IsoRay, Inc.
Form 10QSB/A
May 12, 2006

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

FORM 10-QSB/A

Amendment No. 1
Quarterly Report of Small Business Issuers under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended December 31, 2005

Commission File No. 000-14247

IsoRay, Inc.
(Exact name of registrant as specified in its charter)

Minnesota	41-1458152
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
350 Hills St., Suite 106 Richland, Washington	99354
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code:(509) 375-1202

The issuer has (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) been subject to such filing requirements for the past 90 days.
The registrant is not a shell company (as defined in Rule 12b-2 of the Exchange Act).

Number of shares outstanding of each of the issuer's classes of common equity:

Class	Outstanding as of May 10, 2006
Common stock, $0.001 par value	14,722,686

The issuer is not using the Transitional Small Business Disclosure format.

ISORAY, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

IsoRay, Inc. and Subsidiary
Consolidated Balance Sheets

	(Unaudited) December 31, 2005	June 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 648,684	$ 1,653,144
Accounts receivable, net	467,616	49,969
Inventory	156,019	81,926
Prepaid expenses	208,942	181,266
Total current assets	1,481,261	1,966,305
Fixed assets, net of accumulated depreciation and amortization	1,627,443	842,323
Other assets, net of accumulated amortization	754,305	793,756
Total assets	$ 3,863,009	$ 3,602,384
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 425,048	$ 695,588
Accrued payroll and related taxes	222,958	157,924
Accrued interest payable	83,390	41,325
Notes payable, due within one year	244,219	43,116
Capital lease obligations, due within one year	174,930	9,604
Total current liabilities	1,150,545	947,557
Notes payable, due after one year	531,194	562,224
Capital lease obligations, due after one year	295,874	19,584
Convertible debentures payable, due after one year	530,000	3,587,875
Total liabilities	2,507,613	5,117,240
Shareholders' equity:		
Preferred stock, $.001 par value; 6,000,000 shares authorized:		
Series A: 1,000,000 shares allocated; no shares issued and outstanding	-	-
Series B: 5,000,000 shares allocated; 292,328 and 1,588,589 issued and outstanding	292	1,589
Common stock, $.001 par value; 194,000,000 shares authorized; 13,383,139 and 7,317,073 shares issued	13,383	-

and outstanding				
Subscriptions receivable (Note 9)		(6,227,067)		7,317
Additional paid-in capital		16,835,833		3,804,369
Accumulated deficit		(9,267,045)		(5,328,131)
Total shareholders' equity		1,355,396		(1,514,856)
Total liabilities and shareholders' equity	$	3,863,009	$	3,602,384

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IsoRay, Inc and Subsidiary
Consolidated Statements of Operations
Three and Six Months Ended December 31, 2005 and 2004 (Unaudited)

	For the three months ended		For the six months ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
Product sales	$ 486,247	$ 24,170	$ 697,162	$ 24,170
Cost of product sales	916,274	387,051	1,636,440	387,051
Gross profit (loss)	(430,027)	(362,881)	(939,278)	(362,881)
Operating expenses:				
Research and development	96,837	12,516	122,619	28,031
Sales and marketing expenses	340,532	176,303	655,571	260,542
General and administrative expenses	675,444	414,639	1,636,393	1,005,209
Total operating expenses	1,112,813	603,458	2,414,583	1,293,782
Operating loss	(1,542,840)	(966,339)	(3,353,861)	(1,656,663)
Non-operating income (expense):				
Interest income	3,193	70	10,152	295
Financing expense	(195,480)	(11,964)	(351,108)	(20,789)
Loss on disposal of fixed assets	-	-	-	(52,319)
Debt conversion expense (Note 7)	(244,097)	-	(244,097)	-
Non-operating income (expense), net	(436,384)	(11,894)	(585,053)	(20,494)
Net loss	$ (1,979,224)	$ (978,233)	$ (3,938,914)	$ (1,677,157)
Net loss per weighted-average share of common stock	$ (0.17)	$ (0.17)	$ (0.36)	$ (0.27)
Basic weighted average shares outstanding	11,852,047	6,596,144	10,844,913	6,175,209

IsoRay, Inc. and Subsidiary
Consolidated Statements of Cash Flows
Six Months Ended December 31, 2005 and 2004 (Unaudited)

	For the six months ended December 31, 2005	December 31, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (3,938,914)	$ (1,623,385)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization of fixed assets	95,432	42,561
Amortization of deferred financing costs and other assets	103,546	5,285
Loss on disposal of fixed assets	-	52,319
Compensation recorded in connection with issuance of common stock	330,000	-
Rent expense paid by issuance of common stock	30,009	-
Repair and maintenance expense paid by issuance of common stock	14,752	-
Debt conversion expense (Note 7)	244,097	-
Changes in operating assets and liabilities:		
Accounts receivable, net	(417,647)	(12,912)
Inventory	(74,093)	(15,512)
Prepaid expenses	62,350	(162,725)
Accounts payable	(291,895)	35,602
Accrued payroll and related taxes	65,032	7,033
Accrued interest payable	42,065	(8,235)
Net cash used by operating activities	(3,735,266)	(1,679,969)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of fixed assets	(347,357)	(207,038)
Additions to other assets	(64,096)	(105,403)
Net cash used by investing activities	(411,453)	(312,441)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net advances on bank line of credit	200,000	100,000
Proceeds from issuance of notes payable	250,000	315,000
Proceeds from sales of convertible debentures payable	550,000	-
Principal payments on notes payable	(279,926)	(10,000)
Principal payments on capital lease obligations	(66,329)	-
Proceeds from cash sales of common stock, and LLC member shares, net of issuance costs	2,324,168	1,642,438
Proceeds from cash sales of common stock, pursuant to exercise of warrants	59,565	4,500
Proceeds from cash sales of common stock, pursuant to exercise of options	72,928	-
Payments to common shareholders in lieu of issuing fractional shares	(734)	-
Net cash provided by financing activities	3,109,672	2,051,938
Net increase (decrease) in cash and cash equivalents	(1,037,047)	59,527
Cash and cash equivalents, beginning of period	1,685,731	470,439
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 648,684	$ 529,966
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 205,497	$ 29,024

Non-cash investing and financing activities:

Exchange of convertible debentures payable for shares of common stock	$	3,607,875	$	-
Fixed assets acquired by capital lease obligations	$	507,947	$	-
Prepaid rent paid by issuance of common stock	$	90,026	$	-
Reversal of dividends payable to IsoRay Products LLC members	$	-	$	91,795

NOTE 1— ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization:
The accompanying consolidated financial statements are those of IsoRay, Inc. ("the Company"), formerly known as Century Park Pictures Corporation, and its subsidiary operating company, IsoRay Medical, Inc. ("IsoRay Medical"). Both companies are headquartered in Richland, Washington.

