

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

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

FORM 10-KSB/A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2005

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

Commission file number: **1-16053**

MEDIA SCIENCES INTERNATIONAL, INC.

(Name of small business issuer in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

87-0475073

(I.R.S. Employer Identification No.)

8 Allerman Road, Oakland, NJ

(Address of principal executive offices)

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

07463

(Zip Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class
Common Stock

Name of each exchange on which registered
AMEX

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock
(Title of Class)

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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

State issuer's revenues for its most recent fiscal year: \$17,878,838.

The aggregate market value of voting and non-voting stock of the issuer held by non-affiliates on September 9, 2005 was \$12,400,698.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

As of August 31, 2005, we had 10,978,606 shares of common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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

INTRODUCTORY NOTE

This Amendment on Form 10-KSB/A (the "Form 10-KSB/A") to our previously filed Annual Report on Form 10-KSB for the year ended June 30, 2005 is being filed to reflect the restatement of our 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 1B to the consolidated financial statements included in Item 7 of Part II of this Form 10-KSB/A.

This Form 10-KSB/A amends and restates the previously filed Annual Report on Form 10-KSB, filed on September 13, 2005 (the "Form 10-KSB"), to: (i) amend Items 6 and 7 of Part II to reflect the restatement; (ii) amend Item 8A of Part II to reflect our revised evaluation of our disclosure controls and procedures as of June 30, 2005; and (iii) amend Item 13 of Part III.

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

Please refer to Note 1B to the accompanying consolidated financial statements at Part II, Item 7 for additional information regarding the restatement.

i

MEDIA SCIENCES INTERNATIONAL, INC.

TABLE OF CONTENTS

	<u>Page</u>
PART I	
Item 1. Description of Business	3
Item 2. Description of Property	9
Item 3. Legal Proceedings	9
Item 4. Submission of Matters to a Vote of Security Holders	9
PART II	
Item 5. Market for Common Stock and Related Stockholder Matters	10
Item 6. Management's Discussion and Analysis	12
Item 7. Financial Statements	19
Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure	48
Item 8A. Controls and Procedures	49
Item 8B. Other Information	50
PART III	
Item 9. Directors and Executive Officers of the Registrant	51

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Item 10.	Executive Compensation	55
Item 11.	Security Ownership of Certain Beneficial Owners and Management	58
Item 12.	Certain Relationships and Related Transactions	62
Item 13.	Exhibits	63
Item 14.	Principal Accountant Fees and Services	66
	Signatures	67

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Our Organization History

We are a Delaware corporation named Media Sciences International, Inc. Our web site address is www.mediasciences.com.

We originally incorporated under the laws of the State of Utah on August 11, 1983 under the name Communitra Energy, Inc. On July 16, 1985, we amended our articles of incorporation to change our name to Seafoods Plus, Ltd. We did not engage in any substantive business activity from approximately 1988 to June 18, 1998.

On June 18, 1998, we acquired Cadapult Graphic Systems Inc., a privately-held New Jersey corporation formed on May 1, 1987 engaged in the business of providing of computer graphics systems, peripherals, supplies and services to visual communicators and graphics professionals, in a transaction viewed as a reverse acquisition.

On August 14, 1998, we reincorporated under the laws of the State of Delaware as Cadapult Graphic Systems, Inc. On August 11, 1999, we formed Media Sciences, Inc., as a wholly-owned New Jersey subsidiary, for the manufacture and distribution of digital color printer supplies.

In December 1999, Media Sciences, Inc. acquired the assets of ultraHue, Inc., a New Mexico corporation, a manufacturer of workgroup color printer supplies.

On April 19, 2002, we amended our certificate of incorporation to change our corporate name to Media Sciences International, Inc.

On April 26, 2002, we formed Cadapult Graphic Systems, Inc., as a wholly-owned New Jersey subsidiary, for selling supplies directly to certain end users and for the sale and servicing of electronic pre-press systems.

In May 2005, we discontinued all electronic pre-press systems sales and service operations, the majority of the Cadapult business.

We are presently organized with two operating subsidiaries: Media Sciences, Inc. and Cadapult Graphic Systems, Inc. Media Sciences International, Inc., as a parent corporation, does not engage in substantive independent business operations. We conduct substantially all of our operations through our subsidiaries.

As of August 31, 2005 we had 10,978,606 shares of common stock issued and outstanding, and no preferred shares outstanding.

We have not been subject to bankruptcy, receivership or any similar proceedings.

Our Business

We are a manufacturer of supplies for business color printers and industrial coders (printers). We operate in one business segment through two wholly-owned subsidiaries.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Our wholly-owned subsidiary, Media Sciences, Inc., manufactures and distributes printer supplies, including solid ink sticks and toner cartridges for use in Tektronix, Xerox, QMS-Minolta, Epson, Ricoh, Oki and other color printers. We intend to grow this business through an expansion of our product line, expansion of our distribution channels, through our INKlusive free color printer program and through demand creation marketing activities. While we primarily sell our supplies through an international distribution channel, we also sell supplies directly to certain end users through our INKlusive program.

Our wholly-owned subsidiary, Cadapult Graphic Systems, Inc., sells supplies directly to certain end users through our INKlusive color printer program and to those with whom we have a historical relationship.

3

Operating Strategy

We have a strategic objective of becoming the leading independent manufacturer of supplies for digital color business printers. We intend to achieve this objective through an expansion of our product line, through brand development, an expansion of our distribution network and through marketing programs. Our products are a high quality, lower cost alternative to the printer manufacturers' brand.

The opportunity to sell Media Sciences supplies exists in the installed base of workgroup, or business, color printers. The installed base are those color printers used by organizations of all sizes. Almost all of these organizations are using the printer manufacturers' supplies, such as Xerox, Oki or Konica-Minolta. We believe that as color printers become more commonplace in the office environment, a subset of these users will seek alternative supplies to the printer manufacturers' brands, primarily as a way to reduce the cost of ownership of their color printers. If we look at the color market as being analogous to the monochrome printer and supply market, we believe an opportunity exists for alternate supply manufacturers to achieve a 22-27% market share in the aggregate. Our objective is to be the leader within this market space by providing high quality, less expensive color printer supplies through the same distribution channels used for selling the printer manufacturers' supplies.

In addition to penetrating the installed base, we intend to create a significant new set of color printer users who are contractually committed to our supplies. We are striving to achieve this objective through our sales programs such as our INKlusive color printer program. We believe this program provides a unique opportunity for organizations that are not currently using color printers to migrate to color without the cost and technology risk of buying a printer outright.

Principal Products and Services and Programs

Products

Solid Ink. We manufacture and distribute solid ink sticks for use in certain business color printers. Specifically we manufacture solid ink for use in the Xerox/Tektronix Phaser 340, 350, 360, 840, 850, 860, 8200, 8400, 8500 color printers and for use in the Xerox WorkCentre C2424 multifunction device. Our ink is sold under the Media Sciences brand, and under the house brands of several of our customers. We offer flexible, custom packaging to meet the needs of those distribution partners. Our solid ink is typically sold to organizations at prices that are 20% to 50% less than those of the Xerox brand.

We also manufacture solid ink for use in industrial marking, or coding, applications. These products include solid ink for use in the Markem 9000 and 5000 series coders. These products are sold under private label brands and offer a savings of up to 24-30% versus the Markem brand.

We are in discussions with a printer manufacturer to become their primary supplier of solid ink sticks for the printers they manufacture. Should this opportunity come to fruition, we will sell these products exclusively to that customer for sale under their own brand.

Toner Cartridges. We manufacture toner cartridges for use in Tektronix, Xerox, Konica-Minolta, Oki, Epson, and Ricoh color printers. We offer two lines of toner cartridges: Premium color toner cartridges and our Clearcase line of toner cartridges. As with our ink, our toner cartridges are sold under the Media Sciences brand and under the house brands of our distributors. We plan to expand our toner cartridges offerings both within the above lines of color printers and to other color printer manufacturers as well.

- o Premium Color Toner Cartridges Our Premium Color Toner Cartridge line of toner cartridges includes toner cartridges for Xerox/Tektronix Phaser 1235, 2135, and 7300 and Oki 5000, 7000 and 9000 series color printers. These are new cartridges offered at a discount to those of the printer manufacturer. These cartridges are offered at a discount of up to 30% to the prices of

the printer manufacturers.

- o Clearcase Our Clearcase line of toner cartridges are for use in Xerox/Tektronix Phaser 560, 740, 750, 780, 790, 7700 and 6200 color printers, Konica-Minolta (formally QMS) Magicolor 330, 3100 and 2300 and Epson C4000 and C900 color printers. These are newly manufactured toner cartridges, featuring a unique clear case, allowing the user to see the colored toner within the cartridges. These cartridges are offered at a discount of up to 30% to the prices of the printer manufacturers.

4

INKlusive. Our INKlusive color printer program provides a customer with a workgroup color printer or multifunction device, on-site service and a defined, regular shipment of supplies (ink or toner), all for the cost of just the supplies. It is truly a free color printer program. Consequently, the INKlusive program provides the customer with one of the lowest cost of ownerships of a business color printer in the industry today.

There are currently four versions of the program starting at \$79 per month for two years through \$199 per month for three years. The program includes both color toner and solid ink based printers and a solid ink based multifunction device. The program requires a 24 to 36 month commitment, and upon successful completion of the program, the printer is the customer's to keep at no additional charge.

The INKlusive program is targeted at small businesses, education, not-for-profits and real estate agents and brokers. The program is advanced by our channel partners who receive a commission for each unit placed, and are encouraged to sell additional Media Sciences supplies to the customer. More information on the INKlusive program is available at www.inklusive.com.

Media Sciences offers this program in conjunction with a financing company. Media Sciences does not own or otherwise finance the cost of the printer, nor does Media Sciences guarantee the credit worthiness of the customer. 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, as the case may be) years of supplies. We recognize the revenue from the supplies as they are shipped over the term of the INKlusive agreement. Consequently, the difference in timing between receipt of payment for the supplies and those that are shipped gives rise to deferred revenue on our balance sheet.

For the year ended June 30, 2005 revenue recognized for the shipment of INKlusive supplies represented approximately 3% of our total revenues, and gave rise to an additional \$800,000 in deferred revenue which will be recognized as the supplies are shipped over the remaining terms of those INKlusive agreements.

Marketing and Sales Plans

Our marketing strategy is embodied by four objectives :

- 1) Build awareness among end users and dealers that Media Sciences products are a quality option for business color printer supplies.
- 2) Position Media Sciences as the leader in aftermarket office color printer supplies.
- 3) Reinforce that not all aftermarket choices are the same, and that the safe and profitable choice is Media Sciences.
- 4) Educate our channels on the breadth of the market opportunity showing them that color is no longer a niche market.

The execution of the above strategy is multifaceted and is centered on three areas :

- 1) Product Marketing
- 2) Channel Marketing
- 3) End User Marketing

Product marketing encompasses all product-centric marketing efforts including, but not limited to the identification of new product development targets, packaging, product pricing, and product specific collateral materials. We plan to expand our product line, brand of our warranty, and improve the out-of-box experience with Media Sciences products. Our goal with our product marketing efforts is show the end user that Media Sciences are a quality alternative to the printer manufacturers' brand.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Channel marketing encompasses all communications, efforts and programs centered on the identification, recruitment, training and growth of our channel partners. These efforts include product launches, regular communications via e-mail, mail, telephone and webinars, and channel programs such as our Clear Profits program. The purpose of our channel marketing efforts is to build awareness within the channel, of the market and our products and to help our channel partners see the business opportunity presented by the sale of Media Sciences supplies. In short we strive to show channel partners how they can increase their profitability and customer satisfaction by selling Media Sciences supplies.

5

End user marketing is directed at the owners and users of office color printers and those responsible for purchasing supplies for these printers. Our efforts include direct mail, trade shows, advertising, end user endorsements, and public relations. The goal of these efforts is to build awareness and initiate conversions from the printer manufacturers' supplies to Media Sciences supplies.

Our sales efforts compliment our marketing strategy and focus on channel development, and end user conversions.

Our channel development sales activities include :

- o Identifying and recruiting new and incremental channels for our products and programs (INKlusive).
- o Providing product training, including tactics used by the printer manufacturers to compete with aftermarket supplies.
- o Providing information and training on the office color market to help the channel identify opportunities within their customer base.
- o Providing information and training on the office color market to help the channel identify opportunities within their customer base.
- o Development of incentive programs to increase the focus on Media Sciences products by increasing the financial opportunity for the channel and its salespeople and by making it fun to sell Media Sciences products.
- o Development of channels in markets outside of the US and Western Europe.
- o Getting face to face with as many of our channel partners as possible.

In order to accomplish the above, we are increasing our sales staffing including inside sales personnel and channel managers.

Our end user sales activities are primarily focused on Fortune 1000 companies and other large color printer installations. These activities, often executed in concert with a channel partner, include identifying large opportunities and pursuing them by supporting the individual(s) within the target organization responsible for evaluating, selecting and purchasing color printer supplies, so that they can make an informed decision on Media Sciences as an alternative to the printer manufacturers brand of supplies. This support may include cost of ownership studies, reliability studies, and Media Sciences product to test and evaluate.

Industry and Market Overview

The office environment has been dominated by monochrome (black and white) printers and color monitors. Over the past several years color printers have been introduced in the office environment for high impact communications where color presentation was critical. Today, the production of color documents in the office is less the exception and more the norm, and with many favorable market drivers, the use of color documents is expected to grow. Industry sources forecast a decline in Monochrome supply shipments beginning in 2005. In conjunction with flat monochrome laser printer sales, the percentage share of color laser printers is growing.

The adoption of color in the office has been facilitated by lower costs of acquisition such as sub-\$1000 and sub \$500 color laser printers along with increased print speeds and reliability. In addition to the lower costs, favorable market dynamics are driving the use of office color printers. Primary contributors are the use of internet, which has broadened the acceptance of color communication, and the distribute and print model, where digital document delivery is enhanced with localized printing as a way to shorten turn around times and reduce production costs.

Growth in the installed base of color laser printers has accelerated in recent years with a 15% year over year unit growth in 2001, 23% in 2002 and 49% in 2003 (source: IDC Research; Bear Stearns 2003). In addition, worldwide sales of color laser printers is expected to grow at a CAGR (compound annual growth rate) of 30% within the period 2003-2009 from over 1 million units in 2003 to approximately 7 million units in 2009 (source: Lyra Research, Inc. August 2005, Hard Copy Supplies Advisory Service, Frist Half 2005 Forecast). To compliment the growth of the color printer installed base, the production of color pages is growing. Impressions produced on digital color production printers are expected to grow from 11 billion in 2001 to 54 billion in 2006 (source: Xerox Corporation News Release November 24, 2003).

As a result of the increasing installed base and incremental page production, there is an increase in the usage of supplies. Lyra Research estimates worldwide shipments of color cartridges will increase at a CAGR of nearly 37% from 20.6 million to close to 100 million units over the period of 2003- 2009 (source: Lyra Research, Inc. Hard Copy Advisory Service First Half 2005- Forecast). Lyra also forecasts that laser cartridge sales will outpace the sales of ink cartridges this year (source: News Release Image Source Magazine May 2004).

6

Today, the dominant sources of color printer supplies are the printer manufacturers themselves. These manufacturers reduce the cost of the printer hardware to gain market share, in an effort to capture the recurring profitable revenue stream of supplies. There has been limited competition to this source of supplies. Organizations will have to manage the increasing expense of printing in color as more printers are placed, pages produced and supplies consumed. As a result, they will look for cost saving supply alternatives to manage the ongoing expense. Today the aftermarket is robust for monochrome, remanufactured and new build toner cartridges. These aftermarket monochrome are brought to market through many of the same distribution channels with whom Media Sciences partners. The aftermarket for color cartridges has lagged monochrome's adoption of after market supplies, as the cost of the actual printers has remained high, thereby sustaining a perception of risk when using an alternative to the printer manufacturer's brand. With the recent declines in the cost of office color printers, the perceived risk is diminishing and users are increasing their pace of adoption of aftermarket color printer supplies.

In a 2000 research study, Lyra Research estimated that monochrome third party supply/alternative supply manufacturers will provide approximately 22-27% of the supplies consumed through 2003. We believe that similar metrics exist for color by which up to 27% of the supplies consumed may be aftermarket choices.

Distribution Methods of the Products and Programs

Our primary goal in building our distribution channels is to have our products readily available to the end users. Consequently, we look to mirror the distribution points of the printer manufacturers, and add additional, unique, distribution points that serve the cost conscious end user. As a result, we sell through an international network of channel partners, including wholesalers, distributors, dealers, internet resellers, printer manufacturers and contract stationers.

We have a dual branding strategy – our products are sold under the Media Sciences brand, and where a partner has equity in their own brand we will work with that partner to provide our products to them under their brand. Currently approximately 50% of our sales are under the Media Science brand and the balance under our partners' brands. Our goal is to grow the Media Sciences branded product sales to 75% of our sales within five years.

Our products are available in most parts of the world. However, approximately 85% of our sales are in the United States, with a majority of the balance of our sales in Western Europe. Our goal is to have our international sales represent no less than 30% of our revenues within three years, while continuing to aggressively grow our US sales.

Competition

Media Sciences competes primarily with the original manufacturer of the printers for which we provide supplies, including Xerox, which sells printers under the Tektronix and Xerox brands, Konica-Minolta (formally QMS), Epson, Brother and Ricoh. These competitors use several tactics to limit the penetration of aftermarket supplies including remanufactured products and newly manufactured products such as those offered by Media Sciences. These tactics include protecting their technology through the use of patents, through the development of sales and marketing programs those that provide for incentives to distribution channels that sell exclusively the printer manufacturers' brand supplies, and through fear, uncertainty and doubt (FUD). Media Sciences competes with these manufacturers primarily by offering a compelling value proposition of quality, value (through lower end user costs and higher channel margins) and choice.

