and controls in purchasing, receiving, and inventory management, and was 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.

Changes in Internal Controls over Financial Reporting

There were no 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 September 30, 2005 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

During the three months ended September 30, 2005, the Company continued its search for a Chief Financial Officer. In addition, the Company added certain personnel and additional procedures and controls in purchasing and inventory management. The Company is committed to the continued improvement of its control systems and reporting procedures.

The Company has recently commenced its effort to ensure compliance with Section 404 of the Sarbanes-Oxley Act of 2002. 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. During the periods through June 30, 2008, we will review, and where necessary, enhance our internal control design and documentation, management review, and ongoing risk assessment as part of our internal control program.

19

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 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.

20

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 25, 2006

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

Dated: May 25, 2006

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

21