The accompanying consolidated financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto as of June 30, 2005, and for the nine months then ended, as contained in the Company's transitional report on Form 10-KSB, as amended, and with the audited financial statements of IsoRay Medical as of June 30, 2005 and 2004, and for the years then ended, filed on Form 8-K on November 3, 2005.

Segment Reporting and Major Customers:
IsoRay Medical operates in a single segment: isotope-based medical devices. IsoRay Medical began production and sales of its initial FDA approved product, the IsoRay ^{131}Cs brachytherapy seed, in October 2004 for the treatment of prostate cancer. Sales of the ^{131}Cs brachytherapy seed comprise all operating revenues of the combined companies. Two customers individually comprised more than 10% of product sales for the three month period ended December 31, 2005: Chicago Prostate Cancer Center and Community Hospital of Los Gatos.

Summary of Significant Accounting Policies:

Basis of presentation - The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect all normal recurring adjustments which, in the opinion of management of the Company, are necessary for a fair presentation of the results for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period.

The accompanying consolidated financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto as of June 30, 2005, and for the nine months then ended, as contained in the Company's transitional report on Form 10-KSB, as amended, and with the audited financial statements of IsoRay Medical as of June 30, 2005 and 2004, and for the years then ended, filed on Form 8-K on November 3, 2005.

Basis of consolidation - The accompanying unaudited consolidated financial statements reflect the balance sheets of IsoRay, Inc. and its subsidiary as of December 31, 2005, and the results of operation and statements of cash flows for the three and six months then ended net of all adjustments for inter-company transactions.

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company's 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 revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions and affect the amounts reported in the financial statements.

Cash and cash equivalents - Such assets consist of demand deposits, including interest-bearing money market accounts, held in one financial institution. These amounts are potentially subject to concentration of credit risk. The accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. At December 31, 2005, uninsured cash balances totaled $615,246.

Inventory - Inventory is reported at the lower of cost, determined using the weighted average method, or net realizable value.

Revenue recognition - The Company applies the provisions of SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition." SAB No. 104, which supersedes SAB No. 101, "Revenue Recognition in Financial Statements", provides guidance on the recognition, presentation and disclosure of revenue in financial statements. SAB No. 104 outlines the basic criteria that must be met to recognize revenue and provides guidance for the disclosure of revenue recognition policies. The Company recognizes revenue related to product sales when (i) persuasive evidence of an arrangement exists, (ii) shipment has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is reasonably assured.

Revenue for the three and six months ended December 31, 2005 was derived solely from sales of the ^{131}Cs brachytherapy seed, which is used in the treatment of cancer. The Company generally recognizes revenue once an order has been received and shipped to the customer. Prepayments, if any, received from customers prior to the time that products are shipped are recorded as deferred revenue. In these cases, when the related products are shipped, the amount recorded as deferred revenue is recognized as revenue. The Company accrues for sales returns and other allowances at the time of shipment.

Stock-based compensation - The Company currently provides stock-based compensation under two equity incentive plans approved by the Board of Directors on July 28, 2005: the Amended And Restated 2005 Employee Stock Option Plan, and the Amended and Restated 2005 Stock Option Plan. As of December 31, 2005, there were 2,817,774 options to purchase common stock outstanding, and 982,226 options remaining available for issuance under the Company's equity incentive plans. Under the terms of the two plans, stock option grants are required to be granted with an exercise price equal to the market value of the underlying Company common stock at the date of grant. Options granted expire ten years after the grant date, and have various vesting periods.

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* ("FAS 148"*)*, which amends Statement No. 123, *Accounting for Stock-Based Compensation* ("FAS 123"). FAS 148 requires companies to provide expanded footnote disclosures regarding stock-based expense, but still allows companies to retain the approach set forth in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), provided that expanded footnote disclosure is presented. As of December 31, 2005, the Company had not yet adopted the fair value method of accounting for stock-based compensation under SFAS No. 123, and accounts for stock-based compensation for employees under APB 25. No compensation expense was recognized in net earnings, as all options had an exercise price equal to, or above, the market value of the common stock on the date of grant. In accordance with SFAS No. 148, the following table presents the effect on net earnings and net earnings per share had compensation cost of the Company's stock plans been determined consistent with fair valuation rather than intrinsic valuation:

	For the three months ended		For the six months ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
Net loss, as reported	$ (1,979,224)	$ (978,233)	$ (3,938,914)	$ (1,623,385)
Less: Stock-based compensation expense determined under fair value method for all stock options, net of related tax benefit	$ (3,254)	$ -	(159,254)	$ -
Profoma net loss	$ (1,982,478)	$ (978,233)	$ (4,098,168)	$ (1,623,385)
Basic net loss per common share:				
As reported	$ (0.17)	$ (0.15)	$ (0.36)	$ (0.26)

Proforma	$ (0.17)	$ (0.15)	$ (0.38)	$ (0.26)

Income tax - Deferred taxes are provided, when material, on a liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. There were no material temporary differences for the periods presented. Deferred tax assets, subject to a valuation allowance, are recognized for future benefits of net operating losses being carried forward.

Earnings per share - Statement of Financial Accounting Standards No. 128, "Earnings per Share," requires dual presentation of basic earnings per share ("EPS") and diluted EPS on the face of all income statements issued after December 15, 1997 for all entities with complex capital structures. Basic EPS is computed as net loss divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options, warrants, and other convertible securities. For the periods ended December 31, 2005 and 2004, the effect of the Company's outstanding options and common stock equivalents would have been anti-dilutive. Accordingly, only basic EPS is presented, and is computed on the basis of the weighted-average number of common shares outstanding during the period presented. At December 31, 2005, the Company had 292,329 shares of preferred stock which are exchangeable, on a one-to-one basis, with common stock; debentures which could be converted into 127,711 shares of common stock; options and warrants to purchase 4,615,801 shares of common stock; and warrants to purchase 77,138 shares of preferred stock (which could be exchanged to common stock) issued and outstanding. If the Company had been profitable as of the end of the period, these 5,112,979 shares of common stock that are issuable upon conversion, exercise or exchange of the debentures, options, warrants, and preferred stock would have been included in a separate calculation for diluted EPS.