Media Sciences also competes with entities that remanufacture color toner cartridges that compete with Media Sciences' newly manufactured cartridges. Remanufactured toner cartridges are often available at lower prices than the equivalent, newly manufactured, Media Sciences toner cartridge. Media Sciences competes with these products based on quality, reliability, warranty and excellent product availability. Some

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

remanufacturers choose to sell Media Sciences products to their customer rather than make the substantial investment in developing the technologies and processes necessary to remanufacture color toner cartridges.

Media Sciences is buying certain color toner cartridges, from a supplier, on a non-exclusive basis. While we believe Media Sciences combination of distribution, warranty, channel programs, brand recognition and product breadth will allow us to compete well with others selling similar products, we may see increased competition for these particular products.

7

We have observed some solid ink products entering the market from a Korean manufacturer. We compete with these products based on the quality of Media Sciences solid inks, and our extensive efforts to avoid infringement of the printer manufacturers intellectual property. In addition, our warranty, channel programs, brand recognition and product breadth make Media Sciences a better choice for the distribution channel and the end user.

Principal Suppliers

Purchases in fiscal year ended June 30, 2005 from three vendors amounted to approximately 44% of cost of goods sold, with no one vendor accounting for more than 15% of cost of goods sold.

We purchase certain important raw materials from a sole source or a limited number of suppliers. Management believes that other suppliers could qualify to provide similar raw materials on comparable terms. The time required to locate and qualify other suppliers, however, could cause a delay in manufacturing that could be disruptive to our Company.

Dependence on Major Customers

Net sales to one customer represented approximately 11% of our revenues for the year ended June 30, 2005 and 7% of our revenues for the year ended June 30, 2004. This customer accounts for approximately 4% and 6% of accounts receivable at June 30, 2005 and 2004 respectively.

Intellectual Property

We regard our trademarks, trade secrets, and proprietary technology and similar intellectual property as critical to our success, and rely on trademark, copyright and patent law, trade secret protection and confidentiality and other agreements with our employees, customers, partners and others to protect our proprietary rights. We have registered certain trademarks in the United States and have applied for the registration of other trademarks in the United States. In 2004 we were granted certain patents in the United States, the term of which are 14 years.

Need for Government Approval

Not applicable.

Need for Government Approval

Government Regulation

Not applicable.

Research, Engineering and Development

We direct our research, engineering and development efforts primarily toward developing new products and processes and improving product performance. Research, engineering and product development costs, which consist of salary and related benefits costs of our technical staff, as well as product development costs including conceptual formulation, design and testing of product alternatives, construction of prototypes, are expensed as incurred. For the years ended June 30, 2005 and 2004 our research, engineering and product development costs were approximately \$0.50 million and \$0.74 million respectively.

Compliance with Environmental Laws

Not applicable.

Employees

We currently have 48 full-time employees, including seven management level employees and one part time employee.

ITEM 2. DESCRIPTION OF PROPERTY

We maintain our executive offices at Oakland, New Jersey, pursuant to a lease expiring on September 30, 2009. We occupy approximately 41,800 square feet, including warehousing and manufacturing.

We are subject to a lease expiring on May 31, 2011 for our former facility in Allendale, New Jersey. We have entered into a sublease expiring on May 31, 2011, the expiration date of our lease. The sublease provides for annual rent payments to us of \$0.17 million.

Our offices are adequately covered by insurance for claims arising out of such occupancies.

Our present facilities have been suitable for our operations and needs through the present.

The table below sets forth the location, approximate square footage, approximate annual rent, use of each location and expiration date of each lease. The leases summarized in the table provide for moderate annual rental increases.

ITEM 2. DESCRIPTION OF PROPERTY

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

<u>Location</u>	<u>Approximate Square Feet</u>	<u>Approximate Annual Rent</u>	<u>Use</u>	<u>Lease Expiration Date</u>
8 Allerman Road Oakland, NJ 07436	41,800	\$0.30 million	Executive Offices, Warehouse, and Manufacturing Facility	September 30, 2009
40 Boroline Road Allendale, NJ 07401	15,400	\$0.18 million	Former offices, now being sublet.	May 31, 2011

ITEM 3. LEGAL PROCEEDINGS

In May 2005, we filed suit in New Jersey state court against our former insurance broker for insurance malpractice. The suit contends, in sum and substance, that the insurance broker was negligent and breached its duty of care in connection with the procurement of an umbrella insurance policy. The suit asserts four causes of action for negligent procurement, failure to procure required coverage, breach of the standard of care, and failure to advise.

In particular, the suit alleges that the insurance broker breached its duty by failing to identify our subsidiary in insurance applications; submitting insurance applications, without our review, incorrectly denying the existence of our subsidiary; and failing to correct such an error. The suit further alleges that our insurance broker failed to procure the umbrella insurance we required and were led to believe we purchased. Finally, the suit alleges that our insurance broker breached its duty by failing to be aware that our subsidiary did not have adequate coverage and to advise us that our subsidiary was not adequately covered.

The suit seeks recovery of the balance of unrecovered losses for third party damages that should have been covered under the umbrella insurance procured by our insurance broker but was not due to the aforementioned negligence and breaches of duty of care by our insurance broker.

Other than the above, as at June 30, 2005, we are not a party to any material pending legal proceeding, other than ordinary routine litigation incidental to our business.

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

Not applicable.

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is listed on the American Stock Exchange under the symbol "GFX".

The following table sets forth for the periods indicated, the high and low closing sale prices for a share of our common stock, during the relevant periods, as reported by the American Stock Exchange.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

<u>Fiscal Year</u>	<u>Quarter Ended</u>	<u>High</u>	<u>Low</u>
2004	September 30, 2003	\$1.59	\$0.60
	December 31, 2003	\$1.34	\$1.04
	March 31, 2004	\$1.20	\$0.85
	June 30, 2004	\$1.85	\$1.10
2005	September 30, 2004	\$2.00	\$1.63
	December 31, 2004	\$1.70	\$1.39
	March 31, 2005	\$2.40	\$1.60
	June 30, 2005	\$2.15	\$1.60

Holders

The number of holders of record of our common stock as of September 6, 2005 was 363.

Dividends

We have never declared any cash dividends on our common stock. Future cash dividends on the common stock, if any, will be at the discretion of our Board of Directors and will depend on our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions, and other factors that the Board of Directors may consider important.

No shares of series A preferred stock are presently outstanding. Prior to January 1, 2004, we had shares of series A preferred stock issued and outstanding. Our series A preferred stock carried a fixed dividend at an annual rate of 11.5%. Dividends were to be paid each quarter in arrears. The first dividend payment occurred on January 1, 2000. The certificate of designation for the series A preferred stock provided that unless and until we have fully paid all dividends on the outstanding shares of series A preferred stock, we would not to declare or pay cash dividends, or distribute or set aside assets, for any of our other securities. Further, the certificate of designation for the series A preferred stock provided that we may not pay dividends if payment of dividends would violate certain financial criteria of our senior lending agreement with a financial institution.

Transfer Agent

The transfer agent for our common stock is Continental Stock Transfer & Trust Company, New York, New York.

10

Recent Sales of Unregistered Securities

On August 8, 2005, we issued to a management level employee, Donald Gunn, stock options to purchase up to 100,000 shares of our common stock. The options are subject to vesting, upon Gunn's relocation to corporate offices, as follows: 50,000 stock options on such date, and the other 50,000 stock options at the rate of 10,000 stock options per year for five years starting on the first anniversary of such date. The options are exercisable for ten years at \$1.65 per share. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) under the Securities Act.

11

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

FORWARD-LOOKING INFORMATION

This report on Form 10-KSB/A contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which represent our expectations and beliefs, including, but not limited to statements concerning Media Sciences' expected growth. The words believe, expect, anticipate, estimate, project, and similar expressions identify forward-looking statements, which speak only as of the date such statement was made. These statements by their nature involve substantial risks and uncertainties, certain of which are beyond our control, and actual results may differ materially depending on a variety of important factors.

The following discussion and analysis should be read in conjunction with the information set forth in the audited financial statements 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-KSB/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-KSB for the fiscal year ended June 30, 2005, filed on September 13, 2005. The cumulative effects of these errors have been corrected in the consolidated financial statements included in this Form 10-KSB/A. For additional information regarding the restatement, please refer to Note 1B to the accompanying consolidated financial statements.

RESULTS OF OPERATIONS FOR THE YEAR ENDED JUNE 30, 2005

Sales. Consolidated sales for the year ended June 30, 2005, compared to the year ended June 30, 2004, increased approximately 24% to \$17.9 million from \$14.5 million. Sales of solid ink sticks increased approximately 50% over 2004 while sales of color toner cartridges increased slightly by 3%. The mix of both solid ink and color toner cartridges shifted from older models to new models. This trend is to be expected as lower color printer prices encourage the migration from older slower printers with high service costs to newer, faster color printers with lower service costs. Based on recent and expected product introductions, we believe that our growth in color toner cartridge sales will outpace the growth of our solid ink sales over the coming year.

Gross Profit. The consolidated gross profit for the year ended June 30, 2005 was \$8.7 million, or approximately 49% of sales, as compared to \$7.1 million, also approximately 49% of sales, for the year period ended June 30, 2004. Despite the significant increase in solid ink sales which typically carry higher margins than those of our color toner cartridges, our consolidated gross profit margins were essentially unchanged from the prior year. The primary contributing factor that tempered our margins was a shift in the makeup of our color toner cartridge sales. Specifically, as described above, there was a shift from older, higher margin products to newer, lower margin products. While the shift to newer products will continue, we recently introduced several new color toner cartridge lines that will replace our lower margin toner cartridges. In addition, we have embarked upon several initiatives to increase our manufacturing efficiencies and to reduce raw material costs. Consequently, despite the increased growth in color toner cartridges which have historically carried lower margins than our solid inks, we anticipate consistent, if not expanding, margins over the coming year.

Selling, General and Administrative. Consolidated selling, general and administrative expenses for the year ended June 30, 2005 increased to \$7.9 million, or 44% of sales, from \$6.4 million, or 44% of sales, for the year ended June 30, 2004. Selling, general and administrative expenses for the year ended June 30, 2005 include \$0.55 million of non-recurring expenses that resulted from the move of our administrative and manufacturing facilities. Selling, general and administrative expenses also include \$0.20 million and \$0.35 million in non-cash compensation expense for the years ended June 30, 2005 and 2004 respectively, 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 overall payroll costs, we expect our selling, general and administrative expenses to decrease as a percentage of sales.

Depreciation and Amortization. Depreciation and amortization expense for the year ended June 30, 2005 decreased to \$0.52 million, including \$0.24 million included in cost of sales, from \$0.76 million for the year ended June 30, 2004 of which \$0.50 million was included in cost of sales. The decrease in depreciation and amortization resulted from several tooling investments being fully depreciated in the fiscal year ended June 30, 2004. During the year ended June 30, 2005, we invested approximately \$1.7 million in various fixed assets and leasehold improvements that will be depreciated over useful lives of three to seven years. Consequently, we expect our depreciation and amortization expenses, both in cost of goods and in selling, general and administrative expenses to increase.

Interest Expense. Interest expense for the year ended June 30, 2005 decreased to \$0.18 million from \$0.37 million incurred for the year ended June 30, 2004. The decrease in interest expense was due to decreased borrowings and to reduced borrowing costs. 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 year ended June 30, 2005, we recorded an income tax expense from continuing operations of \$0.25 million as compared to an income tax expense from continuing operations of \$0.20 million for the year ended June 30, 2004. For the years ended June 30, 2005 and 2004 the Company's effective tax rate was 39% and 51% respectively. The effective aggregate state and federal tax rate varies due to the impact of variable plan accounting and certain research and development and manufacturing credits. The restatement reflected in this Form 10-KSB/A had no effect on the 2005 income tax expense.

Preferred Stock Dividends. For the year ended June 30, 2005, we paid no preferred stock dividends. For the year ended June 30, 2004, we incurred a preferred stock dividend charge of \$2.3 million including a \$2.1 million non-cash preferred stock dividend and induced conversion charge associated with the conversion of our preferred stock to common stock.

Income (Loss) from Continuing Operations Applicable to Common Shareholders. For the year ended June 30, 2005, we earned \$0.38 million from continuing operations or \$0.04 per share basic and diluted, as compared to the year ended June 30, 2004, where we incurred a loss from continuing of \$2.07 million or \$(0.33) per share basic and diluted. The loss from continuing operations applicable to common shareholders for the year ended June 30, 2004 was due to the non-cash induced conversion charge. The restatement reflected in this Form 10-KSB/A had no effect on the income (loss) from continuing operations or the net income (loss) for either 2005 or 2004.

Income (Loss) from Discontinued Operations. During the fourth quarter of fiscal 2005, we ceased certain sales operations under Cadapult. Specifically, we ceased all electronic pre-press equipment sales and service operations. In conjunction with the discontinuance of that business, we sold our service contracts to an unrelated entity, wrote off certain inventory associated with that business, and wrote off the goodwill associated with that business. 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 years ended June 30, 2005 and 2004 were \$1.5 million and \$2.0 million, respectively. The income (loss), net of tax, from discontinued operations for the years ended June 30, 2005 and 2004 were \$(0.46) million and \$0.20 million respectively. The restatement reflected in this Form 10-KSB/A had no effect on the income (loss), net of tax, from discontinued operations or the net income (loss) for either 2005 or 2004.

RESULTS OF OPERATIONS FOR THE YEAR ENDED JUNE 30, 2004

Sales. Consolidated sales for the year ended June 30, 2004, compared to the year ended June 30, 2003, increased approximately 22% to \$14.5 million from \$11.9 million. Solid ink sales increased approximately 33%, while color toner cartridge sales increased approximately 16%.

Gross Profit. The consolidated gross profit for the year ended June 30, 2004 was \$7.1 million, or approximately 49% of sales, as compared to \$6.3 million, or approximately 53% of sales, for the year period ended June 30, 2003. The decrease in gross profit margins was due primarily to a shift in the mix of toner product sales. Sales of Premium toner cartridges, which carry significantly lower gross profit margins than do Clearcase cartridges, grew significantly during the year ended June 30, 2004, while Clearcase sales during that same period contracted.

Selling, General and Administrative. Consolidated selling, general and administrative expenses for the year ended June 30, 2004 increased to \$6.4 million, or 44% of sales, from \$4.8 million, or 40% of sales, for the year ended June 30, 2003. The increase in selling, general and

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

administrative expenses was due to an increase in engineering and product development expenses of \$0.62 million and marketing expenses of \$0.25 million both associated with the development, commercialization and launch of ten new products, the most significant of which started shipping in fiscal 2005 and to increased non-cash compensation due to variable plan accounting. These increases to selling, general and administrative expenses were offset by the \$0.5 million settlement with our umbrella insurance carrier.

Depreciation and Amortization. Depreciation and amortization expense for the year ended June 30, 2004 decreased slightly to \$0.76 million, including \$0.5 million included in cost of sales, from \$0.79 million for the year ended June 30, 2003 of which \$0.53 million was included in cost of sales.

Interest Expense. Interest expense for the year ended June 30, 2004 decreased to \$0.37 million from \$0.45 million incurred for the year ended June 30, 2003. The decrease in interest expense was due to the retirement of all non-bank debt which carried interest rates ranging from 13%-23%, and the retirement of several capital leases.

Income Taxes. For the year ended June 30, 2004, we recorded an income tax expense from continuing operations of \$0.20 million as compared to an income tax expense from continuing operations of \$0.43 million for the year ended June 30, 2003. For the years ended June 30, 2004 and 2003, the Company's effective tax rate was 51% and 40%, respectively. The effective aggregate state and federal tax rate varies due to the impact of variable plan accounting. The restatement reflected in this Form 10-KSB/A had no effect on the 2004 income tax expense.

Preferred Stock Dividends. For the year ended June 30, 2004, we incurred a preferred stock dividend charge of \$2.3 million including a \$2.1 million non-cash preferred stock dividend and induced conversion charge associated with the conversion of our preferred stock to common stock. For the year ended June 30, 2003, we incurred a preferred stock dividend charge of \$0.63 million.

Income (Loss) from Continuing Operations Applicable to Common Shareholders. For the year ended June 30, 2004 we incurred a loss from continuing operations applicable to common shareholders of \$2.07 million or \$(0.33) per share basic and diluted, as compared to the year ended June 30, 2003, where we earned \$0.01 million from continuing operations or \$0.00 per share basic and diluted. The loss from continuing operations applicable to common shareholders for the year ended June 30, 2004 was due to the non-cash induced conversion charge. The restatement reflected in this Form 10-KSB/A had no effect on the 2004 loss from continuing operations or the net loss applicable to common shareholders. We did not attempt to apportion the cumulative \$0.16 million adjustment among 2003 and any prior years nor allocate it between continuing or discontinued operations.

Income from Discontinued Operations. Sales and service revenues from the discontinued operations for the years ended June 30, 2004 and 2003 were \$2.0 million and \$2.7 million respectively. The income, net of tax, from discontinued operations for the years ended June 30, 2004 and 2003 was \$0.20 million \$0.23 million. The restatement reflected in this Form 10-KSB/A had no effect on income, net of tax, from discontinued operations or the net loss applicable to common shareholders for 2004. We did not attempt to apportion the cumulative \$0.16 million adjustment among 2003 and any prior years nor allocate it between continuing or discontinued operations.

LIQUIDITY AND CAPITAL RESOURCES

We experienced positive cash flows from operating activities for the year ended June 30, 2005. Cash flows from operating activities of \$0.16 million resulted primarily from income from continuing operations of \$0.38 million and cash provided by discontinued operations of \$0.30 million, net non-cash charges of \$0.79 million, receipt of an insurance claim receivable of \$0.50 million, cash received from landlord of \$0.20 million, and an increase in deferred revenue of \$0.78 million, offset by increases in accounts receivable of \$0.56 million and in inventories of \$0.92 million and a decrease in accounts payable of \$1.3 million. The restatement reflected in this Form 10-KSB/A had no effect on either the 2005 or 2004 net cash provided by operating activities, net cash used in investing activities, or net cash provided by financing activities.

