MEDIABAY INC
Form 10-Q
November 15, 2004

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Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to ________

Commission file number 1-13469

MediaBay, Inc.

(Exact Name of Registrant as Specified in its Charter)

Florida	65-0429858
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employment Identification No.)
2 Ridgedale Avenue, Cedar Knolls, New Jersey	07927
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone number, Including Area Code: (973) 539-9528

Indicate by checkmark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirement for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the Registrant is an accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes [ ] No |X|

As of November 12, 2004, there were 22,298,624 shares of the Registrant's Common Stock outstanding.

MEDIABAY, INC.
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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

MEDIABAY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

Assets

Current Assets:

Cash and cash equivalents...

Accounts receivable, net of allowances for sales returns and doubtful accounts of $2,851 and $4,446 at September 30, 2004 and December 31, 2003, respectively................

Inventory...

Prepaid expenses and other current assets...

Royalty advances..

Total current assets..

Fixed assets, net...

Deferred member acquisition costs...

Deferred income taxes...

Other intangibles..

Goodwill..

Liabilities and Stockholders' Equity

Current liabilities:
- Accounts payable and accrued expenses...
- Accounts payable, related party...
- Common stock subject to contingent put rights, current portion.........................
- Short-term debt, net of original issue discount of $55 and $274 at September 30, 2004 and December 31, 2003, respectively...
- Related party short-term debt, net of original issue discount of $142 at December 31, 2003...

Total current liabilities...

Long-term debt, net of original issue discount of $1,131 at September 30, 2004..............
Related party long-term debt...
Common stock subject to contingent put rights...

Total liabilities...

Commitments and Contingencies

Preferred stock, no par value, authorized 5,000,000 shares; 25,000 shares of Series A and 3,350 shares of Series B issued and outstanding at September 30, 2004 and December 31, 2003 and 43,527 and no shares of Series C issued and outstanding at September 30, 2004 and December 31, 2003, respectively...
Common stock; no par value, authorized 150,000,000 shares; issued and outstanding 18,463,624 and 13,057,414 at September 30, 2004 and December 31, 2003, respectively...............
Contributed capital..
Accumulated deficit..

Total stockholders' equity...

See accompanying notes to condensed consolidated financial statements.

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MEDIABAY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three months ended September 30, 2004	2003
Sales, net of returns, discounts and allowances of $983 and $4,753, and $4,286 and $14,174 for the three and nine months ended September 30, 2004 and 2003, respectively	$ 3,849	$ 9,572

Cost of sales	1,875	4,252
Cost of sales - strategic charges	2,100	--
Advertising and promotion	1,131	2,069
Bad debt	203	931
General and administrative	1,356	1,613
Depreciation and amortization	28	65
Operating (loss) income	(2,844)	642
Interest expense, net of interest income	741	295
(Loss) income before income taxes	(3,585)	347
Income tax expense	--	--
Net (loss) income	(3,585)	347
Dividends on preferred stock	199	62
Net (loss) income applicable to common shares	(3,784)	$ 285
Basic and diluted (loss) income per share:		
Basic(loss) income per common share	$ (.21)	$ .02
Diluted (loss) income per common share	$ (.21)	$ .02

See accompanying notes to condensed consolidated financial statements.

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MEDIABAY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(UNAUDITED)

	NINE MO SEPTE 2004
Cash flows from operating activities:	
Net loss applicable to common shares	$ (12,061)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:	
Depreciation and amortization	116
Non-cash beneficial conversion	4,381
Cost of sales - strategic charges	2,100
Amortization of deferred member acquisition costs	2,203
Loss on extinguishment of debt	1,532
Non-current accrued interest and dividends	1,090
Amortization of deferred financing costs and debt discount	1,060
Non-cash stock compensation	82
Changes in asset and liability accounts, net of acquisitions and asset write-downs and strategic charges:	
Decrease in accounts receivable, net	1,977
Decrease in inventory	62
(Increase) decrease in prepaid expenses	(40)
Increase in royalty advances	(790)
Increase in deferred member acquisition costs	(339)

Decrease in accounts payable and accrued expenses	(5,655)
Net cash (used in) provided by operating activities	(4,282)
Cash flows from investing activities:	
Acquisition of fixed assets	(77)
Assets acquired, net of cash	--
Acquisition of intangible assets	(20)
Net cash used in investing activities	(97)
Cash flows from financing activities:	
Proceeds from exercise of stock options and warrants	1
Net proceeds from issuance of long-term debt	13,500
Payment of long-term debt	(5,987)
Increase in deferred financing costs	(2,071)
Proceeds from issuance of Preferred Stock	--
Payments made in connection with litigation settlement recorded in contributed capital, net of cash received	--
Cash received from bridge loan investors	--
Net cash provided by (used in) financing activities	5,442
Net increase in cash and cash equivalents	1,063
Cash and cash equivalents at beginning of period	683
Cash and cash equivalents at end of period	$ 1,746

See accompanying notes to condensed consolidated financial statements.

MEDIABAY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

1) ORGANIZATION

MediaBay, Inc. ("MediaBay" or the "Company"), a Florida corporation, was formed on August 16, 1993. MediaBay, Inc. is a marketer of spoken audio products, including audiobooks and old-time radio shows, through direct response, retail and Internet channels. The Company markets audiobooks primarily through its Audio Book Club. Its old-time radio programs are marketed through direct-mail catalogs, over the Internet at RadioSpirits.com and, on a wholesale basis, to major retailers.

(2) SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements contained in its Annual Report on Form 10-K. The preparation of financial statements in accordance 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, the 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 these estimates. On an ongoing basis management reviews its estimates based on current available information. Changes in facts and circumstances may result in revised estimates. In the opinion of management, the interim unaudited financial statements include all material adjustments, all of which are of a normal recurring nature, necessary to present fairly the Company's financial position, results of operations and cash flows for the periods presented. The results for any interim period are not necessarily indicative of results for the entire year or any other interim period.

Revenue Recognition

The Company derives its principal revenue through sales of audiobooks, classic radio shows and other spoken word audio products directly to consumers principally through direct mail. The Company also sells classic radio shows to retailers either directly or through distributors. The Company derives additional revenue through rental of its proprietary database of names and addresses to non-competing third parties through list rental brokers. The Company also derives a small amount of revenue from advertisers included in its nationally syndicated classic radio shows. The Company recognizes sales to consumers, retailers and distributors upon shipment of merchandise. List rental revenue is recognized on notification by the list brokers of rental by a third party when the lists are rented. The Company recognizes advertising revenue upon notification of the airing of the advertisement by the media buying company representing the Company. Allowances for future returns are based upon historical experience and evaluation of current trends.

Shipping and Handling Revenue and Costs

Amounts paid to the Company for shipping and handling by customers is included in sales. Amounts the Company incurs for shipping and handling costs are included in cost of sales. The Company recognizes shipping and handling revenue upon shipment of merchandise. Shipping and handling expenses are recognized on a monthly basis from invoices from the third party fulfillment houses, which provide the services.

Cost of Sales

Cost of sales includes the following:

- Product costs (including heavily discounted audiobooks and old-time radio programs in the initial enrollment offer to prospective members and customers)
- Royalties to publishers and rightsholders
- Fulfillment costs, including shipping and handling
- Customer service
- Direct response billing, collection and accounts receivable management.

Cooperative Advertising and Related Selling Expenses

The Company classifies the cost of certain credits, allowances, adjustments and payments given to customers for the services or benefits provided as a reduction of net sales.