NOTE 2 — RELATED-PARTY TRANSACTIONS:

On July 28, 2005, the Board of Directors granted 100,000 options to purchase common stock to each of its three independent Directors: Thomas Lavoy, Stephen Boatwright, and Robert Kauffman. The requisite Form 4 has been filed with the SEC for each grantee. Additionally, the Board voted to compensate each of the independent Directors $1,000 per meeting for their attendance at the Board meetings. Directors who are also serving as management of the Company were not granted stock options for Director service, and will not be paid for attendance at Board meetings.

Mr. Boatwright is a member of Keller Rohrback, PLC, which provides legal services to the Company and IsoRay Medical. During the three and six months ended December 31, 2005, IsoRay Medical paid Keller Rohrback, PLC approximately $97,800, and $238,400 for legal services, respectively.

NOTE 3 - INCOME TAX:

As of December 31, 2005, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. Due to the provisions of Internal Revenue Code Section 338, the Company may have limited net operating loss carryforwards available to offset financial statement or tax return taxable income in future periods as a result of the July 28, 2005 merger which involved a change in control of more than 50 percentage points of the issued and outstanding securities of the Company.

NOTE 4 - GOING CONCERN:

The financial statements have been prepared assuming that the Company will continue as a going concern. Certain conditions indicate substantial doubt that the Company will continue as a going concern. These conditions include the Company's cash balance of $648,684 at December 31, 2005, coupled with its cash expenditure rate of approximately $620,000 per month, excluding capital items that have recently been approximately $70,000 per month. Management has implemented plans to obtain additional cash for the Company (see Notes 8 and 9). However, there is no assurance these plans will be successful in providing the Company with the cash it needs on a timely basis through the end of the current fiscal year. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

NOTE 5 -AMENDMENT OF PRIOR FILINGS:

On March 24, 2006 the Audit Committee of the Company, following discussions with representatives of the Company's independent registered public accounting firm and in response to comments received from the Securities and Exchange Commission (the "SEC") determined that the previously filed consolidated financial statements of the Company as of and for the nine months ended June 30, 2005 and the years ended September 30, 2004 and 2003 need to be restated, and the consolidated financial statements of the Company as of, and for the three months ended December 31, 2003, the three and six months ended March 31, 2004, the three and nine months ended June 30, 2004, the three months ended December 31, 2004, and the three and six months ended March 31, 2005 previously filed on form 10-QSB will also need to be restated.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 1485 Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections ("FAS 145"). FAS 145 amended APB Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions ("APB 30"), by deleting the phrase, "(1) Classifications of gains or losses from extinguishment of debt pursuant to paragraph 8 of FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt." In deleting this phrase, the FASB obviated the customary classification of material aggregations of extinguishment of debt as extraordinary items. However paragraph four of the FAS 145 Summary, leaves open the possibility of classifying the extinguishment of debt as an extraordinary item if these items meet the criteria in APB Option 30.

During the three month period ended December, 2003 the Company was in the process of converting all outstanding debt into shares of the Company's common stock, and had continually attempted to contact specific noteholders. These specific noteholders were unresponsive to the Company's inquiries related to the conversion of the debts into common stock, as discussed in detail in the Company's contemporaneously filed financial statements, and the Board, relying on legal counsel, at the time, acted to create a "technical forgiveness" of the notes and accrued interest. It was the then-management's position and interpretation, after reviewing the requirements of both APB 30 and FAS 145 that the failure to timely convert or post a timely claim for repayment by these specific noteholders, with concurrence of the Company's then-legal counsel, and auditor, met both of the required criteria of "unusual nature" (it is extraordinary that a note holder would not respond to numerous requests to change the nature of an investment), and "infrequency of occurrence" (as no similar event had occurred previously, and none has occurred subsequently) and should be stated as an "extraordinary item."

The SEC staff has taken recent exception to former management's interpretation, and requested reclassification of this item from "extraordinary item" to a component of operating income, and the Company is complying with that request. The change in treatment of the note cancellation has no impact on the Company's net income as previously reported.

The 10-QSB report for the three month period ended March 31, 2005 contained an overstatement of net income. The overstatement was caused by an expense reversal of $304,500 of officer compensation, the actual amount forgiven by the Company's CEO during the three month period ended March 31, 2005. Although this amount was forgiven, the expense should not have been reversed. Actual net loss for the three month period was ($6,034). This expense reversal caused additional paid-in capital and accumulated deficit to be overstated by $304,500 for all financial periods, until the Company's balance sheet was recapitalized by the accounting adjustments made pursuant to the merger with IsoRay Medical, Inc. This error was carried through the Form 10-KSB filing for the transitional nine month period ended June 30, 2005, but was corrected by an amended 10-KSB filing on May 9, 2006.

This consolidated financial report as of, and for the three and six months ended December 31, 2005 replaces the previous report filed on Form 10-QSB on February 17, 2006. The Company previously used the historical financial statements of IsoRay, Inc. (formerly Century Park Pictures Corporation) to compare to the current financial statements. The SEC requested these comparative historical statements be replaced by historical statements of IsoRay Medical, Inc., the accounting acquirer to the merger between IsoRay, Inc. and IsoRay Medical, Inc., completed on July 28, 2005. No changes are made to the balance sheet of December 31, 2005 or the statements of operations and cash flows for the three and six months then ended. Only the comparative historical information has changed, and as appropriate, changes were made in the Management's Discussion and Analysis of Financial Condition and Results of Operations as they make comparisons to the newly replaced historical financial statements.

NOTE 6 - CONTINGENCIES:

On December 14, 2005, the Company entered into an Economic Development Agreement ("Agreement") with the Pocatello Development Authority ("PDA"), an urban renewal agency formed under the laws of the State of Idaho. Pursuant to the Agreement, the PDA has provided the Company with $200,000 of funding, to be used for costs associated with testing of production methods for Cesium-131 at Idaho's Advanced Test Reactor. This agreement stipulates that, pending successful test outcomes, and approval for reactor use, the Company will attempt to construct a manufacturing facility within the city limits of Pocatello so that operations begin no later than January 1, 2008. If the Company elects not to build the manufacturing facility, it will be required to repay the $200,000 funding plus 5% interest from the date of disbursement, within 30 days demand from the PDA.