The increase in inventories was due to the increase in the number of products in our product line, increased sales, minimum order requirements necessary to secure advantageous pricing and the extended lead time from our Asian suppliers. In addition, we sought to increase certain inventory levels in order to assure an in-stock position on our products. An initiative is under way to maintain or reduce our inventory levels while increasing the breadth of our product line and while ensuring an in-stock position and advantageous pricing from our vendors.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Accounts payable decreased significantly as we sought to bring our suppliers into normal payment terms. At June 30, 2005, we had achieved that objective. Therefore, we expect any changes in accounts payable to be relative to overall purchasing activity.

Our most recent INKlusive program has generated positive cash flow since we are paid in advance for the ink to be shipped over a two year period, thus giving rise to deferred revenues. The continued ability for INKlusive to generate positive cash flow through increases in deferred revenue is a function of customer acceptance of future programs and the structure of the financing of those programs.

The cash we used in investing activities for the year ended June 30, 2005 included the purchase of equipment, tooling and leasehold improvements in the amount of \$1.7 million. We plan additional capital expenditures over the next twelve months of approximately \$0.75 million, which we plan to finance through internal cash generation and where appropriate 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 base rate. As of June 30, 2005 we had \$1.6 million outstanding under this line and the interest rate was 6.75%. 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%. The proceeds were used to finance the leasehold improvements to our new facility.

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 March 2, 2005, we sold 500,000 shares of common stock to an investor at \$2.00 per share for net proceeds of \$0.97 million. The proceeds were used for working capital.

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 base rate. The bank will hold title to the equipment leased under the credit line. 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.

15

CRITICAL ACCOUNTING POLICIES

Use of Estimates

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States. When more than one accounting principle, or method of its application, is generally accepted, management selects the principle or method that is appropriate in the Company's specific circumstances. Application of the accounting principles requires the Company's management to make estimates about the future resolution of existing uncertainties and that affect the reported amounts of assets, liabilities, revenues, and expenses which in the normal course of business are subsequently adjusted to actual results. Actual results could differ from such estimates. In preparing these financial statements, management has made its best estimates and judgments of the amounts and disclosures included in the consolidated financial statements giving due regard to materiality.

Revenue Recognition, Accounts Receivable and Allowance for Doubtful Accounts

Revenue is recognized at the point of shipment for goods sold, and ratably through the duration of INKlusive contracts (generally, two years) provided collection is reasonably assured. Provisions for rebates, product returns and discounts to customers are recognized as reductions in determining net sales in the same period as the related sales are recorded. All sales are in US dollars.

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. The Company is not exposed to the credit risk of any individual customer in the INKlusive program. Deferred revenue consists principally of billings on INKlusive contracts prior to shipping supplies to fulfill those contracts.

The Company markets its products to an international network of dealers and distributors. Credit is extended after a credit review by management which is based on a customer's ability to perform its obligations. Such reviews are regularly updated. The allowance for doubtful accounts is based upon agings of customer balances and specific account reviews by management. Foreign receivables are insured up to 90% of face value. Media Sciences International, Inc. has no significant concentrations of credit risks and generally does not require collateral or other security from its customers.

Inventories and Inventory Reserves

Inventories are stated at the lower of cost or market, with costs being determined on a first-in, first-out method. Work-in-process and finished goods include material costs, labor costs and manufacturing overhead. The Company evaluates its inventories periodically to identify excess, slow-moving and obsolete inventories and assess reserve adequacy.

Warranty Accrual

The Company provides a warranty for all of its consumable supply products and under its INKlusive free color 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. The warranty accruals at June 30, 2005 and 2004 were \$0.29 million and \$0.34 million, respectively.

Goodwill and Impairment

The excess of the purchase consideration over the fair value of the net assets of acquired businesses is considered to be goodwill and, until June 30, 2001, was being amortized over 15 years using the straight-line method.

The Company reviews goodwill when events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. We also review goodwill as required by SFAS No. 142, "Goodwill and Other Intangible Assets", which requires that goodwill be tested annually using a two-step process. The first is to identify any potential impairment by comparing the carrying value of reporting units to their fair value. If a potential impairment is identified, the second step is to compare the implied fair value of goodwill with its carrying amount to measure the impairment loss. Reporting unit fair value is estimated using the income approach, which assumes that the value of a reporting unit can be computed as the present value of the assumed future returns of an enterprise discounted at a rate of return that reflects the riskiness of an

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

investment. A significant increase in the rate at which the assumed future returns are discounted could result in an unexpected impairment charge to goodwill, which could have a negative impact on our operating results.

At June 30, 2004, goodwill amounted to \$4.5 million net of accumulated amortization of \$0.52 million. The goodwill resulted from the acquisition of substantially all of the assets of UltraHue, Inc., and from the acquisition of substantially all of the assets of three computer resellers by Cadapult.

In May 2005, we ceased certain sales operations under Cadapult. Specifically we ceased all sales and service of pre-press computer graphics systems. We evaluated the goodwill resulting from the three Cadapult acquisitions and determined that the goodwill resulting from those acquisitions was fully impaired. Consequently, we incurred an impairment charge of approximately \$0.88 million which is reflected in the results from discontinued operations in our Statement of Operations for the year ended June 30, 2005. We have completed all transitional and annual impairment tests necessary to date and concluded that no other goodwill is impaired.

At June 30, 2005, goodwill amounted to \$3.6 million net of accumulated amortization of \$0.40 million.

Stock-Based Compensation

The Company follows the intrinsic value method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations in accounting for its employee stock options. Financial Accounting Standards Board Statement No. 123 Accounting for Stock-Based Compensation (SFAS 123) permits the Company to elect to follow the intrinsic value method of APB 25 rather than the alternative fair value accounting provided under SFAS 123, but requires pro forma net income and earnings per share disclosures as well as various other disclosures. As a result of amendments to SFAS 123, the Company will be required to expense employee stock options over the vesting period beginning with its quarter ending September 30, 2006. The Company has also adopted the disclosure provisions required under Financial Accounting Standards Board Statement No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148). Under APB 25, because the exercise price of all of the Company's stock options has equaled the market price of the underlying stock on the date of grant, no compensation expense was recognized 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 years ended June 30, 2005 and 2004, non-cash compensation expense was \$212,455 and \$358,675, respectively, of which \$13,159 and \$11,205, respectively, was included in the income (loss) 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 will no longer be 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 share applicable to common shareholders is required by SFAS 123 and SFAS 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of those statements based on the assumption disclosed in Note 1 to the 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.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. This statement amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4, previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges ...". SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS 151 shall be applied prospectively and are effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted for inventory costs incurred during fiscal years beginning after the date this statement was issued. The adoption of SFAS No. 151 may have a material impact on our financial position and results of operations.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of assets exchanged. The guidance in that opinion, however, included certain exceptions to that principle. This statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material impact on our financial position and results of operations.

CAPITAL EXPENDITURES

We plan on various capital expenditures over the next twelve months of approximately \$0.75 million. These expenditures will include analytical equipment for toner and solid ink development and quality assurance, instruments and equipment for the development of integrated circuits, and upgrades to our information technology systems. In addition we plan to acquire certain manufacturing equipment to scale our manufacturing capability and to increase productivity. We plan to finance these expenditures through internal cash generation and, where appropriate, through operating leases.

INFLATION

We have been subject to several significant increases in raw materials costs over the last 18 months. While we have historically offset any inflation in operating costs through increased productivity, the recent increases have impacted profit margins. We have embarked on a program to improve our procurement of raw materials and to optimize our processes to increase our yields. We believe that these programs will enhance our margins to offset the increases in raw material prices that we have incurred.

SEASONALITY

We do not experience any significant seasonality in our business.

ITEM 7. FINANCIAL STATEMENTS

Financial Report June 30, 2005

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets	F-2
Consolidated Statements of Operations	F-3
Consolidated Statements of Changes in Shareholders' Equity	F-4
Consolidated Statements of Cash Flows	F-5
Notes to Consolidated Financial Statements	F-6
Presentation of Quarterly Data Showing Discontinued Operations (Unaudited)	F-25

**REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders
Media Sciences International, Inc.

We have audited the accompanying consolidated balance sheets of Media Sciences International, Inc. and Subsidiaries as of June 30, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States.) Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Media Sciences International, Inc. and Subsidiaries as of June 30, 2005 and 2004, and their results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1B to the accompanying consolidated financial statements, the Company has restated its consolidated balance sheets as of June 30, 2005 and 2004, and the related consolidated statements of changes in shareholders' equity and cash flows for the years ended June 30, 2005 and 2004 for the cumulative effects of the 2003 and prior years' income tax provision errors.

/s/ J.H. Cohn LLP

Roseland, New Jersey
August 5, 2005, except for the effects of
the matter discussed in Note 1B,
which are as of May 19, 2006.

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS (RESTATED)

ASSETS	June 30,	
	2005	2004
	(Notes 1A & 1B)	(Notes 1A & 1B)
CURRENT ASSETS :		
Cash	\$ 611,016	\$ 1,000,000
Accounts receivable, less allowance for doubtful accounts of \$35,000	2,175,512	1,000,000
Insurance claim receivable	--	--
Inventories	3,196,323	2,000,000
Deferred tax assets	959,910	--
Prepaid expenses and other current assets	308,822	--
Total Current Assets	7,251,583	6,000,000
PROPERTY AND EQUIPMENT, NET	2,058,251	1,000,000
OTHER ASSETS :		
Goodwill and other intangible assets, net	3,584,231	4,000,000
Other assets	63,911	--
	3,648,142	4,000,000
TOTAL ASSETS	\$ 12,957,976	\$ 11,000,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES :		
Bank line of credit	\$ 1,620,233	\$ 1,000,000
Bank term loan	100,000	--
Current maturities of long-term debt	--	--
Accounts payable	1,254,921	2,000,000
Accrued expenses and other current liabilities	142,432	--
Income taxes payable	295	--
Accrued product warranty	291,733	--
Deferred revenue	526,853	--
Total Current Liabilities	3,936,467	5,000,000

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

OTHER LIABILITIES :		
Bank term loan, less current maturities	375,000	
Deferred rent liability	341,988	
Deferred revenue, less current portion	280,418	
Deferred tax liabilities	404,099	
	-----	-----
Total Other Liabilities	1,401,505	
	-----	-----
TOTAL LIABILITIES	5,337,972	6,
	-----	-----
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 10,953,606 shares		
in 2005 and 9,857,210 shares in 2004	10,954	
Additional paid-in capital	9,753,405	7,
Cost of 54,577 shares in 2005 and 10,564 shares in 2004, of common	(112,913)	
stock in treasury		
Accumulated deficit	(2,031,442)	(1,
	-----	-----
Total Shareholders' Equity	7,620,004	5,
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 12,957,976	\$ 11,
	=====	=====

See accompanying notes to consolidated financial statements.

F-2

21

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended June 30	2005	2004
	-----	-----	-----
NET SALES	\$ 17,878,838	\$ 14,4	
	-----	-----	-----
COST OF GOODS SOLD :			
Cost of goods sold, excluding depreciation	8,924,730	6,8	
Depreciation	238,137	5	
	-----	-----	-----
Total cost of goods sold	9,162,867	7,3	

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

GROSS PROFIT	8,715,971	7,1
OTHER COSTS AND EXPENSES :		
Selling, general and administrative, excluding depreciation, amortization, loss from sublease, moving expenses and impact of variable plan accounting	6,884,306	5,7
Depreciation and amortization	281,719	2
Loss from sublease and moving expenses	545,128	3
Impact of variable plan accounting	199,296	3
Total other costs and expenses	7,910,449	6,3
INCOME FROM OPERATIONS	805,522	7
INTEREST EXPENSE	179,385	3
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	626,137	4
PROVISION FOR INCOME TAXES	245,696	2
INCOME FROM CONTINUING OPERATIONS	380,441	1
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	(789,193)	3
PROVISION (BENEFIT) FOR INCOME TAXES	(325,414)	1
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	(463,779)	1
NET INCOME (LOSS)	(83,338)	3
PREFERRED STOCK DIVIDENDS, INCLUDING CHARGE FOR INDUCED CONVERSION	--	2,2
NET LOSS APPLICABLE TO COMMON SHAREHOLDERS	\$ (83,338)	\$ (1,8)
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,259,423	6,2
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,259,423	6,2
INCOME (LOSS) PER COMMON SHARE FROM CONTINUING OPERATIONS : BASIC AND DILUTED	\$ 0.04	\$
INCOME (LOSS) PER COMMON SHARE FROM DISCONTINUED OPERATIONS : BASIC AND DILUTED	\$ (0.05)	\$
NET LOSS PER COMMON SHARE : BASIC AND DILUTED	\$ (0.01)	\$

See accompanying notes to consolidated financial statements.

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES
IN SHAREHOLDERS EQUITY (RESTATED)**

	Preferred Stock		Common Stock		Additional Paid-in Capital	Treasury Stock
	Shares	Amount	Shares	Amount		
BALANCES, JUNE 30, 2003, as originally reported	547,500	\$ 547	3,577,210	\$ 3,578	\$ 5,163,076	\$ (20,000)
Cumulative net increase in net loss	--	--	--	--	--	--
BALANCES, JUNE 30, 2003 (Restated)	547,500	\$ 547	3,577,210	\$ 3,578	\$ 5,163,076	\$ (20,000)
Issuance of common stock for conversion of preferred stock and accrued dividends and interest, net of costs of \$61,640	(547,500)	(547)	5,275,000	5,275	2,851,757	--
Preferred stock dividend	--	--	--	--	--	--
Charge for induced conversion	--	--	--	--	(1,740,805)	--
Sale of common stock, net of expenses	--	--	1,000,000	1,000	1,199,000	--
Issuance of common stock for exercise of stock options	--	--	5,000	5	6,245	--
Impact of variable plan accounting	--	--	--	--	358,675	--
Net income	--	--	--	--	--	--
BALANCES, JUNE 30, 2004 (Restated)	--	--	9,857,210	9,858	7,837,948	(20,000)
Sale of common stock, net of expenses	--	--	500,000	500	974,500	--
Issuance of common stock for exercise of stock options	--	--	287,396	287	275,836	(92,000)
Issuance of common stock for exercise of stock warrants	--	--	309,000	309	452,666	--
Impact of variable plan accounting	--	--	--	--	212,455	--
Net loss	--	--	--	--	--	--
BALANCES, JUNE 30, 2005 (Restated)	--	\$ --	10,953,606	\$10,954	\$ 9,753,405	\$ (112,000)

See accompanying notes to consolidated financial statements.

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS (RESTATED)

	Year Ended June 30, 2005	2004
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES :		
Income from continuing operations	\$ 380,441	\$ 198,073
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	519,856	758,141
Deferred income taxes	(120,891)	368,421
Provision for bad debts	9,323	55,445
Impact of variable plan accounting	212,455	358,675
Loss on write-off of leasehold improvements	180,364	--
Cash provided by discontinued operations	304,152	198,554
Changes in operating assets and liabilities :		
Accounts receivable	(558,548)	159,328
Insurance claim receivable	500,000	(500,000)
Cash received from landlord as lease incentive	200,000	--
Deferred rent liability	141,988	--
Inventories	(922,235)	(1,184,279)
Prepaid expenses and other current assets	(28,292)	(107,480)
Other assets	(15,811)	10,002
Accounts payable	(1,256,196)	1,170,860
Accrued expenses and other current liabilities	(155,007)	(353,401)
Income taxes payable	(10,338)	(38,774)
Deferred revenue	777,513	(42,961)
	-----	-----
Net cash provided by operating activities	158,774	1,050,604
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES :		
Purchases of property and equipment	(1,692,990)	(458,376)
Sale of Cadapult service contracts	1	--
	-----	-----
Net cash used in investing activities	(1,692,989)	(458,376)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES :		
Bank line of credit, net	(168,821)	9,192
Bank term loan, net	75,000	400,000
Payments of other short-term debt	(39,081)	(405,256)
Payments on loans from officers	--	(475,000)
Payments on loans from investors	--	(600,000)
Dividends paid	--	(66,125)
Proceeds of issuance of common stock, net	1,612,017	1,206,250
Costs of preferred stock conversion	--	(61,640)
	-----	-----
Net cash provided by financing activities	1,479,115	7,421

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

	-----	-----
NET INCREASE (DECREASE) IN CASH	(55,100)	599,649
CASH, BEGINNING OF YEAR	666,116	66,467
	-----	-----
CASH, END OF YEAR	\$ 611,016	\$ 666,116
	=====	=====
SUPPLEMENTAL CASH FLOW INFORMATION :		
Interest paid	\$ 179,385	\$ 406,176
	=====	=====
Income taxes paid	\$ 155,598	\$ 13,431
	=====	=====
NON CASH INVESTING AND FINANCING TRANSACTIONS:		
Issuance of common stock as dividend payment	\$ --	\$ 791,200
	=====	=====
Issuance of common stock for accrued interest on dividends	\$ --	\$ 14,891
	=====	=====
Conversion of preferred stock and accrued dividends to common stock	\$ --	\$ 2,856,485
	=====	=====
Induced conversion of preferred stock	\$ --	\$ 2,112,034
	=====	=====
Cashless exercise of stock options	\$ 92,081	\$ --
	=====	=====

See accompanying notes to consolidated financial statements.

F-5

24

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1A BASIS OF PRESENTATION :

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America. The consolidated financial statements presented herein are restated.