Stock-Based Compensation

The Company accounts for employee stock options in accordance with Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock

Issued to Employees." In October 1995, SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") was issued. SFAS 123, which prescribes the recognition of compensation expense based on the fair value of options on the grant date, allows companies to continue applying APB 25 if certain pro forma disclosures are made assuming a hypothetical fair value method application. Had compensation expense for the Company's stock options been recognized on the fair value on the grant date under SFAS 123, the Company's net loss and net loss per share for the three and nine months ended September 30, 2004 and 2003 would have been as follows:

	Three Months Ended September 30,		
	2004	2003	2
Net (loss) income applicable to common shares, as reported	$(3,784)	$ 285	$
Add: Stock-based employee compensation expense included in reported net loss applicable to common shares, net of related tax effects	--	--	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(206)	(601)	
Pro forma net (loss) income applicable to common shares	$(3,990)	$ (316)	$
Net (loss) income per share:			
Basic and diluted - as reported	$ (.21)	$ .02	$
Basic and diluted - pro forma	$ (.22)	$ (.02)	$

No dividend yield and the following assumptions were used in the pro forma calculation of compensation expense:

DATE	NO. OF SHARES	EXERCISE PRICE	VOLATILITY	RISK-FREE INTEREST RAT
First Nine Months 2004	3,607,500	$0.92	97%	4.00%
First Nine Months 2003	2,213,856	$0.97	165%	4.85%

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

Deferred Member Acquisition Costs

Promotional costs directed at current members are expensed on the date the promotional materials are mailed. The cost of any premiums, gifts or the discounted audiobooks or radio programs in the promotional offer to new members is expensed as incurred. The Company accounts for direct response advertising for the acquisition of new members in accordance with AICPA Statement of Position 93-7, "Reporting on Advertising Costs" ("SOP 93-7"). SOP 93-7 states that the cost of direct response advertising (a) whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and (b) that results in probable future benefits should be reported as assets net of accumulated amortization. Accordingly, the Company has capitalized direct response advertising costs and amortizes these costs over the period of future benefit, which has been determined to be generally 30 months for Audio Book Club advertising costs and 18 months for World's Greatest Old-Time Radio continuity program. The costs are being amortized on accelerated basis consistent with the recognition of related revenue.

Royalties

The Company is liable for royalties to licensors based upon revenue earned from the respective licensed product. The Company pays certain of its publishers and other rightsholders advances for rights to products. Royalties earned on the sale of the products are payable only in excess of the amount of the advance. Advances, which have not been recovered through earned royalties, are recorded as an asset. Advances not expected to be recovered through royalties on sales are charged to royalty expense.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

(3) GOODWILL AND OTHER INTANGIBLES

Goodwill and indefinite-lived intangible assets are tested for impairment annually or when certain triggering events require such tests and are written down, with a resulting charge to operations, only in the period in which the recorded value of goodwill and indefinite-lived intangible assets is more than their fair value.

The Company amortizes other intangible assets over their estimated useful lives over periods from three to seven years. Other intangible assets primarily relate to mailing and non-compete agreements, customer lists, and license agreements associated with the Company's Audio Book Club and Radio Spirits divisions. Amortization expense for other intangible assets was $2 and $30 for the three months ended September 30, 2004 and 2003, respectively and $30 and $151 for the nine months ended September 30, 2004 and 2003, respectively. The Company estimates intangible amortization expenses of the following:

Three months ended December 31, 2004	$ 2
Year ended 2005	8
Year ended 2006	8
Year ended 2007	8
Year ended 2008	1

Total	$ 27

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The following table presents details of Other Intangibles at September 30, 2004 and December 31, 2003:

	September 30, 2004			Dec	
	Cost	Accumulated Amortization	Net	Cost	Ac Am
Mailing Agreements	$ 592	$ 592	$ --	$ 592	$
Customer Lists	4,380	4,380	--	4,380	
Non-Compete Agreements	313	286	27	313	
Other	25	--	25	5	
Total Other Intangibles	$ 5,310	$ 5,258	$ 52	$ 5,290	$

Goodwill of $9,658 as of September 30, 2004 and December 31, 2003 is attributable to the Company's Radio Spirits business. The Company completed its annual impairment tests as of October 31, 2003, which did not result in an impairment loss.

(4) DEBT

	As of September 30, 2004	December 200
Credit agreement, senior secured bank debt,	$ --	$ 2
Credit agreement, senior secured debt, net of original issue discount	8,453	
Subordinated debt	1,600	3
Premier debt, net of original issue discount	676	
October 2003 Notes and related accrued interest, net of original issue discount	--	
Related party notes and related accrued interest, net of original issue discount	7,386	10
Total Debt	18,115	17
Less: Current Portion	(229)	(17,
Long-Term Debt	$ 17,886	$

New Credit Agreement and Related Transactions

On April 28, 2004, MediaBay entered into a new credit agreement ("New Credit Agreement") by and among MediaBay and certain of its subsidiaries, the guarantors signatory thereto, Zohar CDO 2003-1, Limited ("Zohar") as lender, and

Zohar, as agent, pursuant to which MediaBay and certain of its subsidiaries initially borrowed $9,500. The initial term of the New Credit Agreement is one year and it is extendable, at MediaBay's sole option, for two additional one-year terms upon issuance of additional notes of $600 for the first additional year and $300 for the second additional year, provided there is no event of default. The loan bears interest at the rate of LIBOR plus 10%. In the first year of the loan, a fee of $900 has been added to the principal balance, which will be reflected as debt discount and will be accreted to interest expense over the next twelve months. The New Credit Agreement contains certain positive and negative covenants, including, beginning with the quarter ending September 30, 2004, the maintenance of certain minimum levels of EBITDA, as defined in the New Credit Agreement.

MediaBay used a portion of the $8,600 of funds received under the New Credit Agreement to satisfy all of its outstanding obligations under (i) promissory notes that it issued in October 2003 in the aggregate principal amount of $1,065, and (ii) its prior Credit Agreement, which had an outstanding principal balance of approximately $1,386. The Company has included in interest expense a loss on early extinguishment of debt of $73 related to unamortized original issue discount relating to promissory notes that it issued in October 2003 and a loss on early extinguishment of debt of $116 related to unamortized debt discount relating to the prior Credit Agreement.

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The Principal Shareholder and an affiliate of the principal shareholder, which held a $500 principal amount note and 25,000 shares of Series A Convertible Preferred Stock, consented to the New Credit Agreement and the other transactions described above and entered into a subordination agreement with Zohar. The New Credit Agreement required the aggregate amount of principal and interest owed by MediaBay to the Principal Shareholder and the affiliate of the Principal Shareholder be reduced to $6,800 ("Permissible Debt") by June 1, 2004, and that the Permissible Debt be further reduced by up to an additional $1,800 if MediaBay does not raise at least $2,000 in additional equity in the two years after the execution of the New Credit Agreement.

On April 28, 2004, to reduce its debt to $6,800, the Principal Shareholder and his affiliate agreed, subject to, and automatically upon, the receipt of a fairness opinion from an independent investment banking firm, to exchange the principal of their $500 Note, $1,000 Note, $150 Note and $350 Note, plus accrued and unpaid interest owed to the Principal Shareholder aggregating $1,833 and accrued and unpaid dividends owed to the Principal Shareholder aggregating $519 into an aggregate of 43,527 shares of Series C Preferred Stock convertible into (i) an aggregate of 5,580,384 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase an aggregate of 11,160,768 shares of Common Stock. The Warrants are exercisable until April 28, 2014 at an exercise price of $0.53. The Series C Preferred Stock has a liquidation preference of $100 per share. On May 25, 2004, a fairness opinion was received from an independent investment banking firm, and, pursuant to the agreements described above, the exchange of debt for units occurred. The transactions described above resulted in a charge to earnings for debt inducement pursuant to SFAS 84 estimated at $391.

The remaining promissory notes held by the Principal Shareholders and its affiliate are guaranteed by certain subsidiaries of the Company and secured by a lien on the assets of the Company and certain subsidiaries of the Company. If the amount of the Permissible Debt is required to be reduced due to MediaBay's failure to raise the requisite additional equity, such reduction will automatically occur by the exchange of Permissible Debt for additional shares of Series C Preferred Stock in an aggregate liquidation preference equal to the amount of debt exchanged and warrants to purchase a number of shares of common stock equal to two times the number of shares of preferred stock issuable upon conversion of the Series C Preferred Stock.

New ABC Note

Also on April 28, 2004, MediaBay repaid $1,600 principal amount of the $3,200 principal amount convertible note issued to ABC Investment, L.L.C. MediaBay issued a new $1,600 note (the "New ABC Note") for the remaining principal amount. The New ABC Note extends the maturity date from December 31, 2004 to July 29, 2007. In exchange for extending the maturity date, the conversion price of the New ABC Note was reduced to $0.50. The closing sale price of MediaBay's Common Stock on the closing date was $0.48.

Premier Debt

MediaBay has also entered into a settlement agreement, dated as of April 1, 2004, with Premier Electronic Laboratories, Inc. ("Premier"). Pursuant to the settlement, among other things, MediaBay is paying Premier $950 in exchange for Premier waiving its right to put its shares of Common Stock to MediaBay pursuant to a Put Agreement dated December 11, 1998. MediaBay's obligation under the Put Agreement was reduced by $150 in exchange for relinquishing certain leases for real property. MediaBay paid $14 on closing and is paying the remaining balance over six years in monthly payments starting at $7 in July 2004 and increasing to $19 from May 2007 through April 2010.