NOTE 7 - INDUCEMENT TO CONVERT DEBENTURES:

On December 13, 2005, the Board of Directors announced a short-term conversion inducement to current holders of IsoRay Medical, Inc. convertible debentures, originally issued in conjunction with the January 31, 2005 Private Placement Offering. Holders were permitted two conversion options: 1) convert under the original terms of the debenture to the Company's common stock at a $4.15 conversion price, and register the newly issued shares in the Form SB-2 Registration Statement filed with the SEC on November 10, 2005, or 2) convert under terms essentially identical to those offered to purchasers of Units in the Offering of October 17, 2005: a $4.00 conversion price and one callable warrant to purchase one share of the Company's common stock at an exercise price of $6.00 per share for each share issued upon conversion (waiving registration rights for approximately one year). As of December 31, 2005, holders of $2,562,876 of debentures had converted to common stock of the Company responding to the inducement of the second exercise method described above. As of December 31, 2005, the Company had issued 640,719 shares of common stock (including approximately 23,160 incremental shares not previously available to holders of debentures under the original terms), and 640,719 warrants to purchase shares of common, exercisable at $6.00 per share. The Company recognized $244,097 in non-cash short-term inducement expense, in accordance with FASB Statement of Financial Accounting Standards No. 84.

NOTE 8 -SUBSCRIPTIONS RECEIVABLE:

On December 7, 2005, the Company entered into a SICAV ONE Securities Purchase Agreement and a SICAV TWO Securities Purchase Agreement (collectively, the "Purchase Agreements") with Mercatus & Partners, Limited, a United Kingdom private limited company ("Mercatus"). Pursuant to the Purchase Agreements, Mercatus has agreed, subject to receipt of sufficient funding, to purchase 1,778,146 shares of the Registrant's common stock at a purchase price of $3.502 per share. In the event sufficient funding is not received to enable Mercatus to purchase the shares within thirty days (which was extended through Friday, February 17, 2006, and may be further extended by management) from the date of delivery of the share certificates to the custodial bank, the share certificates will be returned to the Company and each party will have no further obligations under the Purchase Agreements. As of May 10, 2006 no funding had been received by the Company.

As part of the Purchase Agreements, the Company has agreed to amend, within sixty days of the date of the Purchase Agreements (this date has also been extended), its Registration Statement on Form SB-2, filed with the Securities and Exchange Commission on November 10, 2005, to provide for registration of the shares being purchased by Mercatus.

NOTE 9 - SUBSEQUENT EVENTS:

Closure of October 17, 2005 Offering - On January 30, 2006 the Company closed an offering of Investment Units ("Units") for sale, pursuant to a Private Placement Offering (the "Offering") of October 17, 2005. The Offering consisted of a maximum of 200 Units, each Unit consisting of 5,000 shares of common stock and a warrant to purchase 5,000 shares of common stock at an exercise price of $6.00 per share. This maximum was increased, pursuant to the terms of the Offering, at the sole discretion of the Company, to a maximum of 300 Units. The Units were sold for $20,000 per Unit. The $6,000,000 maximum amount was fully subscribed as of January 30.

Commencement of February 1, 2006 New Offering - On February 1, 2006 the Company commenced an offering of Investment Units ("Units") for sale, pursuant to a Private Placement Offering (the "New Offering") of February 1, 2006. The New Offering consists of a maximum of 89 Units, each Unit consisting of 5,000 shares of common stock and a warrant to purchase 5,000 shares of common stock at an exercise price of $6.50 per share. This maximum may be increased at the sole discretion of the Company, to a maximum of 178 Units. The Units are being sold for $22,500 per Unit. As of February 28, 2006, approximately $1.21 Million had been raised under the New Offering.

Continuing conversion of debentures - As of February 10, 2006, two additional convertible debenture holders converted under the short-term inducement method provided by the Board of Directors on December 13, 2005. This brought the total debentures converted to $3,682,875, leaving $455,000 of the original debentures. As of February 10, 2006, the Company had issued 911,276 shares of common stock to all converting debenture holders, including those who chose the short-term inducement method, and those electing to convert under the original terms. As of February 10, 2006 the Company had issued approximately 23,840 incremental shares under the short-term inducement method not previously available to holders of debentures under the original terms.

Temporary ordering disruption by primary customer - On January 5, 2006, IsoRay Medical was notified by one of its primary customers, Chicago Prostate Cancer Center (CPCC), that it would no longer accept ^{131}Cs products from the radiopharmacy exclusively used by IsoRay Medical at that time due to quality control concerns. The role of the radiopharmacy is to provide third party assay, preloading, and sterilization of the ^{131}Cs seeds which are then shipped directly to customers for use in patient implants. IsoRay immediately began negotiations with Advanced Care Medical, Inc. ("ACM"), an approved CPCC supplier, and expects to execute a contract with ACM for radiopharmacy services using our ^{131}Cs seed. IsoRay anticipates CPCC will resume ordering and using our ^{131}Cs seed product as soon as ACM receives an amendment to its radioactive materials license to process products containing the ^{131}Cs isotope. Although this temporary suspension of seed orders by CPCC has had a negative impact on revenue in the near term, the Company's management believes any long-term impact will be non-material.

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

IsoRay, Inc. (formerly known as Century Park Pictures Corporation; the "Company" or "IsoRay") is a medical technology company focusing on innovative treatments for prostate cancer and other solid cancer tumors, with a goal of improved patient outcomes. Our wholly-owned subsidiary, IsoRay Medical, Inc., a Delaware corporation ("IsoRay Medical"), began selling its initial product, the Food and Drug Administration approved IsoRay Cesium-131 brachytherapy seed (the "IsoRay^{131}Cs seed"), in October 2004 for the treatment of prostate cancer. Our management believes that the clinical benefits of using Cesium-131 will enable us to capture market share within the existing brachytherapy market, which uses Palladium-103 and Iodine-125. We are also in the process of developing a second product, Yttrium-90, which is a radioisotope that is already in use for the treatment of certain forms of metastasized, or "spread throughout the body," cancers.