NOTE 1B RESTATEMENT OF FINANCIAL STATEMENTS :

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

NOTE 1B RESTATEMENT OF FINANCIAL STATEMENTS :

25

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

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-KSB/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-KSB for the fiscal year ended June 30, 2005, filed on September 13, 2005. The cumulative effects of these errors have been corrected in the accompanying consolidated financial statements included in this Form 10-KSB/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 understate
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.

F-6

25

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1C NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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 12.) We have our corporate headquarters in New Jersey.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Principles of Consolidation The consolidated financial statements include the accounts of Media Sciences International, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Estimates and Uncertainties The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results, as determined at a later date, could differ from those estimates.

Revenue Recognition Revenue is recognized at the point of shipment for goods sold, and ratably through the duration of INKlusive contracts (generally, two years) provided collection is reasonably assured. Provisions for rebates, product returns and discounts to customers recognized for as reductions in determining net sales in the same period as the related sales are recorded.

Under the Company's INKlusive program, we provide a customer with a workgroup color printer or multifunction device, on-site service and a defined, regular shipment of supplies (ink or toner), all for the cost of just the supplies. We offer this program in conjunction with a financing company. Media Sciences does not own or otherwise finance the cost of the printer, nor does Media Sciences guarantee the credit worthiness of the customer. 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. We recognize the revenue from the supplies as they are shipped over the term of the INKlusive agreement. Consequently, the difference in timing between receipt of payment for the supplies and those that are shipped gives rise to deferred revenue on our balance sheet.

Concentrations of Credit Risk Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and unsecured trade receivables. We maintain our cash balances in financial institutions which are insured by the Federal Deposit Insurance Corporation up to \$100,000 each. At various times during the year, such balances may exceed the FDIC limit.

Concentrations of credit risk with respect to all trade receivables are considered to be limited due to the quantity of customers comprising the Company's customer base. We perform ongoing credit evaluations of our customers' financial condition and do not require collateral. We maintain credit insurance on our foreign receivables. We maintain an appropriate allowance for doubtful accounts based on our history of past write-offs, collections and current credit evaluations. Consequently, management believes that credit risk beyond the established allowance at June 30, 2005 is limited.

Financial Instruments Financial instruments include cash, accounts receivable, accounts payable and short-term and long-term debt. The amounts reported for financial instruments are considered to be reasonable approximations of their fair values. The fair value estimates presented herein were based on market or other information available to management. The use of different assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts.

F-7

26

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Vendor Concentrations Purchases in 2005 and 2004 from three vendors amounted to 44% and 45% of cost of goods sold, respectively. No single vendor accounted for more than 15% and 18% of cost of goods sold, respectively.

Major Customers Net sales to one customer represented approximately 11% of revenues for the year ended June 30, 2005 and 7% of revenues for the year ended June 30, 2004. This customer accounts for approximately 4% and 6% of accounts receivable at June 30, 2005 and 2004 respectively.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Inventories Inventories, consisting of materials, labor and manufacturing overhead are stated at the lower of cost or market, with cost being determined on a first-in, first-out basis.

Property and Equipment Property and equipment are stated at cost. The Company provides for depreciation using the straight-line method by charges to expense at rates based upon the useful lives of three to seven years for furniture, equipment, automobiles, tooling and molds and over the useful lives or the lease term, if shorter, for leasehold improvements.

Long-Lived Assets The Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, requires testing of goodwill for impairment at least annually, using a two-step process. The first is to identify any potential impairment by comparing the carrying value of reporting units to their fair value. If a potential impairment is identified, the second step is to compare the implied fair value of goodwill with its carrying amount to measure the impairment loss. Reporting unit fair value is estimated using the income approach, which assumes that the value of a reporting unit can be computed as the present value of the assumed future returns of an enterprise discounted at a rate of return that reflects the riskiness of an investment. Based on the Company's testing of goodwill, no impairment existed at June 30, 2004. Based on the Company's testing of goodwill and the decision to discontinue certain Cadapult operations, the net goodwill resulting from three acquisitions by Cadapult, in the amount of \$880,000 was deemed impaired and written off at June 30, 2005. The impairment charge is reflected in the results from discontinued operations in our Statement of Operations for the year ended June 30, 2005. We have completed all transitional and annual impairment tests necessary to date and concluded that no other goodwill is impaired.

In addition, the Company assesses long-lived assets with definite useful lives, including property and equipment and other intangible assets, for impairment whenever events or circumstances indicate that the carrying value may not be fully recoverable by comparing the carrying value to estimated future undiscounted cash flows. To the extent that there is impairment, analysis is performed based on several criteria, including, but not limited to, revenue trends, operating cash flows and other operating factors to determine the impairment amount. No material impairment adjustments to other intangible assets or other long-lived assets were made during the years ended June 30, 2005 and 2004.

Advertising Expense 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 June 30, 2005 and 2004 totaled approximately \$51,000 and \$63,000, respectively. Advertising expense for the years ended June 30, 2005 and 2004 amounted to approximately \$950,000 and \$650,000, respectively.

Income Taxes The Company recognizes deferred tax assets, net of applicable valuation allowances, related to net operating loss carryforwards and certain temporary differences and deferred tax liabilities related to certain temporary differences. The Company recognizes a future tax benefit to the extent that realization of such benefit is more likely than not. Otherwise, a valuation allowance is applied. At June 30, 2005, the Company believes that the more likely than not criteria have been met and, accordingly, has recorded a net deferred tax asset to recognize a future tax benefit.

Employee Benefit Plan We maintain a 401(k) savings/retirement plan for all eligible employees. The plan allows for employee contributions to be matched by the Company. Our contributions for the years ended June 30, 2005 and 2004 were \$36,700 and \$26,700, respectively.

F-8

27

MEDIA SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Income (Loss) Per Share Basic income (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding as adjusted for the incremental shares attributed to outstanding options and warrants to purchase common stock, and other potentially dilutive securities.

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

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

	Year Ended J
	2005
Numerator:	
Income (loss) from continuing operations applicable to common shareholders - basic and diluted	\$ 380,441 =====
Denominator:	
Denominator for basic income (loss) per common share:	
Weighted average shares	10,259,423
Effect of dilutive securities - stock options and warrants	452,623 -----
Denominator for diluted income (loss) per common share	10,712,046 =====
Income (loss) per common share, basic and diluted	\$ 0.04 =====

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

	Year Ended J
	2005
Numerator:	
Net loss applicable to common shareholders - basic and diluted	\$ (83,338) =====
Denominator:	
Denominator for basic loss per common share:	
Weighted average shares	10,259,423
Effect of dilutive securities - stock options and warrants	-- -----
Denominator for diluted loss per common share	10,259,423 =====
Net loss per common share, basic and diluted	\$ (0.01) =====

The following warrants and options to purchase common stock were excluded from the computation of diluted earnings (on a continuing basis) or net loss per share for the years ended June 30, 2005 and 2004 because their exercise price was greater than the average market price of the common stock for those periods :

	Year Ended June 30,	
	2005	2004

Anti-dilutive warrants and options	149,150	3,386,156
	=====	=====

F-9

28

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock Options and Related Pro Forma Disclosure :

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 earnings (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 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 years ended June 30, 2005 and 2004, non-cash compensation expense was \$212,455 and \$358,675, respectively, of which \$13,159 and \$11,205, respectively, was included in the income (loss) 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 will no longer be 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 share applicable to common shareholders is required by SFAS 123 and SFAS 148, and has been determined as if the Company had accounted for its employee stock options under the fair value method of those statements.

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

	2005	2004
Risk-free interest rate	3.94 - 4.5%	3.83 - 6.0%
Dividend yield	0.0	0.0
Expected common stock market price volatility factor	9 - 16%	74 - 86%
Weighted average expected life of stock options	10 years	8.9 years

F-9

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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:

	Year Ended June 30,	
	2005	2004
Net loss applicable to common shareholders, as reported	\$ (83,338)	\$ (1,872,813)
Impact of variable plan accounting, net of related tax effects	168,440	262,335
Stock-based employee compensation expense under fair value method, net of related tax effects	(63,672)	(136,544)
Pro forma net income (loss) applicable to common shareholders	\$ 21,430	\$ (1,747,022)
Net income (loss) per share applicable to common shareholders:		
Basic and diluted, as reported	\$ (0.01)	\$ (0.30)
	=====	=====
Basic and diluted, pro forma	\$ 0.00	\$ (0.28)
	=====	=====

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.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4. This statement amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4, previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges ...". SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS 151 shall be applied prospectively and are effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted for inventory costs incurred during fiscal years beginning after the date this statement was issued. The adoption of SFAS No. 151 may have a material impact on our financial position and results of operations.

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of assets exchanged. The guidance in that opinion, however, included certain exceptions to that principle. This statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material impact on our financial position and results of operations.

Engineering and Product Development Engineering and product development costs, which consist of salary and related benefits costs of our technical staff, as well as product development costs including conceptual formulation, design and testing of product alternatives, and construction of prototypes, are expensed as incurred. For the years ended June 30, 2005 and 2004, our engineering and product development costs were approximately \$500,000 and \$740,000, respectively.

NOTE 2 INVENTORIES:

Inventories are summarized as follows:

	June 30,	
	2005	2004
Raw materials	\$1,040,390	\$ 265,178
Finished goods	2,155,933	2,008,910
	\$3,196,323	\$2,274,088

NOTE 3 PROPERTY AND EQUIPMENT:

Property and equipment are summarized as follows:

	June 30,		
	2005	2004	Use f
Equipment	\$ 892,424	\$ 1,401,068	3 -
Equipment at customer location **	-	951,109	3 ye
Furniture and fixtures	445,104	433,405	7 ye
Automobiles	30,434	52,035	5 ye
Leasehold improvements	626,351	223,664	5 -

NOTE 2 INVENTORIES:

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Tooling and molds	1,876,716	962,185
	-----	-----
	3,871,029	4,023,466
Less: Accumulated depreciation and amortization	1,812,778	2,951,280
	-----	-----
	\$ 2,058,251	\$ 1,072,186
	=====	=====

3 ye

** Equipment at customer location refers to color printers placed under the Cadapult No-Cap Color printer program which has been discontinued. At June 30, 2004, these assets were fully depreciated.

F-12

31

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 GOODWILL AND OTHER INTANGIBLE ASSETS:

Goodwill and other intangible assets are summarized as follows:

	Life (Years)	June 30,	
	-----	2005	2004
		-----	-----
Goodwill	--	\$ 3,965,977	\$ 4,986,030
Other	1-5	46,000	46,000
		-----	-----
		4,011,977	5,032,030
Less: Accumulated amortization		427,746	563,057
		-----	-----
		\$ 3,584,231	\$ 4,468,973
		=====	=====

The components of other intangible assets include two acquired URLs. The carrying value of the Company's other intangible assets is \$46,000 less accumulated amortization of \$46,000 and \$41,096 at June 30, 2005 and 2004, respectively. Amortization expense for the fiscal years 2005 and 2004 was \$4,904 and \$9,217 respectively.

As of June 30, 2004, the carrying value of goodwill amounted to \$4,986,030, less accumulated amortization from periods prior to the adoption of SFAS 142 in July 2001 of \$521,962. As explained in Note 1, during the year ended June 30, 2005 net goodwill in the amount of \$880,000 was deemed impaired and written off. During the year ended June 30, 2004, no goodwill was impaired or written off.

NOTE 5 DEBT:

The Company's borrowings consisted of the following:

	June 30,	
	2005	2004
Short-term debt:		
Revolving line-of-credit with bank	\$1,620,233	\$1,789,054
Note payable to bank	100,000	400,000
Current maturities of long-term debt	--	39,081
	-----	-----
	\$1,720,233	\$2,228,135
	=====	=====
Long-term debt:		
Note payable to bank, less current maturities	\$ 375,000	\$ --
	=====	=====

We have a revolving line-of-credit which provides for maximum borrowings of \$3,000,000. 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 base rate (an effective rate of 6.75% at June 30, 2005) and are payable on demand. 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 \$500,000 that bears interest at a fixed rate of 6.5%. The proceeds were used to finance the leasehold improvements to our new facility.

On July 27, 2005, we entered into an equipment lease line of credit with \$1 million in availability with the bank.

F-13

32

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

NOTE 6 INCOME TAXES:

The components of income taxes applicable to both continuing and discontinued operations are summarized as follows:

Year Ended June 30,

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

	2005	2004
Current:		
Federal	\$ --	\$ --
State	41,173	(25,454)
Total Current	\$ 41,173	(25,454)
Deferred:		
Federal	(67,760)	265,799
State	(53,131)	102,622
Total Deferred	(120,891)	368,421
Income Tax Expense (Benefit)	\$ (79,718)	\$ 342,967

At June 30, 2005, the Company has available federal net operating loss carryforwards of approximately \$300,000 which expire through 2022, and state net operating loss carryforwards of approximately \$2,960,000 which expire through 2025.

A reconciliation of the total income tax expense (benefit) provided at the federal statutory rate (34%) to income tax expense (benefit) is as follows:

	Year Ended June 30,	
	2005	2004
Income tax expense computed at federal statutory rate	\$ (67,760)	\$ 251,462
State income taxes (net of federal)	(11,958)	50,930
Other (including permanent differences)	--	40,575
	\$ (79,718)	\$ 342,967

F-14

33

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Significant components of the Company's deferred tax assets and liabilities are as follows:

	June 30,	
	2005	2004

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

	(Restated)	(Restated)
	-----	-----
Deferred tax assets :		
Net operating loss carryforwards	\$ 106,550	\$ 660,231
Deferred compensation	140,355	96,340
Deferred rent liability	124,989	--
Deferred revenue	322,908	61,309
R & D and other credits	117,370	--
Accruals and reserves	147,738	160,920
	-----	-----
Total deferred tax assets	\$ 959,910	\$ 978,800
	=====	=====
Deferred tax liabilities :		
Depreciation and amortization	\$ 404,099	\$ 543,880
	=====	=====

NOTE 7 SHAREHOLDERS EQUITY:

a) Stock Compensation Plan:

We have an incentive stock option plan (the 1998 Plan), pursuant to which 500,000 shares of common stock have been reserved. The stock options (which may be incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended) entitle the holder to purchase shares of the Company's common stock for up to ten years from the date of grant (five years for persons owning more than 10% of the total combined voting power of the Company) at a price not less than the fair market value (110% of fair market value for persons owning more than 10% of the combined voting power of the Company) of the common stock on the date of grant. In general, any employee, director, officer or exclusive agent of, or advisor or consultant to, the Company or a related entity, is eligible to participate in the Plan. The stock options are nontransferable, except upon death. As of June 30, 2005, 35,144 stock options are available for grant under the Plan.

b) Non-Plan Options:

In December 1999, the Company granted each of two employees five-year stock options to purchase up to 50,001 shares. The options were exercisable at \$1.27 per share, were completely vested at June 30, 2004, and expired unexercised in December 2004.

During the year ended June 30, 2001, the Company granted an employee five-year stock options to purchase up to 100,000 shares, all of which were vested as of June 30, 2003. The options are exercisable at \$1.25 per share and expire in June 2005. In July 2004, the employee exercised 5,000 options for net proceeds to the Company of \$6,250. In December 2004, the employee exercised 95,000 options for net proceeds to the Company of \$118,750.

F-15

34

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

During the year ended June 30, 2003, the Company granted each of five employees five-year stock options to purchase up to 25,000 shares, which vested on April 6, 2004 and are exercisable at \$0.50 per share. In 2005, two of these employees exercised 25,000 options each for net proceeds to the Company of \$25,000 and one employee executed a cashless exercise of 25,000 options, for which the Company received 6,250 shares of common stock with a fair value of \$12,500, and no cash proceeds.

During the year ended June 30, 2003, the Company granted its President five-year stock options to purchase up to 500,000 shares that are exercisable at \$1.00 per share and expire in June 2008. Options to purchase 250,000 shares vested immediately and options to purchase an additional 250,000 shares vested ratably over the period from July 1, 2003 through June 30, 2005. A total of 500,000 options are vested at June 30, 2005.

During the year ended June 30, 2004, the Company granted each of two employees ten-year stock options to purchase up to 100,000 shares, which are exercisable at \$1.06 per share. Options to purchase 50,000 shares each vested immediately and options to purchase an additional 50,000 shares each vest ratably over the period from May 24, 2004 through May 23, 2006. During 2005, one employee executed a cashless exercise of 50,000 options for which the Company received 25,090 shares of common stock with a fair value of \$53,000, and no cash proceeds. 50,000 options for that same employee were cancelled upon the termination of his employment.

During the year ended June 30, 2005, the Company granted an employee ten-year stock options to purchase up to 100,000 shares, which are exercisable at \$1.60 per share and expire in June 2015. The options vest ratably, on an annual basis, over the period June 6, 2005 through June 5, 2010.

c) **Option Summary:**

The following table summarizes the 1998 Plan and non-plan stock option activity for the two years ended June 30, 2005:

	Number of Shares	Weighted Average Exercise Price
Options outstanding at June 30, 2003	1,363,408	\$1.20
Year ended June 30, 2004:		
Granted	247,500	1.07
Exercised	(5,000)	1.25
Cancelled	(218,750)	1.28

Options outstanding at June 30, 2004	1,387,158	1.17
Year ended June 30, 2005:		
Granted	201,950	1.68
Exercised	(287,396)	0.96
Cancelled	(190,169)	1.30

Options outstanding at June 30, 2005	1,111,543	\$1.29
	=====	=====

F-16

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about outstanding and exercisable 1998 Plan and non-Plan options at June 30, 2005:

Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life-Years	Number Exercisable	Weighted Average Exercise Price
\$0.43 to \$0.85	123,200	\$0.56	5.77	123,200	\$0.56
\$1.00 to \$2.00	884,743	1.23	5.22	694,793	1.13
\$2.01 to \$4.00	103,600	2.69	4.89	95,600	2.73
	-----	-----	-----	-----	-----
	1,111,543	\$1.29	5.25	913,593	\$1.22
	=====	=====	=====	=====	=====

d) Warrants:

In October 1999, the Company issued 30,000 warrants to purchase its common stock exercisable between \$3.00 \$4.00 per share in exchange for investor relations services, the value of which was subsequently capitalized. The value of the warrants, which was approximately \$100,000 using the Black-Scholes option pricing model, was recognized as a cost of issuance of the Series A Preferred shares. The warrants expired on September 29, 2004.