(5) STOCKHOLDERS' EQUITY AND STOCK OPTIONS AND WARRANTS

Stock Options and Warrants

From January 1, 2004 to September 30, 2004, the Company issued options to purchase 4,657,500 shares of its common stock to certain officers, employees, directors and consultants to the Company under its stock option plans. The Company also cancelled options to purchase 1,500,000 shares of its common stock and options to purchase 828,000 shares of its common stock expired.

In addition, the Company issued warrants to purchase 3,098,830 of its common stock in connection with the January 2004 Convertible Debt described immediately below, and warrants to purchase 11,160,768 shares of its common stock to the Principal Shareholder and his affiliate in connection with the debt reduction required by the April 2004 Senior Debt as described in Note 4 above. The Company also issued non-plan warrants to purchase 216, 250 shares of its common stock to holders of the $1,065 principal amount of promissory notes that it issued in October 2003 in the aggregate principal amount of $1,065 ("October 2003 Note"), as previously agreed to under the terms the October 2003 Note. The Company also cancelled non-plan warrants to purchase 339,940 shares of its common stock. Non-plan options to purchase 8,000 shares of our common stock at $.10 were exercised during the nine months ended September 30, 2004.

January 2004 Convertible Debt

On January 29, 2004, the Company issued $4,000 aggregate principal amount of promissory notes (the "January 2004 Notes") and warrants to purchase 2,352,946 shares of common stock (the "Investor Warrants") to institutional and accredited investors (the "Offering"). The notes were due on the earlier of (i) April 30, 2005, (ii) such date on or after July 1, 2004 at such time as all of the Company's indebtedness under its existing credit facility is either repaid or refinanced or (iii) the consummation by the Company of a merger, combination or sale of all or substantially all of the Company's assets or the purchase by a single entity, person or group of affiliated entities or persons of 50% of the Company's voting stock. The January 2004 Notes bore interest at the rate of 6%, increasing to 9% on April 28, 2004 and 18% on July 27, 2004. On receipt of shareholder approval, which was received on April 12, 2004, in accordance with the terms of the January 2004 Notes, the principal amount of the notes automatically converted into MediaBay common stock at the rate of one share of common stock at $0.75, or approximately 5,333,333 shares. In addition accrued interest in the amount $49 also converted into common stock at $0.75 per share, or 64,877 shares.

In connection with the Offering, the Company issued to the placement agent and a broker warrants to purchase an aggregate of 245,000 shares of common stock and also issued to the placement agent warrants to purchase an additional 500,884 shares of Common Stock on April 12, 2004 as partial consideration for its services as placement agent. All warrants issued are exercisable until January 28, 2009 at an exercise price of $1.28 per share.

The Company accounted for the issuance of the January 2004 debt and its subsequent conversion in accordance with Emerging Issues task Force No. 00-27, "Application of Issue No. 95-5 to Certain Convertible Instruments". Accordingly, the Company recorded an expense of $3,991 as beneficial conversion expenses at the date of the conversion. The Company also recorded in interest expense a loss on early extinguishment of debt for the unamortized debt discount relating to the expenses incurred in the transaction and the relative fair value of the warrants issued in the transaction totaling $1,343.

In connection with the Offering, the Principal Shareholder and an affiliate of the Principal Shareholder entered into a letter agreement (the "Letter Agreement") with the purchasers of January 2004 Notes in the Offering pursuant to which the Principal Shareholder granted to the holders of the Notes in the event of an Event of Default (as defined in the Notes) the rights to receive payment under certain secured indebtedness owed by the Company to the Principal Shareholder and to exercise their rights under security agreements securing such secured indebtedness. Pursuant to the Letter Agreement, the Principal Shareholder also executed Powers of Attorney in favor of a representative of the January 2004 Note holders pursuant to which such representative may, following an Event of Default, take actions necessary to enforce the Note holders rights under the Letter Agreement, including enforcing the Principal Shareholder's rights under the security agreements.

(6) COST OF SALES - STRATEGIC CHARGES

The Company has conducted a review of its operations including product offerings, marketing methods and fulfillment. The Company is committed to digitizing and encoding its library of spoken word content that includes audiobooks and famous Old Time Radio shows, including The Shadow, Amos and Andy, Jack Benny, Dragnet, Gunsmoke and more. By making its content available to the digital customer, it believes it can expand the market for its audio content and may be able to significantly reduce the cost of delivery. The Company believes this distribution strategy could lead to increased revenues and potentially put the Company on a track to profitability.

In October 2004 the Company and Microsoft announced that they are working together to offer a wide range of audiobook titles via download to the millions of MSN(R) users in the United States. Among the audiobook titles we will exclusively offer on the MSN Music service are those from the nation's largest audiobook publishers. MSN attracts more than 350 million unique users worldwide per month. With localized versions available globally in 39 markets and 20 languages, MSN is a world leader in delivering Web services to consumers and online advertising opportunities to businesses worldwide.

In October 2004 the Company also announced that it had signed a multi-year agreement with Celebrity Newsletter LLC to develop television personality and syndicated talk show host, Larry King's, On-line Audiobook and Entertainment Club. The Company intends to design The Larry King Audiobook Club to meet, what it believes, are its customers' needs for an easy to use online retail experience. The Company is working to give its members more choice, better customer service, and great prices for repeat buyers.

The Company believes that many of its key operating metrics may be improved by its transition from a predominantly mail order business to an Internet based business. The Company hopes to reduce its return rates, lower its bad debt rates and reduce printing and fulfillment costs.

As a result of these third quarter decisions, the Company has recorded $2,100 of strategic charges for the three months ended September 30, 2004. These charges include: $1,000 of inventory written down to net realizable value due to a reduction in Audio Book Club members and the Company's new focus on delivering spoken word products via downloads and $1,100 of write-downs to royalty advances paid to audiobook publishers and other license holders, which the Company does not believe will be recoverable due to its new focus on delivering spoken word products via downloads.

(7) INTEREST EXPENSES

The following table presents details of interest expense for the three and nine months ended September 30, 2004 and 2003 as follows:

	Three Months Ended September 30,	
	2004	2003
Interest Accrued or Paid:		
Credit agreement, senior secured bank debt,	$ --	$ 55
Credit agreement	274	--
January 2004 Notes	--	--
Subordinated debt	37	83
October 2003 Notes	--	--
Forgiveness of interest to trade creditors	--	(192)
Related party notes	166	218
Total interest accrued or paid	477	164
Amortization of Debt Discount:		
Credit agreement, senior secured bank debt	(12)	25
Credit agreement	266	--
January 2004 Notes	--	--
Premier debt	15	--
October 2003 Notes	--	--
Related party notes	--	106
Total amortization of debt discount	269	131

Loss on Early Extinguishment of Debt:		
Loss on early extinguishment of January 2004 Notes	--	--
Loss on early extinguishment of senior secured bank debt	--	--
Loss on early extinguishment of October 2003 Notes	--	--
Total loss on early extinguishment of debt	--	--
Beneficial conversion expense of January 2004 Notes	--	--
Expense of inducement to convert, related party notes	--	--
Total loss on early extinguishment of debt	--	--
Interest expense	746	295
Less: Interest income	5	--
Net Interest expense	$ 741	$ 295

(8) NET INCOME (LOSS) PER SHARE OF COMMON STOCK

Basic income (loss) earnings per share was computed using the weighted average number of common shares outstanding for the three and nine months ended September 30, 2004 of 18,463,624 and 16,432,589, respectively and for the three and nine months ended September 30, 2003 of 14,128,179 and 14,269,529, respectively.

For the three months ended September 30, 2004 common equivalent shares which were not included in the computation of diluted loss per share because they would have been anti-dilutive were 25,021 common equivalent shares, as calculated under the treasury stock method and 24,008,750 common equivalent shares relating to convertible subordinated debt and preferred stock calculated under the "if-converted method". Interest expense and dividends on the convertible subordinated debt and convertible preferred stock added back to net income applicable to common stockholders would have been $368 for the three months ended September 30, 2004.