The physical characteristics of the Cesium-131 (Cs-131 or ^{131}Cs) isotope are expected to decrease radiation exposure to the patient and reduce the severity and duration of side effects, while treating cancer cells as effectively, if not more so than other isotopes used in seed brachytherapy. Cesium-131 could also enable meaningful penetration in other solid tumor applications such as breast, lung, liver, brain and pancreatic cancer, expanding the total available market opportunity. The second radioisotope, Yttrium-90 (Y-90 or ^{90}Y), is currently being used in the treatment of non-Hodgkin's lymphoma and is in clinical trials for other applications, including brachytherapy. Other manufacturers have received FDA approval for ^{90}Y and IsoRay Medical believes production will not require clinical trials or an extensive FDA application process. Production is expected to begin in 2006.

Brachytherapy seeds are small devices used in an internal radiation therapy procedure. In recent years the procedure has become one of the primary treatments for prostate cancer and is now used more often than surgical removal of the prostate. The brachytherapy procedure places radioactive seeds as close as possible to (in or near) the cancer tumor (the word "brachytherapy" means close therapy). The seeds deliver therapeutic radiation by killing the tumor cells and cells located in the immediate vicinity of the tumor while minimizing exposure to adjacent healthy tissue. This allows doctors to administer a higher radioisotope sealed within a welded titanium capsule. Approximately 85 to 135 seeds are permanently implanted in the prostate in a 45-minute outpatient procedure. The isotope decays over time and the seeds become inert. The seeds may be used as a primary treatment or, in conjunction with other treatment modalities such as external beam radiation therapy, chemotherapy, or as treatment for residual disease after excision of primary tumors.

Management believes that the IsoRay ^{131}Cs seed represents the first major advancement in brachytherapy technology in over 18 years with attributes that could make it the long term "seed of choice" for internal radiation procedures. The ^{131}Cs seed has FDA approval for treatment of malignant disease (e.g. cancers of the head and neck, brain, liver, lung, breast, prostate, etc.) and may be used in surface, interstitial, and intracavity applications for tumors with known radiosensitivity.

IsoRay was incorporated under Minnesota law in 1983 as Century Park Pictures Corporation. Since 1998 and until our recent merger with IsoRay Medical, we had no significant operations. On July 28, 2005, our subsidiary, Century Park Transitory Subsidiary, Inc. merged into IsoRay Medical, Inc., making IsoRay Medical our wholly-owned subsidiary.

Results of Operations.

Three and six month periods ended December 31, 2005 and 2004.

Revenues. During the three month period ended December 31, 2005, the Company generated $486,247 in sales of its ^{131}Cs seed. This represents an increase of $462,077 over sales in the three months ended December 31, 2004 of $24,170. Sales for the six month period ended December 31, 2005 were $697,162 an increase of $672,992 over sales

in the six month period ended December 31, 2004. IsoRay Medical began sales of its ^{131}Cs seed on October 26, 2004 with one medical center customer. By December 31, 2005 the number of medical center customers who have ordered the ^{131}Cs seed had grown to seventeen.

On January 5, 2006, IsoRay Medical was notified by one of its primary customers, Chicago Prostate Cancer Center ("CPCC"), that it would no longer accept ^{131}Cs products from the radiopharmacy exclusively used by IsoRay Medical at that time due to quality control concerns. The role of the radiopharmacy is to provide third party assay, preloading, and sterilization of the ^{131}Cs seeds which are then shipped directly to customers for use in patient implants. IsoRay immediately began negotiations with Advanced Care Medical, Inc. ("ACM"), an approved CPCC supplier, and expects to execute a contract with ACM for radiopharmacy services using our ^{131}Cs seed. IsoRay anticipates CPCC will resume ordering and using our ^{131}Cs seed product as soon as ACM receives an amendment to its radioactive materials license to process products containing the ^{131}Cs isotope. Although this temporary suspension of seed orders by CPCC has had a negative impact on revenue in the near term, the Company's management believes any long-term impact will be non-material.

Gross loss. Gross loss was $430,027 for the three month period ended December 31, 2005. This represents an increased loss of $67,146 or 19% over the three month period ended December 31, 2004. Gross loss was $939,278 for the six month period ended December 31, 2005 which represents an increased loss of $579,397 compared to the six month period ended December 31, 2004. Cost of products sold was $916,274 for the three month period and $1,636,440 for the six month period ended December 31, 2005. During the three months ended December 31, 2005, approximately $356,000 was paid to Pacific Northwest National Laboratory (PNNL) under our contract with them for use of their facilities and personnel to support production. In the three month period ended December 31, 2005, we spent in excess of $109,000 for production materials and small tools, none of which individually exceeded the $2,500 threshold we use in determining whether to capitalize production equipment. These materials and small tools were needed to commence production in our independent production facility, the PEcoS-IsoRay Radioisotope Laboratory ("PIRL"). Most are long-lived items, and will not need replacing in the current fiscal year. According to plan, during the quarter ended December 31, 2005 we moved essentially all Cs-131 production operations to PIRL. We will continue to use the PNNL facility only for certain research and development and quality assurance activities, but in the next quarter, we expect to substantially reduce the PNNL expense.

Research and development. Research and development expenses for the three month period ended December 31, 2005 were $96,837. This represents an increased expenditure of $84,321, or a 674% increase over the expense of $12,516 for the three month period ended December 31, 2004. Research and development expenses for the six month period ended December 31, 2005 were $122,619, an increase of $94,588 or 337% over the six month period ended December 31, 2004 expense of $28,031. Of these amounts, $82,500 was paid in conjunction with the ongoing protocol study on the results of 100 patients who have recently been implanted with the Company's ^{131}Cs brachytherapy seed.

Sales and marketing expenses. Sales and marketing expenses were $340,532 for the three month period ended December 31, 2005. This represents an increase of $164,229 or 93% compared to the three months ended December 31, 2004's expenditure of $176,303 for sales and marketing. Of this amount, approximately $236,000 was paid for wages, including payroll-related taxes, travel, office and other support expenses on behalf of our sales and marketing and customer service staff. The balance was spent on advertising, market research, and trade shows and conferences. Sales and marketing expense for the six month period ended December 31, 2005 was $655,571, which was an increase of $330,029 or 101% over the six month period ended December 31, 2004. These increased expenses are generally due to marketing the Company's ^{131}Cs seed which was only introduced to the market in October 2004.