Between October 1999 and March 2000, the Company issued 1,926,500 warrants to purchase common stock in connection with the issuance of the Series A Preferred shares as more fully described below. 1,100,000 warrants exercisable at \$4.50 per share expired on September 29, 2004, 40,000 warrants exercisable at \$3.75 per share expired on December 10, 2004, 236,500 warrants exercisable at \$1.65 per share expired on March 9, 2005 and 550,000 warrants exercisable at \$3.75 per share expired on March 9, 2005. The value of the warrants was recognized as a cost of issuance of the Series A Preferred shares. In March 2005, 221,500 warrants exercisable at \$1.65 per share were exercised for net proceeds to the Company of \$365,475. The balance of these warrants expired between October 2004 and March 2005.

In June 2001, the Company issued 200,000 warrants to purchase its common stock at \$1.00 per share in consideration for consulting services. The warrants, which were valued at \$25,000, expire on May 31, 2006. In June 2004, 75,000 warrants were exercised for net proceeds to the Company of \$75,000.

In June 2002, the Company issued 87,500 warrants to purchase its common stock at \$1.00 per share in connection with its notes payable. The warrants were valued at \$43,372 and expire in June 2007. In May 2005, 12,500 warrants were exercised for net proceeds to the Company of \$12,500.

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the warrant activity for the two years ended June 30, 2005:

	Number of Shares	Weighted Average Exercise Price
Warrants outstanding at June 30, 2003	2,349,000	\$3.57
Year ended June 30, 2004:		
Granted	-	-
Exercised	-	-
Cancelled	(105,000)	4.29
Warrants outstanding at June 30, 2004	2,244,000	3.54
Year ended June 30, 2005:		
Granted	-	-
Exercised	(309,000)	1.47
Cancelled	(1,735,000)	4.20
Warrants outstanding at June 30, 2005	200,000	\$1.00

The following table summarizes information about outstanding warrants at June 30, 2005:

Warrants Outstanding				Warrants Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life-Years	Number Exercisable	Weighted Average Exercise Price
\$1.00	200,000	\$1.00	1.32	200,000	\$1.00
	=====	=====	=====	=====	=====

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

e) Common Stock:

During the year ended June 30, 2004, we issued 5,275,000 common shares for the conversion of 547,500 shares of Series A Preferred Stock.

On June 30, 2004, we sold 1,000,000 shares of common stock to an investor for net proceeds of \$1,200,000.

On March 2, 2005, we sold 500,000 shares of common stock to an investor at \$2.00 per share for net proceeds of \$975,000.

f) Preferred Stock:

The Company's Certificate of Incorporation authorizes the issuance of up to 5,000,000 shares of Preferred Stock. The Board of Directors is authorized to issue shares of Preferred Stock from time to time in one or more series and to establish and designate any such series and to fix the number of shares and the relative conversion rights, voting rights, terms of redemption and liquidation. In December 1999, the Board authorized the issuance of up to 1,000,000 shares of Series A Preferred Stock.

On March 10, 2000, the Company completed a private placement wherein it sold 550,000 units for \$10.00 per unit representing 550,000 shares of its Series A Preferred Stock and 1,100,000 warrants exercisable for five years to purchase one share of common stock at \$4.50 per share. Net proceeds received from the sale totaled \$4,566,549.

Dividends on the Series A shares accrued at the rate of 11.5% per annum and were payable quarterly. Each Series A share was initially convertible at the option of the holder at the rate of 3.077 shares of common stock for one Series A share. In December 2001, the rate of conversion changed to five shares of common stock for one Series A share.

In November 2003, we initiated a voluntary Offer of Conversion, whereby preferred shareholders who accepted the offer waived their rights to unpaid dividends and interest on their preferred stock and they received ten shares of common stock for each preferred share tendered. 87% of the preferred shareholders tendered a total of 507,500, or 93% of the outstanding, Series A shares. The balance of the Series A shares (40,000) were automatically converted to common stock at the rate of five shares of common stock for each preferred share, pursuant to the terms of the amended Certificate of Designation, which amendment was approved by a majority of the preferred shareholders. Those preferred shareholders whose preferred shares were converted at the rate of five to one were paid their accrued and unpaid dividends which totaled \$66,125.

F-19

38

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The conversion of the preferred stock was accounted for according to EITF Topic No. D-42 as an Induced Conversion of Preferred Stock. Consequently the fair value of the securities (ten shares of common stock) issued over the fair value of the securities issuable pursuant to the original conversion terms (five shares of common stock) less the accrued dividends and interest given up by the shareholders was subtracted from net income to arrive at net loss applicable to common shareholders. The non-cash charge for induced conversion included in preferred stock dividends in the consolidated statement of operations for the year ended June 30, 2004 was calculated as follows :

Fair value of securities issued (5,275,000 x \$1.15)	\$ 6,066,250
Less :	
Fair value of securities issuable pursuant to the original conversion terms (547,500 x 5 x \$1.15)	(3,148,125)
Value of accrued dividends waived	(791,200)
Value of accrued interest waived	(14,891)

Non-cash charge included in preferred stock dividends	\$ 2,112,034
	=====

F-20

39

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 COMMITMENTS AND CONTINGENCIES:

Leases We lease our premises under lease agreements which expire through 2011 and equipment under operating leases that expire through 2006.

Future minimum lease payments are as follows:

Year Ending June 30,	Operating Leases
2006	\$ 606,250
2007	556,266
2008	556,266
2009	556,266
2010	334,027
Thereafter	238,285

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Total future minimum lease payments	\$2,847,360 =====
-------------------------------------	----------------------

Net rent expense amounted to \$449,420 and \$296,369 for the years ended June 30, 2005 and 2004, respectively.

Employment Agreement On July 1, 2003, the Company entered into a five-year employment agreement with its President for a base salary of \$200,000 per annum, subject to certain adjustments.

Litigation In May 2005, we filed suit in New Jersey state court against our former insurance broker for insurance malpractice. The suit contends, in sum and substance, that the insurance broker was negligent and breached its duty of care in connection with the procurement of an umbrella insurance policy. The suit asserts four causes of action for (1) negligent procurement; (2) failure to procure required coverage; (3) breach of the standard of care; and (4) failure to advise.

In particular, the suit alleges that the insurance broker breached its duty by failing to identify our subsidiary in insurance applications; submitting insurance applications, without our review, incorrectly denying the existence of our subsidiary; and failing to correct such an error. The suit further alleges that our insurance broker failed to procure the umbrella insurance we required, and were led to believe we purchased. Finally, the suit alleges that our insurance broker breached its duty by failing to be aware that our subsidiary did not have adequate coverage and to advise us that our subsidiary was not adequately covered.

The suit seeks recovery of the balance of unrecovered losses for third party damages that should have been covered under the umbrella insurance procured by our insurance broker but was not due to the aforementioned negligence and breaches of duty of care by our insurance broker. Proceeds of this suit, if any, will be recorded in the period when received.

The Company is a defendant in legal proceedings arising in the ordinary course of its business activities. Although the ultimate disposition of these proceedings is not presently determinable, management does not expect the outcome to have a material adverse effect on the Company's consolidated financial position or results of operations.

Other than the above, as at June 30, 2005, we are not a party to any material pending legal proceeding, other than ordinary routine litigation incidental to our business.

F-21

40

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 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 years ended June 30, 2005 and 2004 are as follows:

NOTE 9 WARRANTY EXPENSES:

42

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

	Year Ended June 30,	
	2005	2004
Warranty reserve at the beginning of the year	\$ 340,592	\$ 250,000
Warranties accrued during the period	1,115,914	1,409,249
Warranties settled during the period	(1,164,773)	(1,318,657)
Net change in warranty reserve	(48,859)	90,592
Warranty reserve at the end of the year	\$ 291,733	\$ 340,592

The Company filed a claim under its umbrella liability policy for the unreimbursed portion of the warranty expenses associated with a recall of solid ink products in January 2002. The insurance carrier denied coverage under the policy, and filed suit for a declaratory judgement seeking to rescind the policy or in the alternative to have the court declare that the insurance company has no obligation to indemnify the Company for these claims. The Company filed an answer and counterclaim in this matter. On September 10, 2004, the Company agreed to settle the matter and it received \$500,000 as consideration for the settlement. The claim was recorded as a receivable as of June 30, 2004 with a corresponding credit to warranty expense.

F-22

41

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 HEADQUARTERS FACILITY MOVE :

On September 30, 2004, we entered into a lease agreement, effective October 1, 2004, for office facilities in Oakland, New Jersey. The lease is for a term of five years, at an annual rate of \$296,318. Pursuant to the lease, our landlord provided us with a \$200,000 cash allowance for improvements to the facility. These improvements have been capitalized and will be amortized over the term of the lease. The \$200,000 allowance also gives rise to a deferred rent liability on our balance sheet, which is also being amortized over the lease term. The benefit of the amortization of the deferred rent liability is equal to and offset by the amortization expense of the \$200,000 in landlord funded leasehold improvements.

In addition to the above \$200,000 in leasehold improvements, we invested approximately \$400,000 in additional leasehold improvements which are being amortized over the lease term.

The direct costs of moving amounted to approximately \$100,000 for the year ended June 30, 2005. We recorded these expenses as operating expenses.

Indirect costs of the move, which have also been recorded as operating expenses, include rent and utility expenses resulting from operating both the Allendale and Oakland facilities for two months and significant personnel overtime resulting from the breakdown, move and set-up of operations from Allendale to Oakland.

We do not anticipate any material additional moving expenses.

NOTE 11 SUBLEASE OF PREVIOUS FACILITIES :

On January 20, 2005, we entered into a sublease agreement with Dynamic Imaging, Inc. (Dynamic). Pursuant to the sublease agreement, we agreed to sublease to Dynamic our leased premises at 40 Boroline Road, Allendale, New Jersey, 07401(Allendale Facility), at an annual rent of \$177,100. The sublease is for a term of six years and three months commencing March 1, 2005 and expiring on May 30, 2011, the expiration date of our lease. In addition, we provided the tenant with four months of rent at no charge. Our current annual rent for 40 Boroline Road is \$184,800 and will increase to \$209,440 effective June 2006.

As a result of the discontinued use of the Allendale Facility, we incurred the following expenses in the year ended June 30, 2005: the write-off of Allendale leasehold improvements, the real estate broker commission for the sublease, and the present value of the rent differential between our remaining rent liability and our expected rental income. The aggregate value of these one-time expenses was \$443,061 and was recorded as an operating expense. The present value of the rent differential of \$204,834 was recorded as a deferred rent liability on our balance sheet. As a result of this accounting treatment, the effects of the sublease will not impact our future results of operations.

F-23

42

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 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. In connection with the discontinuance of these operations, on May 7, 2005, Cadapult, entered into an Asset Purchase Agreement with IO Integration, Inc. Pursuant to the agreement, for the consideration of \$1, Cadapult sold to IO Integration certain assets related to its systems integration business, consisting of its service and support contracts and pre-paid expenses and IO Integration assumed all obligations and liabilities in connection with the performance of the service and support contracts. Accordingly, the results of operations of the electronic pre-press sales and service operations have been reclassified and are included in discontinued operations. Sales and service revenues from the discontinued operations for the years ended June 30, 2005 and 2004 were \$1.5 million and \$2.0 million, respectively. The pre-tax income (loss) from discontinued operations for the years ended June 30, 2005 and 2004 were \$(0.79) million and \$0.34 million respectively.

We evaluated the goodwill resulting from three Cadapult acquisitions associated with the discontinued operations and determined that the goodwill resulting from those acquisitions was fully impaired. Consequently, we incurred an impairment charge of approximately \$880,000 which is reflected in the results from discontinued operations in our Statement of Operations for the year ended June 30, 2005.

Further, we wrote off approximately \$90,000 of inventory associated with the discontinued operations.

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 will no longer be presented.

NOTE 12 DISCONTINUED OPERATIONS :

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

The unaudited information below shows the effects of reclassifying the electronic pre-press systems sales and service operations as discontinued operations for the four quarters in each of the fiscal years ended June 30, 2005 and 2004.

F-24

43

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
REFLECTING DISCONTINUED OPERATIONS
(UNAUDITED)**

	Three Months Ended September 2004	2003
	-----	-----
NET SALES	\$ 4,411,908	\$ 3,403,030
	-----	-----
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation	2,234,077	1,507,160
Depreciation	63,319	145,150
	-----	-----
Total cost of goods sold	2,297,396	1,652,310
	-----	-----
GROSS PROFIT	2,114,512	1,750,710
	-----	-----
OTHER COSTS AND EXPENSES:		
Selling, general and administrative, excluding depreciation, amortization and impact of variable plan accounting	1,608,450	1,216,390
Depreciation and amortization	66,549	62,440
Impact of variable plan accounting	72,761	107,060
	-----	-----
Total other costs and expenses	1,747,760	1,385,900
	-----	-----
INCOME FROM OPERATIONS	366,752	364,800
	-----	-----
INTEREST EXPENSE	52,520	107,300
	-----	-----
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	314,232	257,490
PROVISION FOR INCOME TAXES	132,818	124,040
	-----	-----
INCOME FROM CONTINUING OPERATIONS	181,414	133,450
	-----	-----
INCOME FROM DISCONTINUED OPERATIONS	55,965	7,140
PROVISION FOR INCOME TAXES	23,485	4,260

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

INCOME FROM DISCONTINUED OPERATIONS	32,480	2,88
NET INCOME	213,894	136,34
PREFERRED STOCK DIVIDENDS	--	157,40
NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	\$ 213,894	\$ (21,06)
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,913,916	3,577,21
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,482,432	3,577,21
INCOME (LOSS) PER COMMON SHARE FROM CONTINUING OPERATIONS : BASIC AND DILUTED	\$ 0.02	\$ (0.0
INCOME PER COMMON SHARE FROM DISCONTINUED OPERATIONS : BASIC AND DILUTED	\$ 0.00	\$ 0.0
NET INCOME (LOSS) PER COMMON SHARE : BASIC AND DILUTED	\$ 0.02	\$ (0.0

F-25

44

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED ENDED DECEMBER 31, 2004 AND 2003
REFLECTING DISCONTINUED OPERATIONS
(UNAUDITED)**

	Three Months Ended December 2004	2003
NET SALES	\$ 4,658,357	\$ 3,548,
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation	2,298,622	1,655,
Depreciation	70,897	139,
Total cost of goods sold	2,369,519	1,794,

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED ENDED DECEMBER 31, 2004 AND 2003

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

GROSS PROFIT	2,288,838	1,753,
OTHER COSTS AND EXPENSES:		
Selling, general and administrative, excluding depreciation, amortization and impact of variable plan accounting	1,795,040	1,355,
Depreciation and amortization	59,121	67,
Impact of variable plan accounting	(26,126)	1,
Total other costs and expenses	1,828,035	1,423,
INCOME FROM OPERATIONS	460,803	329,
INTEREST EXPENSE	52,865	93,
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	407,938	236,
PROVISION FOR INCOME TAXES	165,064	92,
INCOME FROM CONTINUING OPERATIONS	242,874	143,
INCOME FROM DISCONTINUED OPERATIONS	55,936	268,
PROVISION FOR INCOME TAXES	22,478	107,
INCOME FROM DISCONTINUED OPERATIONS	33,458	161,
NET INCOME	276,332	304,
PREFERRED STOCK DIVIDENDS AND CHARGE FOR INDUCED CONVERSION	--	1,913,
NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS	\$ 276,332	\$ (1,609,
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,937,043	3,577,
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,361,754	3,577,
INCOME (LOSS) PER COMMON SHARE FROM CONTINUING OPERATIONS : BASIC AND DILUTED	\$ 0.02	\$ (0
INCOME PER COMMON SHARE FROM DISCONTINUED OPERATIONS : BASIC AND DILUTED	\$ 0.01	\$ 0
NET INCOME (LOSS) PER COMMON SHARE : BASIC AND DILUTED	\$ 0.03	\$ (0

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED ENDED MARCH 31, 2005 AND 2004
REFLECTING DISCONTINUED OPERATIONS
(UNAUDITED)**

	Three Months Ended March 2005	March 2004
	-----	-----
NET SALES	\$ 4,070,179	\$ 3,909,000
	-----	-----
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation	1,981,371	1,944,000
Depreciation	66,629	118,000
	-----	-----
Total cost of goods sold	2,048,000	2,062,000
	-----	-----
GROSS PROFIT	2,022,179	1,846,000
	-----	-----
OTHER COSTS AND EXPENSES:		
Selling, general and administrative, excluding depreciation, amortization, loss from sublease, moving expenses and impact of variable plan accounting	1,818,132	1,668,000
Depreciation and amortization	71,880	61,000
Loss from sublease and moving expenses	528,050	528,000
Impact of variable plan accounting	192,321	26,000
	-----	-----
Total other costs and expenses	2,610,383	1,757,000
	-----	-----
INCOME (LOSS) FROM OPERATIONS	(588,204)	89,000
	-----	-----
INTEREST EXPENSE	44,533	95,000
	-----	-----
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(632,737)	(5,000)
PROVISION (BENEFIT) FOR INCOME TAXES	(176,168)	8,000
	-----	-----
LOSS FROM CONTINUING OPERATIONS	(456,569)	(14,000)
	-----	-----
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	(82,740)	192,000
PROVISION (BENEFIT) FOR INCOME TAXES	(27,783)	77,000
	-----	-----
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	(54,957)	115,000
	-----	-----
NET INCOME (LOSS)	(511,526)	101,000