For the nine months ended September 30, 2004 common equivalent shares which were not included in the computation of diluted loss per share because they would have been anti-dilutive were 876,933 common equivalent shares, as calculated under the treasury stock method and 19,542,673 common equivalent shares relating to convertible subordinated debt and convertible preferred stock calculated under the "if-converted method". Interest expense and dividends on the convertible subordinated debt and convertible preferred stock added back to net income applicable to common stockholders would have been $984 for the nine months ended September 30, 2004.

Differences in the weighted average number of common shares outstanding for purposes of computing diluted earnings per share for the three months ended September 30, 2003 were due to the inclusion of 591,000 common equivalent shares, as calculated under the treasury stock method and 17,087,000 common equivalent shares relating to convertible subordinated debt calculated under the "if-converted method". Interest expense and dividends on the convertible subordinated debt and convertible preferred stock added back to net income was $359 for the three months ended September 30, 2003. .

For the nine months ended September 30, 2003 common equivalent shares which were not included in the computation of diluted loss per share because they would have been anti-dilutive were 694,000 common equivalent shares, as calculated under the treasury stock method and 16,884,000 common equivalent shares relating to convertible subordinated debt and convertible preferred stock calculated under the "if-converted method". Interest expense and dividends on the convertible subordinated debt and convertible preferred stock added back to net income applicable to common stockholders would have been $1,034 for the nine months ended September 30, 2003.

(9) SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest expense was $852 and $412 for the nine months ended September 30, 2004 and 2003, respectively.

On receipt of shareholder approval, which was received on April 12, 2004, the principal amount of $4,000 of the January 2004 Notes, as described in Note 5 above, automatically converted into MediaBay common stock at the rate of one share of common stock at $0.75, or approximately 5,333,333 shares. In addition accrued interest in the amount $49 also converted into common stock at $0.75 per share, or 64,877 shares.

During the nine months ended September 30, 2003, the Company issued 13,333 shares of the Company's common stock to consultants under consulting agreements. The shares have been valued at $10 and are being amortized to expense over the period of benefit.

(10) SEGMENT REPORTING

For 2004 and 2003, the Company has divided its operations into four reportable segments: Corporate, Audio Book Club ("ABC") a membership-based club selling audiobooks in direct mail and on the Internet; Radio Spirits ("RSI") which produces, sells, licenses and syndicates old-time radio programs; and MediaBay.com a media portal offering spoken word audio content in secure digital download formats. Segment operating income is total segment revenue reduced by operating expenses identifiable with that business segment. Corporate includes general corporate administrative costs, professional fees, interest expenses and amortization of acquisition related costs. The Company evaluates performance and allocates resources among its three operating segments based on operating income and opportunities for growth. The Company did not expend any funds or receive any income in the nine months ended September 30, 2004 and 2003 from its newest subsidiary RadioClassics, which is aggregated with RSI for segment reporting purposes. Inter-segment sales are recorded at prevailing sales prices.

THREE MONTHS ENDED SEPTEMBER 30, 2004

	Corporate	ABC	RSI	Mbay.com
Sales, net of returns, discounts and allowances	$ --	$ 2,654	$ 1,154	$ 52
Profit (loss) before depreciation and amortization, interest and dividends	(353)	(2,103)	(270)	(99)
Depreciation and amortization	2	17	9	--
Interest expense	740	--	1	--
Dividends on preferred stock	199	--	--	--
Net (loss) income applicable to common shares	(1,294)	(2,120)	(280)	(99)
Total assets	--	19,096	13,623	10
Acquisition of fixed assets	--	10	--	--

THREE MONTHS ENDED SEPTEMBER 30, 2003

Corporate	ABC	RSI	Mbay.com

Sales, net of returns, discounts and allowances	$ --	$ 6,493	$ 3,071	$ 42
Profit (loss) before depreciation and amortization, interest and dividends	(532)	541	813	(118)
Depreciation and amortization	30	25	10	--
Interest expense	292	--	3	--
Dividends on preferred stock	62	--	--	--
Net (loss) income applicable to common shares	(916)	516	800	(118)
Total assets	--	28,397	16,441	3
Acquisition of fixed assets	--	--	--	--

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Nine Months Ended September 30, 2004

	Corporate	ABC	RSI	Mbay.com
Sales, net of returns, discounts and allowances	$ --	$ 9,719	$4,514	$ 158
Profit (loss) before depreciation and amortization, interest and dividends	(1,194)	(2,229)	501	(315)
Depreciation and amortization	22	66	28	--
Interest expense	8,337	--	3	--
Dividends on preferred stock	378	--	--	--
Net (loss) income applicable to common shares	(9,931)	(2,295)	470	(315)
Total assets	--	19,096	13,623	10
Acquisition of fixed assets	--	68	9	--

Nine Months Ended September 30, 2003

	Corporate	ABC	RSI	Mbay.com
Sales, net of returns, discounts and allowances	$ --	$ 21,873	$ 7,781	$ 94
Profit (loss) before depreciation and amortization, interest and dividends	(1,802)	1,351	1,172	(415)
Depreciation and amortization	151	79	33	--
Interest expense	1,337	--	10	--
Dividends on preferred stock	183	--	--	--
Net (loss) income applicable to common shares	(3,473)	1,272	1,129	(415)
Total assets	--	28,397	16,441	3
Acquisition of fixed assets	--	13	2	--

(11) RECENT ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation", which amends SFAS No. 123 to provide alternative methods of transaction for an entity that voluntarily changes to the fair value method of accounting for stock based compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock based employee compensation. Finally, SFAS No. 148 amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure of those effects in interim financial statements. SFAS No. 148 is effective for fiscal years ended after December 15, 2002, but early adoption is permitted. Accordingly, the Company has adopted the applicable disclosure requirements of this Statement within this report. The adoption of SFAS No. 148 did not have a significant impact on the Company's financial disclosures.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities," which is effective for interim periods beginning after December 15, 2003. This interpretation changes the method of determining whether certain entities should be included in the Company's consolidated financial statements. An entity is subject to FIN 46 and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries." A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority of the expected losses or a majority of the expected residual returns or both. The Company has evaluated FIN 46 and it had no impact on its financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 33 on Derivative Instruments and Hedging Activities", which amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities that fall within the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 149 amends SFAS No. 133 regarding implementation issues raised in relation to the application of the definition of a derivative. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for similarly. This Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The adoption of

SFAS No. 149 did not have a material impact on the Company's financial position or results of operations.

On May 15, 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 provides guidance on classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The Company reclassified certain items to debt as a result of the SFAS 150.

(12) SUBSEQUENT EVENTS

Stock Options

From October 1, 2004 to November 12, 2004, the Company issued options to purchase 925,000 shares of MediaBay common stock to directors, employees and consultants.

Sale of Equity

On October 11, 2004, the Company entered into a Securities Purchase Agreement pursuant to which it issued to the purchasers thereunder an aggregate of 1,800,000 shares (the "Shares") of the Company's common stock, no par value per share (the "Common Stock"), and warrants to purchase 400,000 shares of Common Stock (the "Warrants"). The purchasers paid an aggregate purchase price of $900 for the Shares and Warrants. Each Warrant is exercisable to purchase one share of the Company's Common Stock at an exercise price of $0.83 per share during the five (5)-year period commencing on October 11, 2004.

Conversion of Debt

In October 2004, the holder of a $1,600 convertible note ("ABC Note") converted $1,000 principal amount of the ABC Note, such that the holder received 600,000 and 1,400,000 shares of the Company's Common Stock, respectively, on October 6, 2004 and October 7, 2004. Following the conversion, the principal amount of the ABC Note was reduced to $600.

Licensing Agreement

In the fourth quarter of 2004, the Company issued to Celebrity Newsletter LLC ("CNL") 25,000 shares of common stock pursuant to a multi-year agreement to develop television personality and syndicated talk show host, Larry King's on-line audiobook and entertainment club.

Amendment to New Credit Agreement

In November 2004, the New Credit Agreement was amended to amend the definition of Adjusted EBITDA to exclude the $2.1 million of Cost of Sales - Strategic Charges discussed above and to allow the Company to retain the entire $900,000 received in the Sale of Equity discussed below.

Pro Forma Balance Sheet

The following pro forma balance sheet reflects the effects of the following:

- o The issuance of an aggregate of 1,800,000 shares of the Company's common stock for $900,000,
- o The conversion rights of $1,000 principal amount of the ABC Note into 2,000,000 shares of Common Stock and
- o The issuance to CNL of 25,000 shares of Common Stock.