General and administrative expenses. General and administrative expenses for the three month period ended December 31, 2005 amounted to $675,444. This represents an increase of $260,805 or 63% in comparison to the three months ended December 31, 2004 expense of $414,639. Approximately $199,040 was paid in wages and related benefits and taxes during the period. Legal expenses were $104,110 for the period. General and administrative expenses for the six month period ended December 31, 2005 amounted to $1,636,393 an increase of $802,275 or 96% over the six month period ended December 31, 2004.

Operating (loss). Due to our significant research and development expenditures, additional responsibilities as a reporting company, rapid structural growth, and nominal product revenues, we have not been profitable, and have generated operating losses since our inception. In the three month period ended December 31, 2005, the Company had an operating loss of $1,542,840. This represents an increased loss of $576,501 or 60%, in comparison with the three months ended December 31, 2004 operating loss of $966,339. The operating loss for the six month period ended December 31, 2005 was $3,353,861, which is an increased loss of $1,803,289 over the six month period ended December 31, 2004.

Non-operating income (expense). Total non-operating income (expense) was $(436,384) for the three month period ended December 31, 2005. This represents an increase in net expense of $424,490 over the three month period ended December 31, 2004 non-operating income (expense) of $(11,894). Total non-operating income (expense) for the six month period ended December 31, 2005 was $(585,053) which represents an increased expense of $512,240 over the six month periods ended December 31, 2004. This increase in non-operating income (expense) was largely due to the one-time recognition of $244,097 expense in short-term inducement to convert debentures (see Note 7) and an increase in financing expense. The Company earned $3,193 interest income on funds held in certain near-liquid accounts. This was $3,123 greater than the three month period ended December 31, 2004's interest income of $70. During the three months ended December 31, 2005, financing expense was $195,480, or an increased expense of $183,516 over the three month period ended December 31, 2004 financing expense of $11,964. Of this amount, $143,706 was paid as interest on loans, notes and convertible debentures outstanding. The balance of the financing expense was amortization of prepaid financing expense, primarily the January 2005 issuance of common stock to guarantors of certain loans made to the Company, and commissions and legal costs paid in conjunction with the issuance of convertible debentures.

Liquidity and capital resources. At December 31, 2005, cash and cash equivalents amounted to $648,684. During the three months ended December 31, 2005, the Company issued 645,500 shares of common stock and granted warrants to purchase 645,500 shares of common stock pursuant to the October 17, 2005 Offering. This issuance of common stock provided the Company $2,324,168, in cash, net of legal costs and commissions paid pursuant to the October 17, 2005 Offering. Additionally, the Company issued 5,488 shares of common stock pursuant to the exercise of options to purchase common stock, and options to purchase preferred stock, which were exchanged for common stock immediately upon exercise. This exercise of options provided the Company with $5,009. Also during the three months ended December 31, 2005, the Company issued 10,000 shares of common stock in exchange for $40,000 of production equipment repair and maintenance, certain capital production equipment, and consulting, and 24,007 shares of common stock in exchange for one year's lease of the PIRL facility.

On January 30, 2006, IsoRay closed a round of private financing under its October 17, 2005 private placement memorandum, as amended, which was fully sold at $6 million. In February 2006, IsoRay commenced a new round of private financing under its February 1, 2006 private placement memorandum, and had raised approximately $1.21 million under that offering as of February 10, 2006.

The Company had approximately $3.7 million cash on hand as of February 10, 2006**.** As of that date the Company's monthly required cash operating expenditures were approximately $620,000, and capital expenditures were approximately $70,000. Equipment installed at our facility includes a hot cell, a glove box, three fume-hoods, laser welders and laser welding tooling, which complete the laser sealing of the seeds; sophisticated testing equipment that allows us to test materials used at several stages of the production process and assay the completed seeds prior to shipment; and sterilizing and packaging systems that allow the seeds to be pre-loaded into delivery systems according to customer specifications. We believe we will need to add to the capital production equipment installed at this facility within the next six to twelve months to meet increasing demand for our product, and have adequate room at the facility to install equipment that would approximately double the production capacity up to 60,000 seeds per month; approximately 600 patient treatments. As of February 10, 2006, management believes that assuming expenditures continue at approximately the same monthly rate that the Company's cash on hand would fund operating expenditures through the beginning of August 2006.

On December 7, 2005, the Company entered into a SICAV ONE Securities Purchase Agreement and a SICAV TWO Securities Purchase Agreement (collectively, the “Purchase Agreements”) with Mercatus & Partners, Limited, a United Kingdom private limited company (“Mercatus”). Pursuant to the Purchase Agreement, Mercatus has agreed, subject to receipt of sufficient funding, to purchase 1,778,146 shares of the Company’s common stock at a purchase price of $3.502 per share, or an aggregate payment of $6,227,067. In the event Mercatus does not purchase the shares, the share certificates will be returned to the Company and each party will have no further obligations under the Purchase Agreements. To date no funding has been received by the Company and there can be no assurance that any funding will be received as the funding is contingent upon factors outside of the Company’s control.

Our growth plan for 2006 includes expanding sales to existing customers, continuing a trend that has improved in the second quarter of FY 2006; discontinuing production efforts at Pacific Northwest National Laboratory, which should decrease operating costs; enhancing efforts to reduce internal production costs; and expanding the base of suppliers of direct materials and value added services to direct materials.

On February 2, 2006, IsoRay signed a definitive license agreement with International Brachytherapy s.a. ("IBt") covering North America and providing IsoRay with access to IBt's Ink Jet production process and its proprietary polymer seed technology for use in brachytherapy procedures using Cesium-131. IsoRay intends to apply for FDA approval for the use of IBt's proprietary technology in tandem with IsoRay's Cesium-131 proprietary technology following completion of initial milestones designed to determine whether the two technologies are compatible. This agreement will require a cash outlay of approximately $225,000 in March 2006.

IsoRay Medical has four outstanding loans. The first, from Tri-City Industrial Development Council, with an original principal amount of $40,000, was funded in 2001 and requires a final principal only payment of $10,000 in August 2006. It is non-interest bearing and unsecured. The second loan is from the Benton-Franklin Economic Development District in an original principal amount of $230,000 and was funded in December 2004. It bears interest at eight percent and has a sixty month term with a final balloon payment. As of December 31, 2005, the principal balance owed was $212,893. This loan is secured by certain equipment, materials and inventory of IsoRay Medical, and also required personal guarantees, for which the guarantors were issued approximately 70,455 shares of our common stock. The third loan is a line of credit from Columbia River Bank, which provides credit in the amount of $395,000. It bears interest at a floating prime plus two percent rate, and is secured by certain accounts receivable and inventory and personal guarantees, for which the guarantors were issued approximately 107,401 shares of our common stock. As of December 31, 2005, $200,000 was owed on the line of credit. The fourth loan is with Columbia River Bank in the amount of $150,000, of which $50,000 was funded as of October 31, 2005. This loan is to be used for equipment purchases only and is secured by the equipment purchased with the borrowed funds. It bears interest at seven percent for thirty-six months. As of December 31, 2005, the principal balance owed was approximately $36,156.