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

PREFERRED STOCK DIVIDENDS AND CHARGE FOR
INDUCED CONVERSION

--

NET INCOME (LOSS) APPLICABLE TO COMMON SHAREHOLDERS

\$ (511,526)

\$ 101

BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING

10,288,450

8,602

DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING

10,288,450

8,691

LOSS PER COMMON SHARE FROM CONTINUING OPERATIONS :
BASIC AND DILUTED

\$ (0.04)

\$ (

INCOME (LOSS) PER COMMON SHARE FROM DISCONTINUED OPERATIONS :
BASIC AND DILUTED

\$ (0.01)

\$

NET INCOME (LOSS) PER COMMON SHARE :
BASIC AND DILUTED

\$ (0.05)

\$

F-27

46

**MEDIA SCIENCES INTERNATIONAL, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED ENDED JUNE 30, 2005 AND 2004
REFLECTING DISCONTINUED OPERATIONS
(UNAUDITED)**

	Three Months Ended June 30, 2005	2004
	-----	-----
NET SALES	\$ 4,738,394	\$ 3,612,
	-----	-----
COST OF GOODS SOLD:		
Cost of goods sold, excluding depreciation	2,410,660	1,735,
Depreciation	37,292	100,
	-----	-----
Total cost of goods sold	2,447,952	1,836,
	-----	-----
GROSS PROFIT	2,290,442	1,776,
	-----	-----

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED ENDED JUNE 30, 2005

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

OTHER COSTS AND EXPENSES:

Selling, general and administrative, excluding depreciation, amortization, loss from sublease, moving expenses and impact of variable plan accounting	1,662,684	1,511,
Depreciation and amortization	84,169	62,
Loss from sublease and moving expenses	17,078	-
Impact of variable plan accounting	(39,660)	212,
Total other costs and expenses	1,724,271	1,785,
INCOME (LOSS) FROM OPERATIONS	566,171	(9,
INTEREST EXPENSE	29,467	76,
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	536,704	(86,
PROVISION (BENEFIT) FOR INCOME TAXES	123,982	(46,
INCOME (LOSS) FROM CONTINUING OPERATIONS	412,722	(40,
LOSS FROM DISCONTINUED OPERATIONS	(818,354)	(129,
BENEFIT FOR INCOME TAXES	(343,594)	(48,
LOSS FROM DISCONTINUED OPERATIONS	(474,760)	(80,
NET LOSS	(62,038)	(121,
PREFERRED STOCK DIVIDENDS AND CHARGE FOR INDUCED CONVERSION	--	198,
NET LOSS APPLICABLE TO COMMON SHAREHOLDERS	\$ (62,038)	\$ (319,
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,906,933	6,214,
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	10,906,933	6,214,
INCOME (LOSS) PER COMMON SHARE FROM CONTINUING OPERATIONS : BASIC AND DILUTED	\$ 0.04	\$ (0
LOSS PER COMMON SHARE FROM DISCONTINUED OPERATIONS : BASIC AND DILUTED	\$ (0.05)	\$ (0
NET LOSS PER COMMON SHARE : BASIC AND DILUTED	\$ (0.01)	\$ (0

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**(a) Former Independent Accountant**

Wiss & Company LLP audited our financial statements for our fiscal year ended June 30, 2003. Wiss & Company had been our principal independent accountant since about June 1998.

In 2003, Wiss & Company informed us that they decided to discontinue providing audit services to publicly-held companies registered with the United States Securities and Exchange Commission and to exit the practice area.

We requested Wiss & Company to stand for re-election as our principal independent accountant and to continue to perform audit services for us in connection with our 2004 fiscal quarters until we had the opportunity to select and obtain new independent accountants in connection with our June 30, 2004 fiscal year end, and Wiss & Company agreed to do so.

On February 10, 2004, we engaged J.H. Cohn LLP as our principal independent registered public accounting firm, and the services of Wiss & Company as our principal independent accountant were concluded. The change in accountants was necessitated by the decision of Wiss & Company to exit the SEC practice area.

Wiss & Company's reports on our financial statements for the two years prior to its resignation, did not contain an adverse opinion or disclaimer of opinion, and were not modified as to uncertainty, audit scope, or accounting principles. There were no disagreements with Wiss & Company, whether or not resolved, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to Wiss & Company's satisfaction, would have caused it to make reference to the subject matter of the disagreement in connection with its reports.

(b) New Independent Accountant

On February 10, 2004, we engaged J.H. Cohn LLP as our principal independent registered public accounting firm. As described above, the change in accountants was necessitated by the decision of Wiss & Company to exit the SEC practice area. Our Audit Committee, and our Board of Directors, approved the selection of J.H. Cohn LLP as our principal independent registered public accounting firm. We did not previously consult with J.H. Cohn LLP regarding the application of accounting principles to a specific completed or contemplated transaction, or the type of audit opinion that might be rendered on our financial statements, and no written or oral advice was provided that was an important factor considered by us in reaching a decision as to any accounting, auditing or financial reporting issue.

ITEM 8A. 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 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 June 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 June 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 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.

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 2006, 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 March 31, 2006, prior quarters in this 2006 fiscal year, or for the years ended June 30, 2005 or 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 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, filed on September 13, 2005.

Corrections to properly reflect the carrying values of the Company's deferred tax assets, income taxes payable, and retained earnings for the fiscal years ended June 30, 2005 and 2004 are reflected in this Form 10-KSB/A, as further discussed in Note 1B to the consolidated financial statements. Corresponding corrections to the Company's interim condensed consolidated financial statements for the quarters ended September 30, 2005 and December 31, 2005 will also be filed on Form 10-QSB/As.

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 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 June 30, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

certain previously unrecognized compensation expense should have been recognized as compensation expense in certain of the financial statements previously issued by the Company.

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

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

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

ITEM 8B. OTHER INFORMATION

In March 2005, we entered into a \$500,000 note with a bank, carrying a 6.5% fixed interest rate and payable in monthly installments over five years. The note is cross collateralized and cross defaulted with the revolving line of credit. The proceeds were used to finance the leasehold improvements to our Oakland facility.

In June 2005, we entered in an amendment to the loan documents with the bank. As amended, both our 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 of not more than 2.50 to 1.00 and a ratio of Cash Flow to Cash Uses of not less than 1.0, measured on a rolling four quarter basis.

On July 27, 2005, we entered into an equipment lease line of credit with \$1 million in availability with the bank.

50

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Our Management

The persons listed in the table below are our present directors and executive officers.

Name	Age	Position
Michael W. Levin	40	Chief Executive Officer, President and Chairman of the Board
Frances Blanco	44	Vice President Sales and Marketing, Treasurer, and Director
Larry Anderson	53	Vice President Operations and Technical Services
Denise Hawkins	36	Vice President, Controllor and Secretary
Paul C. Baker	68	Director
Edwin Ruzinsky	72	Director
Donald Gunn	53	Director and Vice President of Engineering
Henry Royer	73	Director
Alan Bazaar	35	Director

Our directors are elected annually to serve for one year and hold office until the next annual meeting of the shareholders and until their successors are elected and qualified. Our Board of Directors may increase the size of the Board of Directors. Any director who fills a position created by the Board of Directors serves until the next annual meeting of the shareholders. Our officers are elected by the Board of Directors at the first meeting after each annual meeting of our shareholders, and hold office until their death, resignation or removal from office.

Management Profile

Michael W. Levin, Chief Executive Officer, President and Chairman of the Board:

Michael W. Levin has served as our Chief Executive Officer, President and Chairman of the Board since June 18, 1998. Mr. Levin serves on the compensation committee. Before June 1998, he had served as President, Treasurer, Secretary and Chairman of Media Sciences' predecessor, Cadapult Graphic Systems Inc. (CGSI) since 1987, when he founded CGSI while attending Lehigh University. He is responsible for a senior management team as well as merger and acquisition activity and corporate finance. In 2002, Mr. Levin was recognized in *Business News New Jersey's* annual 40 under 40 issue, which profiles the state's outstanding business leaders under the age of 40. He also was selected as the honorary annual fundraising chairman for the Children's Cancer Research Fund of New York Medical College in 1999. In 1987, Mr. Levin graduated summa cum laude from Lehigh University, receiving a Bachelor of Science Degree in Mechanical Engineering.

Frances Blanco, Vice President of Marketing and Investor Relations, Treasurer, and Director:

Frances Blanco has served as our Vice President of Marketing and Investor Relations, Treasurer, and a Director since June 18, 1998. She also served as Secretary from June 18, 1998 through June 30, 2004. From 1993 to June 18, 1998, she served as Vice President of Marketing and Investor Relations, Treasurer, Secretary and a director of CGSI. Blanco manages all aspects of marketing, including brand identity, demand creation and vendor relationships for us as well as investor relations. From 1984 through 1989, Blanco was a Reseller Account Manager at Lotus, where she designed and implemented tactical channel programs. From August 1989 through June 1993, Blanco served as a Business Development Manager at Tektronix, Inc., where she was responsible for the development of color printing standards in strategic customers. She earned a Bachelor of Science degree in Marketing from Bentley College in 1982 and a Masters of Business Administration degree from Boston College in 1985.

51

Lawrence Anderson, Vice President:

Lawrence Anderson has served as Vice President of Operations since June 6, 2005. From April 1997 to November 2000, Mr. Anderson was Vice President World Wide Operations for Katun Corporation, located in Bloomington, Minnesota. From January 2001 to November 2004, Mr. Anderson was Vice President Manufacturing/Operations for WatchGuard Technologies Inc., located in Seattle, Washington. Prior to joining our company, Mr. Anderson had been retired since November 2004.

Denise Hawkins, Vice President, Controller and Secretary:

Denise Hawkins has served as Vice President for Media Sciences since February 12, 2003, and as Secretary since July 1, 2004. Ms. Hawkins manages the accounting aspects of the business while working closely with the President and senior management team. She is a Certified Public Accountant and a Certified Management Accountant. She began her employment with the company in July of 2001 as the Controller. Ms. Hawkins graduated from the State University of New York-The College at New Paltz with a Bachelor of Science degree in Accountancy in 1990 and graduated from Marist College in 1998 with a Masters in Business Administration in Finance. Prior to her position at Media Sciences, Ms. Hawkins was the controller for NFK Excavating and Construction, Inc. (2000-2001), Horizon Medical Group, PC (1998-2000) and VAC Service Corp.(1992-1998). She is currently serving as the Treasurer for the Board of Helping Hands Christian Pre-School. Ms Hawkins is affiliated with the New Jersey State Society of Certified Public Accountants, the Institute of Management Accountants and the Society for Human Resource Management.

Paul C. Baker, Director:

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Paul C. Baker has served as a Director since June 18, 1998. Mr. Baker is the chairman of the Compensation committee and also serves on the audit committee. From 1986 to 2000 he was President of Sherwood Partners, Inc., a venture capital and management consulting company, which he founded, that focused on developing companies with high growth potential. From 2000 to present, he has been General Partner of PCB Associates, LLC which performs similar services. Prior to 1986, Baker held various management positions during 25 years of employment with American Cyanamid Co., including President of Cyanamid's Shulton, Inc. subsidiary from 1977 to 1979 and Group Vice President of Cyanamid from 1979 to 1984. Baker graduated from Lehigh University in 1959 and 1960 with degrees in Engineering and Liberal Arts and received his MBA degree from Fairleigh Dickinson University in 1963.

Edwin Ruzinsky, Director:

Mr. Ruzinsky has served as a Director since August 27, 1999 and is the chairman of the audit committee. He is a Certified Public Accountant and a Certified Management Consultant. Prior to his retirement on June 1, 1996 as a Partner in Deloitte Consulting LLC, a wholly-owned subsidiary of Deloitte & Touche LLP, he served for many years as the firm's National Director-Media Industry Services. He previously served Times Mirror Company as Vice President of Finance & Administration/Book Publishing Group and Parent's Magazine Enterprises, Inc. as Chief Accounting Officer. Mr. Ruzinsky continues serving as a member of the Pace University/Dyson School of Liberal Arts & Sciences/Master of Science in Publishing Advisory Board. He is currently a member of the Board of Gentis, Inc., engaged in the research and development of therapeutic products for the repair and regeneration of human tissues (such as cartilage tissue and intervertebral disc tissue) through the use of scaffolds that beneficially affect progenitor and other cells at the site of repair or regeneration. On March 31, 2005, Dowden Health Media, Inc. on whose board Mr. Ruzinsky served, was sold.

52

Donald Gunn, Vice President of Engineering and Director:

Donald Gunn has served as a Director since December 23, 1999. Since December 13, 1999, he has served as Vice President of Engineering. Gunn manages product development and strategic major account relationships for Media Sciences. He founded ultraHue, Inc., a manufacturer of ink and toner products for computer printers in March 1996. He served as President and Chief Executive Officer of ultraHue until we acquired ultraHue on December 13, 1999. From June 1997 to November 1998, he served as the Western Sales Manager for Invention Machine Corporation, a Boston based provider of software designed to aid engineers in the development of engineering solutions. From August 1995 to May 1997, he worked as Regional Manager for the Pacific Northwest for 3D Systems, located in Valencia, California, a company that produces stereo lithography machines. From October 1987 to August 1995, he worked for the Color Printer Division of Tektronix, Inc., located in Wilsonville, Oregon, in various sales and marketing positions, including Major Account Manager and VAR Account Manager for the Western United States. From July 1986 to October 1987, he worked as a sales manager for Silma, Inc., located in Santa Clara, California, a company that produced software for industrial equipment. From January 1985 to June 1986, he was the Western Area Sales Manager for AAB Robotics, located in Fort Collins, Colorado, a company that produced equipment for the welding industry. He received a Bachelors of Science degree in Electrical Engineering from the University of Illinois in 1974.

Henry Royer, Director:

Henry Royer has served as a Director since December 23, 1999. Mr. Royer serves on the Compensation committee. From 1965 to 1983, Mr. Royer held several positions at First National Bank of Duluth, serving as Executive Vice President/Loans when he left First National Bank. He then joined The Merchants National Bank of Cedar Rapids, now named US Bank Cedar Rapids, N.A., where he served as Chairman and President until August 1994. From September 1994 through December 31, 1997, he served as the President and Chief Executive Officer of River City Bank, Sacramento, California. He served as an Independent Trustee of Berthel Growth & Income Trust I from its date of inception in 1995 through February 5, 1999, when he resigned to join Berthel Fisher & Company Planning Inc., and was elected President of Berthel Trust in July 1999. He was elected President of Berthel SBIC, LLC in August 1999. He currently serves as Chairman of the board of Cedar Rapids Bank and Trust and as a member of the board of QCRH a bank holding company. He also serves on various Boards of privately-held companies. He graduated in 1953 from Colorado College with a B.A. in Money and Banking.

Alan Bazaar, Director:

Alan Bazaar has served as a Director since June 30, 2004. Mr. Bazaar serves on both the audit committee and the compensation committee. He is a Certified Public Accountant. Mr. Bazaar is a Vice President and Portfolio Manager at Richard L. Scott Investments, LLC. His responsibilities include co-managing a public company portfolio for Richard L. Scott Investments, LLC, a value-oriented, family investment office, focused on both public and private equity investments. Mr. Bazaar performs all elements of due diligence on perspective investment companies. From 1995 to July 1999, Mr. Bazaar was with Arthur Andersen LLP. At Arthur Andersen, he worked for both the Assurance and Financial Buyer's Practices and in his last position he served as a Supervisory Senior Consultant in their Business Fraud and Investigation Services Unit. Mr. Bazaar graduated from Bucknell University in 1992 with a degree in History, and he received a MBA from New York

University, Leonard N. Stern School of Business in 1997.

Board Committees and Meetings

During the fiscal year that ended on June 30, 2005, the Board of Directors held five meetings. During this period, all of the directors serving on the Board at the time attended or participated in more than 75% of the aggregate of the total number of meetings of the Board of Directors. The Audit Committee met four times in connection with fiscal year 2005.

We have an Audit Committee, which consists of the following members of the Board of Directors: Edwin Ruzinsky, Paul Baker and Alan Bazaar.

Mr. Ruzinsky and Mr. Bazaar are financial experts. The function of the Audit Committee includes reviewing internal financial information, monitoring cash flow, budget variances and credit arrangements, reviewing the audit program of Media Sciences, reviewing with Media Sciences independent accountants the results of all audits upon their completion, annually selecting and recommending independent accountants, overseeing the quarterly unaudited reporting process and taking such other action as may be necessary to assure the adequacy and integrity of all financial information distribution by Media Sciences. Each member of the Audit Committee is independent as defined under the American Stock Exchange's listing standards. The Audit Committee consists of non-employee directors whom Media Sciences has determined are free of any relationship that could influence their judgement as a committee member and are not associated with a major vendor to, or a customer of, Media Sciences.

53

We have a Compensation Committee, which has consisted of the following members of the Board of Directors: Paul Baker, Henry Royer and Alan Bazaar. The function of the Compensation Committee is to make determinations concerning salaries and incentive compensation for our officers and employees.

Members of the Audit Committee and Compensation Committee are selected each year by our Board of Directors after our annual stockholders meeting. Selection to a committee of the Board of Directors is determined by the majority vote of the Board of Directors. The Board of Directors intends to elect incumbent directors who are re-elected to the Board of Directors to continue to serve on the committees they presently serve.

We have adopted a Code of Ethics. Our Code of Ethics is available on our website at www.mediasciences.com.

We presently do not have a separate nominating committee of the Board of Directors for the selection of directors, and do not have a nominating committee charter. Presently, all such actions are performed by the entire Board of Directors.