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Condensed Pro Forma Balance Sheet

	September 30, 2004	Pro Forma Adjustments	Notes	Pro Forma September 30, 2004
Assets				
Current Assets:				
Cash and cash equivalents	$ 1,746	$ 900	1	$ 2,646
Accounts receivable, net	1,287			1,287
Inventory	3,001			3,001
Prepaid expenses and other current assets	158			158
Royalty advances	494			494
Total current assets	6,686	900		9,686
Fixed assets, net	209			209
Deferred member acquisition costs	1,309			1,309
Deferred income taxes	14,753			14,753

Other intangibles	52	16	2	68
Goodwill	9,658			9,658
	$ 32,667	$ 916		$ 33,583
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable and accrued expenses	$ 5,033			5,469
Accounts payable, related parties	436			436
Short-term debt, net	229			229
Total current liabilities	5,698			5,698
Long-term debt, net	10,500	(1,000)	3	9,500
Related party long-term debt, net	7,386			7,386
Total liabilities	23,584	(1,000)		22,584
Preferred stock	7,181			7,181
Common stock	98,543	900	1	100,443
		1,000	3	
Contributed capital	17,436	16	2	17,452
Accumulated deficit	(114,077)			(114,077)
Total stockholders' equity	9,083	1,916		10,999
	$ 32,667	$ 916		$ 33,583

Notes:

1. To reflect the issuance of an aggregate of 1,800,000 shares of the Company's common stock for $900,000.
2. To reflect the issuance to CNL 25,000 unregistered shares MediaBay's common stock.
3. To reflect the partial exercise of conversion rights under the ABC Note (the "Exercises"), such that the holder received 600,000 and 1,400,000 shares of the Company's Common Stock.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

FORWARD-LOOKING STATEMENTS

Certain statements in this Form 10-Q constitute "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included in this Report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of our management for future operations are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "believe," or "continue" or the negative thereof or variations thereon or similar terminology. Although we believe that the expectations reflected in such forward looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. These forward looking statements involve certain known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any results, performances or achievements expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from our expectations, include, without limitation, our history of losses; the success of our new digital media distribution strategy and new Larry King initiatives, our ability to anticipate and respond to changing customer preferences, license and produce desirable content, protect our databases and other intellectual property from unauthorized access, collect receivables; dependence on third-party providers, suppliers and distribution channels; competition; the costs and success of our marketing strategies; product returns; member attrition and other risks detailed in our Annual Report on Form 10-K for the year ended December 31, 2003. Undue reference should not be placed on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to update any forward-looking statements.

INTRODUCTION

We are a seller of spoken audio and nostalgia products, including audiobooks and old-time radio shows, through direct response, retail and Internet channels. Our content and products are sold in multiple formats, including physical (cassette and compact disc) and secure digital download formats.

We are digitizing and encoding our library of spoken word content that includes audiobooks and famous Old Time Radio shows, including The Shadow, Amos and Andy, Jack Benny, Dragnet, Gunsmoke and more. By making our content available to the digital customer, we believe we can expand the market for our audio content and we may be able to significantly reduce the cost of delivery. We believe this distribution strategy could lead to increased revenues and potentially put the Company on a track to profitability.

In October 2004, the Company and Microsoft announced that we are working together to offer a wide range of audiobook titles via download to the millions of MSN(R) users in the United States. Among the audiobook titles we will exclusively offer on the MSN Music service (http://www.music.msn.com) are those from many of the nation's largest audiobook publishers.

This new relationship complements the already extensive MSN Music service catalog, which provides music fans with an easy, comprehensive service for discovering and downloading legal digital music. MSN Music offers simple sign-up, no-hassle purchasing and superior sound quality, either through a Web browser or the new Microsoft(R) Windows Media(R) Player 10. We believe that MSN will provide us with access to the growing number of audiobook listeners who are using the Internet more and more to access their entertainment and information needs, as well as attract new listeners who are unfamiliar with the format. We believe that the growth of the MSN Music Service will be driven by the launch of approximately 70 new portable media devices with Microsoft's digital rights management software.

MSN attracts more than 350 million unique users worldwide per month. With localized versions available globally in 39 markets and 20 languages, MSN is a world leader in delivering Web services to consumers and online advertising opportunities to businesses worldwide.

In October 2004, we also announced that we had signed a multi-year agreement to with Celebrity Newsletter LLC to develop television personality and syndicated talk show host, Larry King's, On-line Audiobook and Entertainment Club. We intend to design The Larry King Audiobook Club to meet, what we believe, are our customers' needs for an easy to use online retail experience. We are working to give our members more choice, better customer service, and great prices for repeat buyers. In addition, we plan to offer a variety of exclusive audio content and entertainment to our members as an added benefit of membership.

We believe that many of our key operating metrics may be improved by our transition from a predominantly mail order business to an Internet based business. We hope to reduce our return rates, lower our bad debt rates and reduce our printing and fulfillment costs.

We report financial results on the basis of four business segments: Corporate, Audio Book Club, Radio Spirits and MediaBay.com. A fifth division, RadioClassics, is aggregated with Radio Spirits for financial reporting purposes. Except for corporate, each segment serves a unique market segment within the spoken word audio industry.

We derive our principal revenue through sales of audiobooks, classic radio shows and other spoken word audio products directly to consumers principally through direct mail. We also sell classic radio shows to retailers either directly or through distributors. We derive additional revenue through rental of our proprietary database of names and addresses to non-competing third parties through list rental brokers. We also derive a small amount of revenue from advertisers who advertise on our nationally syndicated classic radio shows.

The preparation of financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We record reductions to our revenues for future returns and record an estimate of future bad debts arising from current sales in general and administrative expenses. These allowances are based upon historical experience and evaluation of current trends. If the financial condition of our customers, including either individual consumers or retail chains, were to deteriorate or if the payment behavior were to change, resulting in either their inability or refusal to make payment to us, additional allowances would be required. We capitalize direct response marketing costs for the acquisition of new members and amortize these costs over the period of probable future benefits. In order to determine the amount of advertising to be capitalized and the manner and period over which the advertising should be amortized, we prepare estimates of probable future revenues arising from the direct-response advertising in excess of future costs to be incurred in realizing those revenues. We record an estimate of our anticipated bad debt expense based on our historical experience.

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which temporary timing differences become deductible. Although realization of net deferred tax assets is not assured, management has determined that it is more likely than not that a portion of our deferred tax asset relating to temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements will be realized in future periods.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis we evaluate our estimates including those related to product returns, bad debts, the carrying value and net realizable value of inventories, the recoverability of advances to publishers and other

rightsholders, the future revenue associated with deferred advertising and promotion costs, investments, fixed assets, the valuation allowance provided to reduce our deferred tax assets and valuation of goodwill and other intangibles.

The Securities and Exchange Commission ("SEC") defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

Our significant accounting policies are described in Note 2 to the Notes to Consolidated Financial Statements. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However the following policies are considered to be critical within the SEC definition:

Revenue Recognition

We derive our principal revenue through sales of audiobooks, classic radio shows and other spoken word audio products directly to consumers principally through direct mail. We also sell classic radio shows to retailers either directly or through distributors. We derive additional revenue through rental of our proprietary database of names and addresses to non-competing third parties through list rental brokers. We also derive a small amount of revenue from advertisers included in our nationally syndicated classic radio shows. We recognize sales to consumers, retailers and distributors upon shipment of merchandise. List rental revenue is recognized on notification by the list brokers of rental by a third party when the lists are rented. We recognize advertising revenue upon notification of the airing of the advertisement by the media buying company representing us. Allowances for future returns are based upon historical experience and evaluation of current trends. The historical return rates for ABC members have been consistent for the past year and our estimate is based on a detailed historical examination of trends. Based on the current performance and historical trends, we do not expect significant changes in the estimate of returns for ABC members. The estimate of returns for wholesale sales of our old-time radio products is based on a detailed review of each significant customer, depending on the amount of products sold to a particular customer in a specific periods, the overall return rate for wholesale sales could vary.

We record reductions to our revenue for future returns and record an estimate of future bad debts arising from current sales in general and administrative expenses. These allowances are based upon historical experience and evaluation of current trends. If members and customers return products to us in the future at higher rates than in the past or than we currently anticipate, our net sales would be reduced and our operating results would be adversely affected. In November 2001, the Emerging Issues Task Force ("EITF") issued EITF No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)", which addresses the income statement classification of certain credits, allowances, adjustments, and payments given to customers for the services or benefits provided. We adopted EITF No. 01-9 effective January 1, 2002, and, as such, have classified the cost of these sales incentives as a reduction of sales.