The BFEDD has granted IsoRay Medical a waiver from enforcing violations of paying officers in excess of $100,000 per year and maintaining a certain current asset ratio. The waiver, effective from March 31, 2005 through June 30, 2006, also excuses non-compliance with covenants prohibiting fixed asset or lease obligations in excess of $24,000 per year, covenants prohibiting mergers, and covenants requiring maintenance of a certain long-term debt to equity ratio. However, IsoRay Medical is currently in default of a covenant requiring that it pay no greater than forty-five thousand dollars ($45,000) annually for lease payments during the life of the loan. Management believes that if the BFEDD accelerates repayment that is has sufficient cash resources to satisfy this obligation.

IsoRay Medical also had $530,000 in principal amount of convertible debentures outstanding as of December 31, 2005, which were issued between February and July 2005. As of February 10, 2006, the amount of convertible debentures outstanding had been reduced to $445,000, with holders of $75,000 in convertible debentures converting subsequent to the end of the three month period ended December 31, 2005. These debentures could be converted into 127,711 shares of common stock at a conversion rate of $4.15 per share. Each debenture bears interest at an annual rate of eight percent (not compounded), and has a twenty-four month term with accrued interest paid quarterly.

IsoRay Medical also had $316,364 in principal amount of notes payable outstanding as of December 31, 2005, which were issued in a private placement to a predecessor IsoRay company between October 2003 and September 2004. Each note bears interest at an annual rate of ten percent (not compounded), and has a thirty-six month term with accrued interest paid quarterly. The Company intends to retire these note payable obligations with part of the proceeds received from the New Offering of February 1, 2006.

On April 4, 2005 a capital lease agreement was executed by IsoRay Medical with Nationwide Funding LLC, whereby the lessor funded the $75,000 acquisition of a glove box built to the Company's specifications by Premier Technology, Inc. of Pocatello, ID. This is a 48 month agreement with minimum monthly lease payments of $2,475.

On May 16, 2005 a capital lease agreement was executed by IsoRay Medical with Vencore Solutions LLC. This is a capital lease for a hot cell with a lease line in the amount of $430,000. This is a 36 month lease, with a purchase option at fair market value, defined in the lease agreement as not more than 15% of the initial fair value purchase price. Based on this amount, for the first five months, the minimum monthly lease payment will be $8,349. The minimum monthly lease payment increases to $17,500 for the remaining 31 months, based on the entire value of the $430,000 lease line. In connection with the lease agreement, IsoRay granted warrants to purchase 5,692 shares of its common stock at $4.15/share.

We expect to finance our future cash needs through the sale of equity securities, solicitation to warrant holders to exercise their warrants, and possibly strategic collaborations or debt financing or through other sources that may be dilutive to existing shareholders. If we need to raise additional money to fund our operations, funding may not be available to us on acceptable terms, or at all. If we are unable to raise additional funds when needed, we may not be able to market our products as planned or continue development and regulatory approval of our future products. If we raise additional funds through equity sales, these sales may be dilutive to existing investors.

We have no material commitments for capital expenditures and no off-balance sheet arrangements.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS AND RISK FACTORS

The Company's Form 10-KSB, any Form 10-QSB or any Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995, which reflect the Company's current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "project," and similar expressions identify forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any statements of the plans, strategies and objectives of management for future operations; any statements concerning proposed new products, services, developments or industry rankings; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing. Such "forward-looking statements" are subject to risks and uncertainties set forth from time to time in the Company's SEC reports and are generally set forth below and particularly discussed in the Company's Form 10-KSB for the transition period ended June 30, 2005 and in the Company's Registration Statement on Form SB-2 filed on November 10, 2005, as amended.

Readers are cautioned not to place undue reliance on such forward-looking statements as they speak only of the Company's views as of the date the statement was made. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Risk Factors

You should consider the following discussion of risks as well as other information regarding our operations. The risks and uncertainties described below are not the only ones. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

- Our independent accountants have expressed uncertainty about our ability to continue as a going concern.
- Our revenues depend upon one product, our ^{131}Cs brachytherapy seed, which is used to treat only one type of cancer as of the date of this report, although it is approved to treat any malignant tissue.
- We have limited data on the clinical performance of the ^{131}Cs seed.
- We will need to raise additional capital to fund our operations through 2006.
- The passage of Initiative 297, which may in the future impose restrictions on sites generating certain types of radioactive wastes in Washington, may result in the relocation of our manufacturing operations.
- We have limited manufacturing experience and may not be able to meet future demand without increasing our supply of the isotopes used to manufacture our product and also increasing our level of staffing.
- We have limited specific experience with the sales and marketing of the ^{131}Cs seed.
- Our quarterly operating results will be subject to significant fluctuations.
- We rely heavily on a limited number of suppliers.
- We are subject to uncertainties regarding reimbursement for use of our product.
- It is possible that other treatments may be deemed superior to brachytherapy for the treatment of cancer and if this were to occur, demand for our product would decline.

- Our industry is intensely competitive, and many of our competitors are larger than we are and possess greater resources.
- We may be unable to adequately protect or enforce our intellectual property rights or secure rights to third-party patents, the value of our granted patent and our patents pending is uncertain, and one of our licensed patents may be terminated under certain conditions.
- Failure to comply with government regulations, which are quite complex, could harm our business.
- Our business exposes us to product liability claims and also involves environmental risks.
- We rely heavily upon our executive officers and key scientific personnel.
- Our ability to expand into foreign markets is uncertain.
- Our ability to successfully commercialize our product is uncertain.
- Our reporting obligations as a public company are costly.
- There is a limited market for our common stock, and our stock price is likely to be volatile.
- Our common stock may be subject to penny stock regulation.
- Future sales by shareholders of the shares available for sale in the public market, or the perception that such sales may occur, may depress the price of our common stock.