Other Information About Directors

Other than Mr. Royer, who is a Board member of QCR Holdings, Inc., a reporting company, none of the directors are directors of other reporting companies. None of the directors are associated by family relationships, or have been involved in legal proceedings.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires Media Sciences' executive officers, directors, and persons who beneficially own more than ten percent of Media Sciences' common stock to file with the Securities and Exchange Commission initial reports of beneficial ownership and reports of changes in beneficial ownership of Media Sciences' common stock. Such persons are also required by Securities and Exchange Commission regulations to furnish Media Sciences with copies of all such Section 16(a) forms filed by such person. Based solely on a review of the copies of such reports furnished to Media Sciences during and in connection with Media Sciences' fiscal year ended 2005, Media Sciences is not aware of any material delinquencies in the filing of such reports, except as follows:

- o On January 21, 2005, Berthel SBIC LLC filed a Form 4 reporting late three transactions, the expiration of warrants in October 2004 and December 2004, and the acquisition of stock options in December 2004.
- o On March 4, 2005, Berthel SBIC LLC filed a late Form 4 reporting one transaction, the sale of common stock in February 2005.
- o On July 14, 2005, Duncan Huyler, a former officer, who resigned as of March 31, 2005, filed a Form 4 reporting late five transactions, the expiration of stock options on March 31, 2005, three exercises of stock options in April and May 2005, and a sale

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

in July 2005.

o On August 9, 2005, Donald Gunn filed a Form 4 reporting late one transaction, the expiration of warrants in December 2004.

54

ITEM 10. EXECUTIVE COMPENSATION

Summary Compensation Table

The table below sets forth information concerning the annual and long-term compensation during our last three fiscal years of our Chief Executive Officer and all of our other officers (Named Executive Officers).

Name and Principal Position	Year	Annual Compensation		Long Term Compensation	
		Salary	Bonus	Options/SARS (#)	Co
Michael W. Levin Chief Executive Officer and President	2005	\$200,000	\$ 0	0	
	2004	\$200,000	\$28,500	0	
	2003	\$150,000	\$15,000 (b)	500,000 (c)	
Frances Blanco Vice President and Treasurer and (former) Secretary	2005	\$130,000	\$25,000	0	
	2004	\$120,000	\$ 3,500	100,000 (d)	
	2003	\$100,000	\$15,000 (b)	25,000 (e)	
Larry Anderson Vice President	2005	\$ 13,333 (i)	\$25,000	100,000 (g)	
Duncan Huyler Former Vice President	2005	\$102,500 (j)	\$ 0	0	
	2004	\$120,000	\$ 6,000	100,000 (d)	
	2003	\$107,185	\$ 8,000 (b)	25,000 (e)	
Duncan Yates Former Vice President	2005	\$ 97,883 (k)	\$20,000	0	
	2004	\$130,000	\$11,000	0	
	2003	\$116,845	\$15,000 (b)	25,000 (e)	
Donald Gunn Vice President	2005	\$125,000	\$20,000	0	
	2004	\$100,000	\$20,607	0	
	2003	\$ 90,833	\$10,000	25,000 (e)	
Denise Hawkins Vice President Principal Financial Officer and Secretary	2005	\$ 68,890	\$ 5,000	20,000 (h)	
	2004	\$ 64,890	\$ 1,000	0	
	2003	\$ 51,731 (f)	\$ 0	0	

- (a) Refers to our matching contribution under our 401(k) plan, and premiums for life insurance where the beneficiary is not the company.
- (b) Refers to bonus compensation, including deferred bonus of \$15,000 for each of Levin, Blanco and Yates, and of \$8,000 for Huyler.
- (c) Refers to stock options granted in June 2003, pursuant to an employment agreement effective as of July 1, 2003. The stock options are exercisable at \$1.00 per share and expire in June 2008. Options to purchase 250,000 shares vested immediately and options to purchase an additional 250,000 shares vested ratably over the period July 1, 2003 through June 30, 2005. As of June 30, 2005, 500,000 options are vested.
- (d) On May 24, 2004, we issued to Frances Blanco and Duncan Huyler, stock options to purchase 100,000 shares of our common stock, of which 50,000 options vested on the grant date, and the remaining 50,000 options are subject to vesting over the period May 25, 2004 through May 24, 2006. The options are exercisable for ten years at \$1.06 per share. As of March 31, 2005, Mr. Huyler was vested with 50,000 options and the reminder was forfeited. As of June 30, 2005, Ms. Blanco is vested with 75,000 options.
- (e)

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

On April 7, 2003, we issued to each of Frances Blanco, Duncan Huyler, Duncan Yates and Donald Gunn, stock options to purchase 25,000 shares of common stock, exercisable until April 5, 2008 at \$0.50 per share. The stock options vested on April 6, 2004.

- (f) Became an officer on February 12, 2003. Her reported fiscal year 2003 compensation covers the full fiscal year.
- (g) On June 6, 2005, we issued to Larry Anderson, stock options to purchase 100,000 shares of our common stock, which vest ratably over five years. The options are exercisable until June 5, 2015 at \$1.60 per share.

55

- (h) On January 12, 2005, we issued Denise Hawkins, stock options to purchase 20,000 shares of our common stock, which vest equally over three years. The options are exercisable until January 11, 2015 at \$1.91 per share.
- (i) Became an officer on June 6, 2005. His reported fiscal 2005 compensation covers the period June 6, 2005 through June 30, 2005.
- (j) Ceased being an officer and an employee on March 31, 2005. His reported fiscal 2005 compensation covers the period July 1, 2004 through March 31, 2005.
- (k) Ceased being an officer and an employee on March 11, 2005. His reported fiscal 2005 compensation covers the period July 1, 2004 through March 11, 2005.

Stock Option Information

Option Grants in Fiscal 2005

The table below sets forth information concerning stock options granted during the fiscal year ended June 30, 2005 to the Named Executive Officers. The percentage of total stock options is based on 201,950 stock options granted to officers, directors, and employees during the 2005 fiscal year.

Name	Number of Securities Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise of Base Price (\$/Sh)	Expiration Date
Larry Anderson	100,000	50%	\$1.60	6-05-15
Denise Hawkins	20,000	10%	\$1.91	1-11-15

Option Exercises in Fiscal 2005 and Year End Option Values

The following table sets forth information concerning the value of unexercised stock options at June 30, 2005 for the Named Executive Officers. The dollar values of the options was determined by multiplying the number of stock options by the difference between the fair market value of a share of common stock underlying an option and the exercise price of the option. Out-of-the-money options are reported as having a dollar value of \$0. The last sale price of a share of our common stock on June 30, 2005 was \$1.73, as reported by AMEX.

Name	Number of Shares Acquired on Exercise	Value Realized	Number of Unexercised Securities Underlying Options at Fiscal Year End		Val In at
			Exercisable	Unexercisable	Exerci

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Michael W. Levin	0	0	500,000	0	\$ 36
Frances Blanco	0	0	107,471	25,000	\$ 8
Larry Anderson	0	0	0	100,000	\$
Donald Gunn	0	0	25,000	0	\$ 3
Denise Hawkins	0	0	10,002	20,000	\$

56

Director Compensation

We have a compensation plan for our independent directors. For the year ended June 30, 2004, eligible outside directors were paid \$5,000 per year, payable quarterly, for attendance at regular and special meetings. Effective July 1, 2005, eligible outside directors are paid \$10,000 per year, payable quarterly, for attendance at regular and special meetings and may be reimbursed for their reasonable out-of-pocket expenses incurred in connection with their attendance at meetings of the Board of Directors and for other expenses incurred in their capacity as directors of Media Sciences. Outside directors are granted five or ten year stock options under the incentive stock option plan to purchase 10,000 shares of common stock, exercisable at the fair market value on the date of appointment to the Board. Outside directors will also be granted, annually, additional stock options to purchase 10,000 shares of common stock.

Employment Agreement with Named Executive Officer

Michael W. Levin serves as our Chief Executive Officer and President pursuant to a five-year employment agreement that began as of July 1, 2003. His current annual salary for fiscal year 2006 is to be \$200,000. We granted him 500,000 five-year stock options to purchase 500,000 shares of common stock. The exercise price for the stock options is \$1.00 per share. Stock options to purchase 250,000 shares vested on the date of grant, additional stock options to purchase 125,000 shares vested on June 30, 2004, and the remaining stock options to purchase 125,000 shares vested on June 30, 2005. These stock options are cumulative and are subject to anti-dilution rights.

He is also entitled to receive:

- o death benefits of \$100,000;
- o a fifteen-year term life insurance policy for \$2,000,000;
- o a luxury automobile;
- o reimbursement for reasonable travel and other business related expenses;
- o six weeks vacation;
- o medical and dental insurance; and
- o participation in any employee plan, perquisite and other benefits made available to Media Sciences employees or management in general.

We may also award him an annual performance bonus or other bonus as determined by the Board of Directors.

If we undergo a change of control, we must pay him an amount equal to 290% of his base compensation. He has the right to terminate his employment if we undergo a change in control. As defined in his employment agreement, a change of control refers to:

- o a change in our ownership or management that is required to be reported under the federal securities laws;
- o the acquisition, other than directly from Media Sciences, of 25% or more of our common stock or our voting securities by persons other than Media Sciences or Levin;
- o a change in a majority of the current Board of Directors, excluding a Board approved change that does not result from a proxy contest;
- o a reorganization, merger, consolidation or sale of substantially all of our assets, after which our shareholders do not own, in the same proportion, more than 50% of the voting power, after which a majority of the board of directors changes, and after which a new shareholder beneficially owns 25% or more of the voting power; or
- o shareholder approval of our liquidation or dissolution.

The employment agreement provides for termination for cause.

57

Stock Option Plan

Under our incentive stock option plan for employees, which was adopted by our Board of Directors and approved by our shareholders in 1998, we reserved 500,000 shares of our common stock for issuance pursuant to exercises of incentive stock options. An incentive stock option entitles the holder to purchase a share of our common stock at a purchase price equal to the fair market value of the common stock on the day of grant. During the year ended June 30, 2005, 67,396 stock options granted under this stock option plan were exercised. As of June 30, 2005, we had outstanding stock options under the plan to purchase 361,543 shares of common stock, exercisable, subject to vesting, for ten years from the date of grant at prices of \$0.43 to \$4.00. If we undergo a change of control, the incentive based stock options shall vest immediately.

Employee Profit Sharing Plan

We have a tax-qualified employee paired profit sharing plan sponsored by Scudder Financial Services, Inc. This 401(k) plan covers all of our employees that have been employed for at least six months and meet other age and eligibility requirements. Under the 401(k) plan, employees may choose to reduce their current compensation by up to 15% each year and have that amount contributed to the 401(k) plan. We make matching contributions equal to 25% of the employee's contribution. In our discretion, we may contribute unmatched contributions. The 401(k) plan qualifies under Section 401 of the Internal Revenue Code, so that we can deduct contributions by employees or by us. Employee contributions to the 401(k) plan are fully vested at all times, and our contributions, if any, vest at the rate of 25% after two years and after two years at the rate of 25% a year until fully vested.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**Security Ownership of Certain Beneficial Owners**

The table below sets forth, as of August 17, 2005, the shares of our common stock beneficially owned by each person known to us to be the beneficial owner of more than five percent of our outstanding shares of common stock, except that the security ownership of management is provided in a separate table. This information was determined in accordance with Rule 13(d)-3 under the Securities Exchange Act of 1934, and is based upon the information provided by the persons listed below. As of August 17, 2005, we had 10,978,606 shares of common stock issued and outstanding.

All persons named in the table have the sole voting and dispositive power with respect to common stock beneficially owned. Beneficial ownership of shares of common stock that are acquirable within 60 days upon the exercise or conversion of stock options and warrants are listed separately. For each person named in the table, the calculation of percent of class gives effect to those acquirable shares.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Owner	Additional Shares Acquirable Within 60 days	Percent of Class
Berthel SBIC, LLC (a) 100 Second Street SE, Cedar Rapids, Iowa 52407	1,063,416	20,000 (c)	9.9%
Richard L. Scott (b) 100 First Stamford Place Stamford, Ct. 06902	1,829,750	15,000 (d)	16.8%
MicroCapital LLC (e) 201 Post Street, Suite 1001 San Francisco, CA 94108	964,900	0	8.8%

(a) The beneficial owners of Berthel SBIC are: Thomas J. Berthel, Chief Executive Officer and Chairman; Ronald O. Brendengen, Chief Financial Officer and Chief Operation Officer; Henry Royer, President; Leslie D. Smith, Secretary; and Julie K. Driscoll, Assistant Secretary.

(b)

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Holds the securities through different entities, including GFX Investments, LLC, for which he is the beneficial owner. Includes 6,000 shares purchased by the Frances Annette Scott Revocable Trust, of which his spouse is the trustee.

- (c) Refers to shares acquirable upon exercise of 10,000 options at \$3.13 per share which expire in December 2009, 5,000 options at \$2.19 per share which expire in July 2010, and 5,000 options at \$2.00 per share which expire in July 2011.

58

- (d) Refers to shares acquirable upon exercise of 10,000 options at \$1.69 per share which expire in June 2009, and 5,000 options at \$1.45 per share which expire in December 2009.
- (e) Holds the securities through different entities, including MicroCapital Fund LP and MicroCapital Fund Ltd.

Security Ownership of Management

The table below sets forth, as of August 17, 2005, the shares of our common stock beneficially owned by each of our officers and directors, and by all of our officers and directors as a group. This information was determined in accordance with Rule 13(d)-3 under the Securities Exchange Act of 1934, and is based upon the information provided by the persons listed below. As of August 17, 2005, we had 10,978,606 shares of common stock issued and outstanding.

All persons named in the table have the sole voting and dispositive power with respect to common stock beneficially owned. Beneficial ownership of shares of common stock that are acquirable within 60 days upon the exercise or conversion of stock options and warrants are listed separately. For each person named in the table, the calculation of percent of class gives effect to those acquirable shares.

The address of each of the persons named in the table is c/o Media Sciences International, Inc., 8 Allerman Road, Oakland, NJ 07463, unless otherwise indicated.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Owner	Additional Shares Acquirable Within 60 days	Perce of C
Michael W. Levin	1,418,450 (a)	500,000 (c)	17.
Frances Blanco	42,775 (b)	107,741 (d)	1.
Larry Anderson	0	0 (e)	
Denise Hawkins	500	10,002 (f)	0.
Paul Baker	67,500	105,500 (g)	1.
Edwin Ruzinsky	20,000	45,000 (h)	0.
Donald Gunn	25,000	25,000 (i)	0.
Henry Royer (j) c/o Berthel SBIC 100 Second Street SE Cedar Rapids, Iowa 52407	1,063,416	20,000 (k)	9.
Alan L. Bazaar (l) c/o Richard L. Scott Investments, LLC 100 First Stamford Place Stamford, CT 06902	1,829,750	15,000 (m)	16.
All present officers and directors as a group (9 persons)	4,467,391	829,613	48.

- (a) Includes 120,000 shares owned by his minor children.

- (b) Includes 2,000 shares owned by her husband.
- (c) Refers to shares acquirable upon exercise of 500,000 options at \$1.00 per share, which expire in June 2008.
- (d) Refers to shares acquirable upon exercise of 7,741 options at \$1.25 per share which expire in June 2008, 25,000 options at \$0.50 per share which expire in April 2008, and 75,000 options at \$1.06 per share, which expire in May 2014. Does not include an additional 25,000 options at \$1.06 per share, which vest in May 2006 and which expire in May 2014.
- (e) Refers to shares acquirable upon exercise of 1,370 options at \$1.60 per share which expire in June 2015. Does not include an additional 100,000 options at \$1.60 per share which vest ratably, on an annual basis, over the period July 1, 2005 through June 5, 2011 and which expire in June 2015.
- (f) Refers to shares acquirable upon exercise of 10,002 options at \$1.70 per share which expire in July 2011. Does not include 20,000 options at \$1.91 per share which vest equally on January 12, 2006, 2007 and 2008 and which expire in January 2015.
- (g) Refers to shares acquirable upon exercise of 3,000 options at \$2.00 per share which expire in August 2008, 30,000 options at \$3.31 per share which expire in April 2009, 5,000 options at \$2.19 per share which expire in July 2010, 5,000 options at \$2.00 per share which expire in July 2011, 5,000 options at \$0.65 per share which expire in September 2012, 10,000 options at \$0.43 per share which expire in May 2013, 5,000 options at \$1.45 per share which expire in December 2014 and 5,000 options at \$0.85 per share which expire in February 2014.

- (h) Refers to shares acquirable upon exercise of 10,000 options at \$2.06 per share which expire in August 2009, 5,000 options at \$2.19 per share which expire in July 2010, 5,000 options at \$2.00 per share which expire in July 2011, 5,000 options at \$0.65 per share which expire in September 2012, 10,000 options at \$0.43 per share which expire in May 2013, 5,000 options at \$1.45 per share which expire in December 2014 and 5,000 options at \$0.85 per share which expire in February 2014.
- (i) Refers to shares acquirable upon exercise of 25,000 options at \$0.50 per share which expire in April 2008. Does not include stock options to purchase up to 100,000 shares of our common stock, issued in August 2005, subject to future vesting.
- (j) For purposes of the table, Henry Royer's reported beneficial ownership refers to the beneficial ownership of Berthel SBIC.
- (k) Refers to shares acquirable upon exercise of 10,000 options at \$3.13 per share which expire in December 2009, 5,000 options at \$2.19 per share which expire in July 2010, and 5,000 options at \$2.00 per share which expire in July 2011.
- (l) For purposes of the table, Alan Bazaar's reported beneficial ownership refers to the beneficial ownership of Richard L. Scott Investments, LLC and its affiliates.
- (m) Refers to shares acquirable upon exercise of 10,000 options at \$1.69 per share which expire in June 2009, and 5,000 options at \$1.45 per share which expire in December 2009.