Deferred Member Acquisition Costs

We are required to capitalize direct response marketing costs for the acquisition of new members in accordance with AICPA Statement of Position 93-7 "Reporting on Advertising Costs" and amortize these costs over the period of probable future benefits. In order to determine the amount of advertising to be capitalized and the manner and period over which the advertising should be amortized, we prepare estimates of probable future revenues arising from the direct-response advertising in excess of future costs to be incurred in realizing those revenues. If future revenue does not meet our estimates or if members buying patterns were to shift, adjustments to the amount and manner of amortization would be required.

Accounts Receivable Valuation

We record an estimate of our anticipated bad debt expense and return rates based on our historical experience. If the financial condition of our customers, including either individual consumers or retail chains, were to

deteriorate, or if the payment or buying behavior were to change, resulting in either their inability or refusal to make payment to us, additional allowances would be required.

Income Taxes

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which temporary timing differences become deductible. Although realization of net deferred tax assets is not assured, we have determined that it is more likely than not that a portion of our deferred tax asset relating to temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements will be realized in future periods. We determine the utilization of deferred tax assets in the future based on our current year projections of future periods.

At September 30, 2004, we have a remaining net deferred tax asset in the amount of $14.8 million. Should we determine we would be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to our deferred tax asset would increase income in the period such determination is made. Likewise, should we determine that we will not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be recorded as an increase to the valuation allowance, resulting in a deferred tax expense charged against income in the period such determination is made.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations accounted for using the purchase method of accounting. In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. The statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. At September 30, 2004, we had $9.7 million of goodwill, all of which related to our Radio Spirits operations. If conditions or circumstances were to change resulting in a deterioration of our Radio Spirits business, a future impairment of goodwill could be necessary.

Inventory

Inventory, consisting primarily of audiocassettes and compact discs held for resale, is valued at the lower of cost (weighted average cost method) or market. We record an estimate for inventory obsolescence based on future sales projections. These sales projections are based on estimates of future marketing expenditures and the anticipated success of future marketing efforts. If the Company does not invest in marketing or if sales estimates are not met for the other reasons, the estimate of inventory obsolescence would need to be increased which would result in a lower reported inventory value.

Royalty Advances

We are liable for royalties to licensors based upon revenue earned from the respective licensed product. We pay certain of its publishers and other rightsholders advances for rights to products. Royalties earned on the sale of the products are payable only in excess of the amount of the advance. Advances, which have not been recovered through earned royalties, are recorded as an asset. The estimate of future advances to be recovered is based on an estimate of future sales. Advances not expected to be recovered through royalties on sales are charged to royalty expense. If the Company does not invest in marketing or if sales estimates are not met for the other reasons, the royalty expense would be understated and the value of the royalty advance we reported would require reduction.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, historical operating data as a percentage of net sales.

	Three Months Ended September 30, 2004	2003
Sales	100%	100%
Cost of sales	48.7	44.4
Cost of sales - strategic charges	54.6	--
Advertising and promotion	29.4	21.6
Bad debt expense	5.3	9.7
General and administrative expense	35.2	16.9
Depreciation and amortization expense	0.7	0.7
Interest expense, net	19.3	3.1
Income tax expense (benefit)	--	--
Net (loss)	(93.1)	3.6
Dividends on preferred stock	5.2	0.6
Net (loss) applicable to common shares	(98.3)%	3.0%

RESULTS OF OPERATIONS

Three months ended September 30, 2004 compared to three months ended September 30, 2003:

NET SALES
(In thousands)

	2003	2004	CHANGE FROM 2003 TO 2004	% CHANGE
AUDIO BOOK CLUB	$6,493	$2,654	$(3,839)	(59.1) %
RADIO SPIRITS				
Catalog	916	515	(401)	(43.8)
Wholesale	1,327	287	(1,040)	(78.4)
Continuity	794	341	(453)	(57.1)
	3,037	1,143	(1,894)	(62.4)
MediaBay.com	42	52	10	23.8
	$9,572	$3,849	$(5,723)	(59.8) %

Audio Book Club sales decreased principally due to a decrease in club membership as a result of a substantial reduction in our advertising expenditures for new members. For the three months ended September 30, 2004, the Audio Book Club spent $110,000 to attract new members, a reduction of $381,000, or 77.6%, from the amount spent to attract new members of $491,000 during the three months ended September 30, 2003. Audio Book Club attracted approximately 4,540 new members in the three months ended September 30, 2004 as compared to approximately 24,558 members in the three months ended September 30, 2003. The reduction of advertising spending compared to historical levels occurred throughout the year ended December 31, 2003 and the first nine months of 2004. For the year ended December 31, 2003, advertising expenditures to attract new members were down 74.7%, from the amount spent to attract new members during the year ended December 31, 2002. Audio Book Club attracted approximately 134,000 new members in the year ended December 31, 2003 as compared to approximately 290,000 new members in the year ended December 31, 2002.

The decrease in Radio Spirits catalog sales of $401,000, or 43.8%, is principally attributable to lower sales from catalogs mailed in the third

quarter of 2004 due to less new product introduced into the catalogs during the quarter and the timing of shipments from the catalog mailed in September 2004. The Company has begun to develop more new product offerings and is beginning to offer other nostalgia products in the catalogs beginning in September 2004. Wholesale sales of old-time radio products decreased principally due to lower orders from mass merchants and other retailers and the timing of 2004 holiday sales.

Sales of our World's Greatest Old-Time Radio continuity program decreased for the three months ended September 30, 2004, as compared to the three months ended September 30, 2003, principally due to the reduction in our advertising expenditures for new members. For the three months ended September 30, 2004, we did not spend any money to attract new continuity customers, compared to $60,000 spent to attract new customers during the three months ended September 30, 2003.

Cost of Sales (In thousands)	2003 $	2003 As a % of Net Sales	2004 $	2004 As a % of Net Sales
Audio Book Club	$ 2,796	43.1%	$ 1,275	48.0%
Radio Spirits				
Catalog	411	44.9%	242	47.0%
Wholesale	761	57.3%	229	79.8%
Continuity	284	35.8%	129	37.8%
Total Radio Spirits	1,456	47.9%	600	52.5%
MediaBay.com	--	--	--	--
Cost of Sales - Before Strategic Charges	4,252	44.4%	1,875	48.7%
Cost of Sales - Strategic Charges	--	--	2,100	54.6%
	$ 4,252	44.4%	$ 3,975	103.3%

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 59.1% as described above. Cost of sales as a percentage of sales at Audio Book Club for the three months ended September 30, 2004 was 48.0%, compared to 43.1% for 2003. The increase in cost of sales as a percentage of sales is principally due to an increase in product costs as a percentage of sales since smaller active membership required us to purchase finished goods from publishers rather than the licensing and manufacture of product due to lower sales and our inability to meet manufacturing minimums and recoup advances to publishers, higher sales of unabridged and CD titles with higher costs, higher manufacturing costs due to lower volumes and the offering of more discounted titles in our catalogs in an effort to increase sales.

The principal reason for the decline in cost of sales at Radio Spirits was a reduction in sales of 62.4% as described above. As a percentage of sales, cost of sales at Radio Spirits increased to 52.5% for the three months ended September 30, 2004 from 47.9% for the three months ended September 30, 2003. Cost of catalog sales increased as a percentage of sales to 47.0% for the three months ended September 30, 2004 as compared to 44.9% for the three months ended September 30, 2003 principally due to more sales of discounted items. The cost of wholesale sales as percentage of sales increased to 79.8% for the three months ended September 30, 2004 as compared to 57.3% for the three months ended September 30, 2003 principally due to sales to discounters of discontinued items in the third quarter of 2004.

The Company has conducted a review of its operations including product offerings, marketing methods and fulfillment. The Company is committed to digitizing and encoding its library of spoken word content and making its content available to the digital customer as described in the introduction to this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Also as described in this Item 2, the Company announced that it had signed a multi-year agreement with Celebrity Newsletter LLC to develop television personality and syndicated talk show host, Larry King's, On-line Audiobook and Entertainment Club. The Company intends to design The Larry King Audiobook Club to meet, what it believes, are its customers' needs for an easy to use online retail experience.