ITEM 3. CONTROLS AND PROCEDURES

(a) Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the design and operation of our disclosure controls and procedures, as such term is defined under Rules 13a-14(c) and 15d-14(c) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2005. Based on that evaluation, our principal executive officer and our principal financial officer concluded that the design and operation of our disclosure controls and procedures were effective in timely alerting them to material information required to be included in the Company's periodic reports filed with the SEC under the Exchange Act. 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, regardless of how remote. However, management believes that our system of disclosure controls and procedures is designed to provide a reasonable level of assurance that the objectives of the system will be met.

(b) In connection with the review of our consolidated financial statements for the period ended September 30, 2005, our independent registered public accounting firm advised the Board of Directors and management of certain significant internal control deficiencies that they considered to be, in the aggregate, a material weakness. In particular, our independent registered public accounting firm identified the following weaknesses in our internal control system: (1) a lack of segregation of duties and (2) a lack of formal procedures relating to all areas of financial reporting. The independent registered public accounting firm indicated that they considered these deficiencies to be reportable conditions as that term is defined under standards established by the American Institute of Certified Public Accountants. A material weakness is a significant deficiency in one or more of the internal control components that alone or in the aggregate precludes our internal controls from reducing to an appropriately low level of risk that material misstatements in our financial statements will not be prevented or detected on a timely basis. The Company considered these matters in connection with the period end closing of accounts and preparation of the related consolidated financial statements and determined that no prior period financial statements were materially affected by such matters. Notwithstanding the material weaknesses identified by our independent registered public accountants, we believe that the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operation and cash flows of the Company as of, and for, the periods represented in this report.

The size of the Company has prevented us from being able to employ sufficient resources at this time to enable us to have an adequate level of supervision and segregation of duties within our internal control system. Set forth below is a discussion of the significant internal control deficiencies that had not been remediated as of the end of the period covered by this report.

Lack of segregation of duties. Our size has prevented us from being able to employ sufficient resources to enable us to have an adequate level of segregation of duties within our internal control system. There are one full-time and three part-time persons involved in processing of transactions. Therefore, it is difficult to effectively segregate accounting duties. While we strive to segregate duties as much as practicable, budgetary considerations have not previously allowed the additional of full time staff. We hired a controller effective May 1, 2006 to assist with segregation of duties and believe this internal control weakness will soon be alleviated.

Lack of formal procedures relating to all areas of financial reporting including a lack of review by management. Due to the size of our Company, and as a consequence of the lack segregation of duties, we do not have formal month end close procedures. As a result, there is a lack of timely review of the financial statements and Form 10-QSB. This significant internal control deficiency has not been remediated as of the end of the period covered by this report.

If we are unable to remediate the identified material weaknesses, there is a more than remote likelihood that a material misstatement to our SEC reports will not be prevented or detected, in which case investors could lose confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our ability to raise additional capital and could also have an adverse effect on our stock price.

PART II - OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES

In the three month period ended December 31, 2005, the Company sold 645,500 shares of common stock pursuant to the October 17, 2005 Offering, in exchange for a cash payment of 2,582,000 (less commissions of ten percent (10%) on securities placed by broker/dealers). This common stock was sold as part of a unit offering including one share of common stock and a callable warrant to purchase one share of common stock at $6.00 per share with a two-year term. These sales were made between October 20 and December 31, 2005 and were effected pursuant to the exemption from registration provided by Regulation D promulgated under the Securities Act of 1933, as amended (the “Securities Act”), and Section 4(2) of the Securities Act.

The Company also issued 10,000 shares of common stock, on November 18, 2005, to Intellegration LLC in exchange for $40,000 of capital production equipment, consulting services, and repair and maintenance services on production equipment used in the PIRL facilities pursuant to the exemption from registration provided by Section 4(2) of the Securities Act. Additionally, on October 6, 2005, the Company issued 24,007 shares of common stock to Nuvotec USA, Inc. as payment for one year’s lease of the PIRL facilities pursuant to the exemption from registration provided by Section 4(2) of the Securities Act.

On December 7, 2005, the Company entered into a SICAV ONE Securities Purchase Agreement and a SICAV TWO Securities Purchase Agreement (collectively, the “Purchase Agreements”) with Mercatus & Partners, Limited, a United Kingdom private limited company (“Mercatus”). Pursuant to the Purchase Agreements, Mercatus has agreed, subject to receipt of sufficient funding, to purchase 1,778,146 shares of the Company’s common stock at a purchase price of $3.502 per share. As of the date of this Report, no funding had been received by the Company.

Pursuant to the Purchase Agreements, Mercatus, a foreign entity, was issued 1,778,146 shares of the Company’s common stock in exchange for a future cash payment of $6,227,067.29. If the future payment is not made then the shares will be returned. This sale was effected pursuant to the exemption from registration provided by Regulation D promulgated under the Securities Act, and Section 4(2) of the Securities Act.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

31.1 Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer

32 Section 1350 Certifications

(b) Reports on Form 8-K:

On November 3, 2005, the Company filed a Current Report on Form 8-K providing audited financial statements for IsoRay Medical, Inc. for the years ended June 30, 2005 and 2004.

On November 3, 2005, the Company filed a Current Report on Form 8-K announcing the commencement of quotations of its common stock on the OTC Bulletin Board under the symbol "ISRY.OB" and IsoRay Medical, Inc.'s nomination for a FLC Award for Excellence in Technology Transfer.

On December 12, 2005, the Company filed a Current Report on Form 8-K announcing its entry into two securities purchase agreements with Mercatus & Partners, Limited.

On December 14, 2005, the Company filed a Current Report on Form 8-K announcing the engagement of DeCoria, Maichel &Teague, P.S. as its new independent auditor.

On December 20, 2005, the Company filed a Current Report on Form 8-K announcing its entry into an Economic Development Agreement with the Pocatello Development Authority.

On December 29, 2005, the Company filed a Current Report on Form 8-K announcing the sale of 598,000 shares of its common stock (with accompanying warrants) under its October 17, 2005 Private Placement Memorandum.

SIGNATURES

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

Dated: May 11, 2006

ISORAY, INC., a Minnesota corporation

By: /s/ Roger E. Girard

Roger E. Girard, Chief Executive Officer

By: /s/ Michael K. Dunlop

Michael K. Dunlop, Chief Financial Officer