Changes in Control

We do not have any arrangements that may result in a change in control.

Securities Authorized for Issuance under Equity Compensation Plans

The following table set forth outstanding securities authorized for issuance under equity compensation plans as of June 30, 2005.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
-----	-----	-----	-----

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

Equity compensation plans approved by securities holders	1,011,543	\$1.26
Equity compensation plans not approved by security holders	300,000	1.20

Total	1,311,543	\$1.25

Plans in the Shareholder Approved Category

Under our incentive stock option plan for employees, directors and consultants, which was adopted by our Board of Directors and approved by our shareholders on August 10, 1998, we reserved 500,000 shares of our common stock for issuance pursuant to exercises of incentive stock options. An incentive stock option entitles the holder to purchase a share of our common stock at a purchase price equal to the fair market value of the common stock on the day of grant. As of June 30, 2005, we have outstanding incentive stock options to purchase 361,543 shares of common stock, exercisable, subject to vesting, for five or ten years from the date of grant, at prices of \$0.43 to \$4.00 per share.

On April 7, 2003, we issued to each of Frances Blanco and Donald Gunn, stock options to purchase 25,000 shares of common stock. The stock options vest on April 6, 2004 and are exercisable until April 5, 2008 at \$0.50 per share.

In June 2003, we issued to Michael Levin stock options to purchase up to 500,000 shares of common stock, exercisable at \$1.00 per share and expiring in June 2008.

On May 24, 2004, we issued to Frances Blanco, options to purchase 100,000 shares of our common stock, of which 50,000 options vested on the grant date, 25,000 and the remaining 50,000 options are subject to vesting over the period May 25, 2004 through May 24, 2006. The options are exercisable for ten years at \$1.06 per share. As of August 17, 2005, 75,000 options have vested.

Plans Not in the Shareholder Approved Category

On May 31, 2001, we issued warrants to purchase up to 200,000 shares of our common stock exercisable for five years at \$1.00 per share in consideration for consulting services. In July 2004, three warrant holders exercised their warrants to purchase an aggregate of 75,000 shares at \$1.00 per share.

On June 14, 2002, in connection with the issuance of short-term promissory notes, we issued warrants to purchase up to 87,500 shares of our common stock exercisable for five years at \$1.00 per share. In May 2005, one warrant holder exercised its warrants to purchase 12,500 shares at \$1.00 per share.

On June 6, 2005, we issued to Larry Anderson options to purchase 100,000 shares of our common stock, which vest ratably, on an annual basis, over the period June 6, 2005 through June 5, 2010. The options are exercisable for ten years at \$1.60 per share. As of August 17, 2005, no options had vested.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Between August 2000 and September 2003, we borrowed an aggregate of \$450,000 from Michael W. Levin, our President. The funds were used for general corporate purposes. The debt was structured through two notes payable. The first note, in the amount of \$255,000, bore an interest rate of 10% per annum and was payable in monthly installments of interest only through May 2004. The second note, in the amount of \$195,000, bore an interest rate of 20% per annum and was payable in monthly installments of interest only through May 2005. In January 2004, Mr. Levin, voluntarily reduced the interest rate on the loan due May 2005 to 10%. We repaid both loans in May and June 2004. There is no representation or assurance made that Mr. Levin will make any further loans to us.

The terms of loans from our officers, directors, and others having relationships with our officers and directors were determined by the Board of Directors in light of our financial condition, the terms of previous borrowings from such persons, and the terms on which short-term loans were available from public resources. The terms of these loans were deemed fair to the company and viewed as arm's length transactions. There are no

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

ongoing contractual or other commitments with any of these persons resulting from these transactions, and there is no representation or assurances made that any of these persons will make any further loans to us.

On June 5, 2003, we entered into eight, \$50,000 promissory notes, due on June 5, 2005 and carrying a 20% interest rate, to the eight individuals including Paul Baker who is a director of Media Sciences and Mitchell Baker who is the son of Paul Baker. These notes were unsecured. In June 2004, we repaid these notes after securing a one year, \$400,000 term loan from our bank, carrying an interest rate of the banks base rate plus 2%.

In December 2002, we entered into four, one-year notes aggregating \$100,000 and bearing simple interest of 20%, payable quarterly. In December 2003, we repaid the notes in full. Three of the note holders were persons who bear the following relationships with Media Sciences or with our officers and directors: Paul Levin is the father of Michael W. Levin, President and Chairman of Media Sciences; Frank and Edna Blanco are the parents of Frances Blanco, Vice President and a director of Media Sciences; and Mitchell Baker is the son of Paul Baker, a director of Media Sciences.

In October 2002, we borrowed \$100,000 at a 23% interest rate, with interest due monthly, from Paul Baker, a director of Media Sciences. This loan matured in, and was repaid in, October 2003.

In December 2002, we borrowed \$25,000 at a 23% interest rate, with interest due monthly, from Duncan Yates, a former officer. This loan matured in and was repaid in December 2003.

On May 24, 2004, we issued to each of Frances Blanco an officer and director, and Duncan Huyler, a former officer, stock options to purchase 100,000 shares of our common stock, of which 50,000 options vested on the grant date, and the remaining 50,000 options are subject to vesting over the period May 25, 2004 through May 24, 2006. The options are exercisable for ten years at \$1.06 per share. In May 2005, Duncan Huyler executed a cashless exercise of 50,000 options. The balance of Mr. Huyler's options were forfeited upon the termination of his employment.

On June 30, 2004, we sold 1,000,000 shares of common stock to GFX Investments, LLC, an entity controlled by Richard L. Scott, for \$1.25 million. In conjunction with the investment, we agreed to appoint a nominee of GFX Investments, Alan Bazaar, Vice President and Portfolio Manager for Richard L. Scott Investments, LLC, to our board of directors, and we granted Mr. Scott 10,000 stock options, exercisable at \$1.69 per share for five years in connection with Board of Directors services. At various times between March 17, 2004 and May 21, 2004, Mr. Scott, through entities controlled by him, purchased an aggregate of 823,750 shares in the open market, at prices of \$1.07 to \$1.36 per share, for an aggregate purchase price of \$982,513. On June 3, 2004, the Frances Annette Scott Revocable Trust, of which Mr. Scott's spouse is the trustee, purchased 6,000 shares in the open market for \$6,735.

62

On March 2, 2005, we sold an aggregate of 500,000 shares of our common stock at a price of \$2 per share to MicroCapital Fund LP and MicroCapital Fund Ltd. for aggregate gross proceeds of \$1 million. MicroCapital Fund LP purchased 375,000 shares and MicroCapital Fund Ltd. purchased 125,000 shares.

On June 6, 2005, we issued to Larry Anderson, an officer, stock options to purchase 100,000 shares of our common stock, which vest ratably, on an annual basis, over the period June 6, 2005 through June 5, 2010. The options are exercisable for ten years at \$1.60 per share.

On August 8, 2005, we issued to Donald Gunn, an officer, stock options to purchase up to 100,000 shares of our common stock. The options are subject to vesting, upon Gunn's relocation to corporate offices, as follows: 50,000 stock options on such date, and the other 50,000 stock options at the rate of 10,000 stock options per year for five years starting on the first anniversary of such date. The options are exercisable for ten years at \$1.65 per share.

ITEM 13. EXHIBITS

Exhibits required to be filed by Item 601 of Regulation S-B are included in Exhibits to this Report as follows:

<u>Exhibit</u>	<u>Description</u>
2	Agreement of Change in Corporate Structure (Incorporated by reference to Exhibit 2 of Quarterly Report on Form 10-QSB filed on May 15, 2002).

ITEM 13. EXHIBITS

64

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

- 3(i)(1) Certificate of Incorporation of Cadapult Graphic Systems, Inc., a Delaware corporation (Incorporated by reference to Exhibit 3.1 of Quarterly Report on Form 10-QSB/A filed on September 1, 1998).
- 3(i)(2) Certificate of Amendment of Certificate of Incorporation of Cadapult Graphic Systems, Inc. (Incorporated by reference to Exhibit 3(i)(5) of Annual Report on Form 10-KSB filed on September 28, 1999).
- 3(i)(3) Certificate of Incorporation of Media Sciences, Inc. (Incorporated by reference to Exhibit 3(i)(6) of Annual Report on Form 10-KSB filed on September 28, 1999).
- 3(i)(4) Certificate of Amendment of Certificate of Incorporation of Cadapult Graphic Systems, Inc. (Incorporated by reference to Exhibit 3(i)(1) of Quarterly Report on Form 10-QSB filed on May 15, 2002).
- 3(i)(5) Certificate of Incorporation of Cadapult Graphic Systems, Inc. (a New Jersey corporation) (Incorporated by reference to Exhibit 3(i)(2) of Quarterly Report on Form 10-QSB filed on May 15, 2002).
- 3(ii) By-Laws (Incorporated by reference to Exhibit 3.2 of Quarterly Report on Form 10-QSB/A filed on September 1, 1998).
- 4.1 Specimen of common stock certificate (Incorporated by reference to Exhibit 4.7 of Form 8-A filed on August 8, 2000).
- 4.2 Specimen of preferred stock certificate (Incorporated by reference to Exhibit 4.8 of Form 8-A filed on August 8, 2000).
- 4.3 1998 Incentive Plan (Incentive Stock Option Plan) (Incorporated by reference to Exhibit 4.1 of Annual Report on Form 10-KSB filed on September 28, 1999).
- 4.4 Certificate of Designation (Incorporated by reference to Exhibit 4.5 of Registration Statement on Form SB-2, Registration Number 333-91005, originally filed on November 15, 1999).
- 4.5 Form of Warrant Certificate for Purchasers of Units (Incorporated by reference to Exhibit 4.6 of Registration Statement on Form SB-2, Registration Number 333-91005, originally filed on November 15, 1999).
- 4.6 Certificate of Amendment of Certificate of Designation of Series A Preferred Stock (Incorporated by reference to Exhibit 3(i)(6) of Annual Report on Form 10-KSB filed on September 15, 2003).
- 4.7 Certificate of Amendment of Certificate of Designation of Series A Preferred Stock (Incorporated by reference to Exhibit 4.7 of Registration Statement on Form SB-2, Registration Number 333-112340, filed on January 30, 2004).

63

-
- 10.1 Lease Agreement (Incorporated by reference to Exhibit 10.13 of Annual Report on Form 10-KSB filed on or about September 28, 2000).
 - 10.2 Amended Employment Agreement of Duncan Huyler (Incorporated by reference to Exhibit 3.2 of Quarterly Report on Form 10-QSB filed on May 4, 1999).
 - 10.3 Amended Employment Agreement of Frances Blanco (Incorporated by reference to Exhibit 3.3 of Quarterly Report on Form 10-QSB filed on May 4, 1999).
 - 10.4 Agreement with Consonant Services Group (Incorporated by reference to Exhibit 10.6 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.5 Form of Warrant Agreement with Consonant Services Group (Incorporated by reference to Exhibit 10.11 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.6 Form of Amended Option Agreement with Frances Blanco (Incorporated by reference to Exhibit 10.8 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.7 Form of Amended Option Agreement with Duncan Huyler (Incorporated by reference to Exhibit 10.9 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.8 Form of Amended Option Agreement with Duncan Yates (Incorporated by reference to Exhibit 10.10 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.9 Form of Amended Option Agreement with Donald Gunn (Incorporated by reference to Exhibit 10.12 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.10 Form of Amended Option Agreement with Randy Hooker (Incorporated by reference to Exhibit 10.13 of Registration Statement on Form SB-2, Registration Number 333-83668, filed on March 4, 2002).
 - 10.11 Form of Promissory Note issued in June 2002 (Incorporated by reference to Exhibit 10.14 of Annual Report on Form 10-KSB filed on October 15, 2002).
 - 10.12 Form of Warrants issued in June 2002 (Incorporated by reference to Exhibit 10.14 of Annual Report on Form 10-KSB filed on October 15, 2002).
 - 10.13 Form of Employment Agreement with Michael W. Levin (Incorporated by reference to Exhibit 10.16 of Annual Report on Form 10-KSB filed on September 15, 2003).
 - 10.14 Form of Loan and Security Agreement (Incorporated by reference to Exhibit 10.17 of Annual Report on Form 10-KSB filed on September 15, 2003).
 - 10.15 Form of Option Agreement with Management issued April 2003 (Incorporated by reference to Exhibit 10.15 of Registration Statement on Form SB-2, Registration Number 333-112340, filed on January 30, 2004).

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

- 10.16 Option Agreement with Frances Blanco issued May 2004 (Incorporated by reference to Exhibit 10.16 of Registration Statement on Form SB-2, filed on July 30, 2004).
- 10.17 Option Agreement with Duncan Huyler issued May 2004 (Incorporated by reference to Exhibit 10.17 of Registration Statement on Form SB-2, filed on July 30, 2004).
- 10.18 First Amendment to Loan and Security Agreement, dated June 11, 2004 (Incorporated by reference to Exhibit 10.18 of Registration Statement on Form SB-2, filed on July 30, 2004).
- 10.19 Term Note, dated June 11, 2004 (Incorporated by reference to Exhibit 10.19 of Registration Statement on Form SB-2, filed on July 30, 2004).
- 10.20 Common Stock Purchase Agreement, dated June 30, 2004 (Incorporated by reference to Exhibit 10.20 of Registration Statement on Form SB-2, filed on July 30, 2004).
- 10.21 Registration Rights Agreement, dated June 30, 2004 (Incorporated by reference to Exhibit 10.21 of Registration Statement on Form SB-2, filed on July 30, 2004).

64

-
- 10.22 Loan Agreement with PNC Bank (Incorporated by reference to Exhibit 10 of Current Report on Form 8-K filed on December 20, 2004).
 - 10.23 Sublease Agreement (Incorporated by reference to Exhibit 10 of Current Report on Form 8-K filed on January 24, 2005).
 - 10.24 Term Note with PNC Bank, dated as of March 28, 2005 (Incorporated by reference to Exhibit 10.1 of Current Report on Form 8-K filed on April 4, 2005)
 - 10.25 Amendment to Loan Documents with PNC Bank, dated a of March 28, 2005 (Incorporated by reference to Exhibit 10.2 of Current Report on Form 8-K filed on April 4, 2005)
 - 10.26 Second Amendment to Loan Documents, June 2005 (Incorporated by reference to Exhibit 10.26 of Annual Report on Form 10-KSB filed on September 13, 2005)
 - 10.27 Master Lease Agreement, July 2005 (Incorporated by reference to Exhibit 10.27 of Annual Report on Form 10-KSB filed on September 13, 2005)
 - 10.28 Option Agreement with Larry Anderson, June 2005 (Incorporated by reference to Exhibit 10.28 of Annual Report on Form 10-KSB filed on September 13, 2005)
 - 10.29 Option Agreement with Donald Gunn, August 2005 (Incorporated by reference to Exhibit 10.29 of Annual Report on Form 10-KSB filed on September 13, 2005)
 - 11* Statement Concerning Computation of Per Share Earnings is hereby incorporated by reference to Financial Statements of Part II Item 7, contained in this Form 10-KSB.
 - 21 Subsidiaries of the Registrant (Incorporated by reference to Exhibit 21 of Registration Statement on Form SB-2, filed on July 30, 2004).
 - 23.1* Consent of J.H. Cohn LLP
 - 31.1* Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
 - 31.2* Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
 - 32.1* Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350
 - 32.2* Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350

* Filed herewith.

65

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Audit Fees

Fees for audit services provided by J.H. Cohn LLP, our current principal independent registered public accounting firm, during the years ended June 30, 2005 and 2004 were \$56,105 and \$11,315, respectively. Fees for audit services provided by Wiss & Company, LLP, our former principal accountant, during the year ended June 30, 2004 were \$11,710.

Audit services consisted primarily of the annual audits, review of our financial statements, services provided in connection with the restatement of our financial statements for the year ended June 30, 2004, and services that are normally provided by our accountants in connection with statutory and regulatory filings or engagements for those fiscal years.

Audit-Related Fees

Fees for audit-related services provided by J.H. Cohn LLP, our current principal independent registered public accounting firm, during the year ended June 30, 2005 were \$7,511. There were no fees billed for services reasonably related to the performance of the audit or review of our financial statements outside of those fees disclosed above under the caption Audit Fees for fiscal year ended June 30, 2004.

Audit-related fees consisted primarily of the review of financial statements for inclusion in registration statements filed by the Company.

Tax Fees

Fees for tax services provided by J.H. Cohn LLP, our current principal independent registered public accounting firm, during the years ended June 30, 2005 and 2004 were \$5,117 and \$1,172, respectively. Fees for tax services provided by Wiss & Company, LLP, our former principal accountant, during the year ended June 30, 2004 were \$7,895.

Tax services related primarily to the preparation of Company tax filings with regulatory agencies.

All Other Fees

There were no other fees billed for services.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MEDIA SCIENCES INTERNATIONAL, INC.

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

Dated: May 25, 2006

In accordance with the Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated:

SIGNATURES

TITLE

DATE

SIGNATURES

Edgar Filing: MEDIA SCIENCES INTERNATIONAL INC - Form 10KSB/A

<u>/s/ Michael W. Levin</u> Michael W. Levin	Chairman of the Board, President and Chief Executive Officer	May 25, 2006
<u>/s/ Kevan D. Bloomgren</u> Kevan D. Bloomgren	Chief Financial Officer	May 25, 2006
<u>/s/ Frances Blanco</u> Frances Blanco	Director and Vice President	May 25, 2006
<u>/s/ Paul C. Baker</u> Paul C. Baker	Director	May 25, 2006
<u>/s/ Edwin Ruzinsky</u> Edwin Ruzinsky	Director	May 25, 2006
<u>/s/ Henry Royer</u> Henry Royer	Director	May 25, 2006
<u>/s/ Alan L. Bazaar</u> Alan L. Bazaar	Director	May 25, 2006