As a result of these third quarter decisions, the Company has recorded $2,100 of strategic charges for the three months ended September 30, 2004. These charges include: $1,000 of inventory written down to net realizable value due to a reduction in Audio Book Club members and the Company's new focus on delivering spoken word products via downloads and $1,100 of write-downs to royalty advances paid to audiobook publishers and other license holders, which the Company does not believe will be recoverable due to its new focus on delivering spoken word products via downloads.

Advertising and Promotion

			From 2003 to 200	
	2003	2004	Change	% Ch
(In thousands)				
Audio Book Club				
New Member	$ 492	$ 110	$(382)	(77
Current Member	393	251	(142)	(36
Total Audio Book Club	885	361	(524)	
Radio Spirits				
Catalog	198	203	5	2.
Wholesale	(7)	8	15	-
Continuity	60	--	(60)	-
Total Radio Spirits	251	211	(40)	(15
New Projects	36	47	11	30
Total Spending	1,172	619	(553)	(47
Amount Capitalized	(498)	(96)	(402)	(80
Amount Amortized	1,395	608	(787)	(56
Advertising and Promotion Expense	$2,069	$1,131	$(938)	(45

Advertising and promotion expenses decreased $938,000 to $1.1 million for the three months ended September 30, 2004 as compared to $2.1 million in the prior comparable period. Actual advertising expenditures for the three months ended September 30, 2004 decreased $552,000 to $619,000 from $1.2 million during the three months ended September 30, 2003. The decrease was due to a minimal amount of new member marketing for Audio Book Club new members due to cash constraints and decreased advertising to existing members due to the reduction in Audio Book Club membership because of normal attrition with no marketing to replace leaving members. Radio Spirits continuity advertising was reduced due to cash constraints.

Bad Debt Expense

(In thousands)	2003 $	2003 As a % of Net Sales	2004 $	2004 As a % of Net Sales	C
Audio Book Club	$ 835	12.9 %	$ 180	6.8 %	
Radio Spirits					
Catalog	--	--	--	--	
Wholesale	4	0.2%	4	0.5%	
Continuity	92	8.7%	19	5.6%	
	96		23		
MediaBay.com	--	--	--	--	
	$ 931	9.7%	$ 203	5.3%	$

The principal reason for the decline in bad debt expense at Audio Book Club was a reduction in net sales of 59.1% as described above. Bad debt expense as a percentage of net sales at Audio Book Club for the three months ended September 30, 2004 was 6.8%, compared to 12.9% for the three months ended September 30, 2003. The decrease in bad debt expense as a percentage of net sales is principally due to a reduced number of new members, who typically have higher bad debt expense, since a lower number of new members were added in the three months ended September 30, 2004 as compared to the three months ended September 30, 2003.

General and Administrative

(In thousands)	2003 $	2003 As a % of Net Sales	2004 $	2004 As a % of Net Sales	F C
Audio Book Club	$ 619	9.8%	$ 555	20.9%	
Radio Spirits	302	25.5%	298	25.8%	
MediaBay.com	160	381.0%	151	290.4%	

Corporate	532	--	352	--
	$1,613	16.8%	$ 1,356	35.2%

The decrease in general and administrative expenses for the three months ended September 30, 2004 as compared to the three months ended September 30, 2003 is principally due to a reduction in personnel, as a result of a restructuring, which occurred in September 2003 and reductions in insurance costs.

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Depreciation and Amortization

(In thousands)	2003	2004
Depreciation		
Audio Book Club	$ 25	$17
Radio Spirits	10	9
Total depreciation	35	26
Amortization		
Corporate	30	2
Total depreciation and amortization	$65	$28

The decrease in depreciation and amortization expenses for the three months ended September 30, 2004 as compared to the three months ended September 30, 2003 is principally attributable to reductions in the amortization of intangibles, which had been fully amortized or written off during the year ended December 31, 2003.

Interest Expense

(In thousands)	2003	2004	Change
Total interest paid, net	$ 128	$ 312	$ 184
Accrued interest paid this period	73	--	(73)
Current interest paid	55	312	257
Interest accrued	(109)	--	109
Interest included in debt	218	165	(53)
Amortization of deferred financing costs and original issue discount	131	269	138
Total interest expense	295	746	451

Interest income	--	(5)	(5)
Total interest expense, net	$ 295	$ 741	$ 446

The increase in interest expenses is principally due to increased debt and higher interest costs and amortization of debt discount relating to the financing transactions in the first nine months of 2004 as described in the Liquidity and Capital Resources section of this Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.

PREFERRED STOCK DIVIDENDS

	2003	2004
(In thousands)		
Dividends accrued on Series A Preferred Stock	$ 57	$ 57
Dividends accrued on Series B Preferred Stock	5	8
Dividends accrued on Series C Preferred Stock	--	134
Total dividends accrued on preferred stock	$ 62	$199

The increase in preferred stock dividends for the three months ended September 30, 2004 as compared to the three months ended September 30, 2003 is due to the accrual of dividends for Series B Preferred Stock issued May 2003 and accrual of dividends on the Series C Preferred Stock issued in May 2004. Our Principal Shareholder agreed to exchange the principal of certain notes, plus accrued and unpaid interest owed to the Principal Shareholder aggregating $3.8 million and accrued and unpaid dividends owed to the Principal Shareholder aggregating $519,000 into an aggregate of 43,527 shares of Series C Preferred Stock convertible into (i) an aggregate of 5,580,384 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase an

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aggregate of 11,160,768 shares of Common Stock. The Series C Preferred Stock accrues dividends at the rate of 9% per annum.

Income (Loss) Applicable to Common Stockholders

	2003	2004	Cha
(In thousands)			
Income (Loss) applicable to common stockholders	$285	$(3,784)	$

Principally due to reduced sales and higher interest costs, partially offset by lower advertising, bad debt and general and administrative expenses, our net loss applicable to common shares for the three months ended September 30, 2004 increased $4.1 million to $3.8 million, or $.21 per diluted share as compared to a net income applicable to common shares for the three months ended September 30, 2003 of $285,000, or $.02 per diluted share of common stock.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003:

Net Sales

($000's)	2003	2004	Change from 2003 to 2004	% Change
Audio Book Club	$ 21,874	$ 9,719	$ (12,155)	(55.6)%
Radio Spirits				
Catalog	3,101	2,125	(976)	(31.5)%
Wholesale	2,228	1,270	(958)	(43.0)%
Continuity	2,380	1,062	(1,318)	(55.4)%
	7,709	4,457	(3,252)	(42.2)%
MediaBay.com	94	158	64	68.1%
	$ 29,677	$ 14,334	$ (15,343)	(51.7)%

Audio Book Club sales decreased principally due to a decrease in club membership as a result of a substantial reduction in our advertising expenditures for new members. For the nine months ended September 30, 2004, the Audio Book Club spent $382,000 to attract new members, a reduction of $1.7 million, or 81.7%, from the amount spent to attract new members of $2.1 million during the nine months ended September 30, 2003. Audio Book Club attracted approximately 17,600 new members in the nine months ended September 30, 2004 as compared to approximately 129,400 new members in the nine months ended September 30, 2003. The lack of advertising spending also occurred throughout the year ended December 31, 2003. For the year ended December 31, 2003, the Audio Book Club spent $2.1 million to attract new members, a reduction of $6.2 million, or 74.7%, from $8.3 million spent to attract new members during the year ended December 31, 2002. Audio Book Club attracted approximately 134,000 new members in the year ended December 31, 2003 as compared to approximately 290,000 new members in the year ended December 31, 2002.

The decrease in Radio Spirits catalog sales of $976,000, or 31.5%, is principally attributable to lower sales from catalogs mailed in 2004 due to reduced discounting in attempt to improve margins and a reduction in new product offerings in the catalog mailings. Based on the performance of these catalogs we have revised our mailings beginning in September 2004 to include more discounted products and have increased the number of new product offerings, including other nostalgia products. Wholesale sales of old-time radio products decreased principally due to lower sales to mass marketers and other retailers and the timing of holiday orders. Sales of our World's Greatest Old-Time Radio continuity program decreased for the nine months ended September 30, 2004, as compared to the nine months ended September 30, 2003, principally due lower membership because we reduced advertising expenditures for new members. For the nine months ended September 30, 2004, we spent $6,000 to attract new continuity

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customers; a reduction of $735,000, or 99.2% less, from the amount spent to attract new customers of $741,000 during the nine months ended September 30, 2003.

Cost of Sales (In thousands)	2003		2004	
	$	As a % of Net Sales	$	As a % of Net Sales
Audio Book Club	$ 9,621	44.0%	$4,500	46.3%
Radio Spirits				
Catalog	1,473	47.5%	921	43.4%
Wholesale	1,427	64.0%	834	65.7%
Continuity	1,086	45.6%	416	39.2%
Total Radio Spirits	3,986	51.7%	2,171	48.7%
MediaBay.com	4	4.3%	1	0.6%
Cost of Sales Before Strategic Charges	13,611	45.9%	6,672	46.5%
Cost of Sales - Strategic Charges	--	--	2,100	14.7%
	$ 13,611	45.9%	$8,772	61.2%

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 55.6% as described above. Cost of sales as a percentage of sales at Audio Book Club for the nine months ended September 30, 2004 was 46.3%, compared to 44.0% for 2003. The increase in cost of sales as a percentage of sales is principally due to an increase in product costs as a percentage of sales since smaller active membership required us to purchase finished goods from publishers rather than the licensing and manufacture of product due to lower sales and our inability to meet manufacturing minimums and recoup advances to publishers, higher sales of unabridged and CD titles with higher costs, higher manufacturing costs due to lower volumes and the offering of more discounted titles in our catalogs in an effort to increase sales.

The principal reason for the decline in cost of sales at Radio Spirits was a reduction in sales of 42.2% as described above. As a percentage of sales, cost of sales at Radio Spirits decreased to 48.7% for the nine months ended September 30, 2004 from 51.7% for the nine months ended September 30, 2003. Cost of catalog sales as a percentage of sales decreased principally due to fewer sales of discounted items. The cost of wholesale sales as percentage of sales for the nine months ended September 30, 2004 increased principally due to sales to discounters of discontinued products in the quarter ended September 30, 2004. The cost of World's Greatest Old-Time Radio continuity sales as a percentage of sales decreased because the continuity sales for the nine months ended September 30, 2003 included heavily discounted introductory merchandise designed to attract new buyers. Since we did very little new customer marketing in the nine months ended September 30, 2004, very little of the product sales were of heavily discounted products.

The Company has conducted a review of its operations including product offerings, marketing methods and fulfillment. The Company is committed to digitizing and encoding its library of spoken word content and making its content available to the digital customer as described in the introduction to this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Also as described in this Item 2, the Company announced that it had signed a multi-year agreement with Celebrity Newsletter LLC to develop television personality and syndicated talk show host, Larry King's, On-line Audiobook and Entertainment Club. The Company intends to design The Larry King

Audiobook Club to meet, what it believes, are its customers' needs for an easy to use online retail experience.

As a result of these third quarter decisions, the Company has recorded $2,100 of strategic charges for the three months ended September 30, 2004. These charges include: $1,000 of inventory written down to net realizable value due to a reduction in Audio Book Club members and the Company's new focus on delivering spoken word products via downloads and $1,100 of write-downs to royalty advances paid to audiobook publishers and other license holders, which the Company does not believe will be recoverable due to its new focus on delivering spoken word products via downloads.

Advertising and Promotion
(In thousands)

			From 2003 to 200	
	2003	2004	Change	% Ch
Audio Book Club				
New Member	$ 2,082	$ 382	$ (1,700)	
Current Member	1,507	885	(622)	
Total Audio Book Club	3,589	1,267	(2,322)	
Radio Spirits				
Catalog	696	543	(153)	
Wholesale	29	19	(10)	
Continuity	741	6	(735)	
Total Radio Spirits	1,466	568	(898)	
New Projects	340	61	(279)	
Total Spending	5,395	1,896	(3,499)	
Amount Capitalized	(2,393)	(341)	(2,052)	
Amount Amortized	4,526	2,203	(2,323)	
Advertising and Promotion Expense	$7,528	$ 3,758	$ (3,770)	

Advertising and promotion expenses decreased $3.8 million to $3.8 million for the nine months ended September 30, 2004 as compared to $7.6 million in the prior comparable period. Actual advertising expenditures for the nine months ended September 30, 2004 decreased $3.5 million to $1.9 million from $5.4 million during the nine months ended September 30, 2003. The decrease was due to a minimal amount of new member marketing for Audio Book Club new members, reduced spending on the World's Greatest Old-Time Radio continuity and reduced spending on new projects all due to cash constraints and restrictions placed on us by our new senior debt covenants and the reduction in Audio Book Club membership due to normal attrition with no marketing to replace leaving members.

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Bad Debt Expense

(In thousands)	2003 $	2003 As a % of Net Sales	2004 $	2004 As a % of Net Sales	F
Audio Book Club	$2,528	11.6%	$ 731	7.5%	$(1
Radio Spirits					
Catalog	--	--			
Wholesale	11	0.5%	11	0.9%	
Continuity	195	8.2%	81	7.6%	
	206		92		
MediaBay.com	--	--	--	--	
	$2,734	9.2%	$ 823	5.7%	$(1

The principal reason for the decline in bad debt expense at Audio Book Club was a reduction in net sales of 55.6% as described above. Bad debt expense as a percentage of net sales at Audio Book Club for the nine months ended September 30, 2004 was 7.5%, compared to 11.6% for the nine months ended September 30, 2003. The decrease in bad debt expense as a percentage of net sales is principally due to a reduced number of new members, who typically have higher bad debt expense, since a lower number of new members were added in the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003.

General and Administrative

(In thousands)	2003 $	2003 As a % of Net Sales	2004 $	2004 As a % of Net Sales	F C
Audio Book Club	$2,184	10.0%	1,829	18.8%	
Radio Spirits	1,001	13.0%	712	16.0%	
MediaBay.com	504	536.2%	473	299.4%	
Corporate	1,802		1,194		

$5,491	18.5%	$4,208	29.4%	(1

The decrease in general and administrative expenses for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 at Audio Book Club is principally due to a reduction in personnel, as a result of a restructuring, which occurred in September 2003 and lower insurance costs. The decrease in general and administrative expenses for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 at Radio Spirits is principally due to a reduction in personnel, as a result of a restructuring, which occurred in September 2003, and lower insurance costs. The reduction in corporate general and administrative expenses for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 is principally due to a reduction in personnel, as a result of a restructuring, a reduction in accounting fees due principally to a change in our auditors and reduction in legal expenses partially offset by higher investor relations expenses.

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Depreciation and Amortization

(In thousands)	2003	2004
Depreciation		
Audio Book Club	$ 79	$ 67
Radio Spirits	33	28
Total depreciation	112	95
Amortization		
Corporate	151	21
Total depreciation and amortization	$ 263	$ 116

The decrease in depreciation and amortization expenses for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 is principally attributable to reductions in the amortization of intangibles, which had been fully amortized or written off during the year ended December 31, 2003.

Interest Expense

(In thousands)	2003	2004	Change
Total interest paid	$ 422	$ 852	$ 430
Accrued interest paid this period	74	74	--
Current interest paid	348	778	430

Interest accrued	(14)	--	14
Interest included in debt	634	602	(32)
Amortization of deferred financing costs and original issue discount	379	1,058	679
Loss on early extinguishment of debt	--	1,532	1,532
Beneficial conversion expenses of January 2004 Notes	--	3,991	3,991
Expense of inducement to convert, related party debt	--	390	390
Total interest expense	1,347	8,351	7,004
Interest income	--	(11)	(11)
	$ 1,347	$ 8,340	$ 6,993

The increase in interest expenses is principally due to the recognition of expenses relating to our financing transactions in the first nine months of 2004 as described in the Liquidity and Capital Resources section of this Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations. These items which total $5.9 million include a loss on early extinguishment of debt of $1.5 million; beneficial conversion expenses of January 2004 Notes of $4.0 million and the expense of inducement to convert, related party debt of $390,000.

Preferred Stock Dividends

(In thousands)	2003	2004
Dividends accrued on Series A Preferred Stock	$ 171	$ 171
Dividends accrued on Series B Preferred Stock	12	23
Dividends accrued on Series C Preferred Stock	--	184
Total dividends accrued on preferred stock	$ 183	$ 378

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The increase in preferred stock dividends for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 is due to the accrual of dividends for Series B Preferred Stock issued May 2003 and accrual of dividends on the Series C Preferred Stock issued in May 2004. Our Principal Shareholder agreed to exchange the principal of certain notes, plus accrued and unpaid interest owed to the Principal Shareholder aggregating $3.8 million and accrued and unpaid dividends owed to the Principal Shareholder aggregating $519,000 into an aggregate of 43,527 shares of Series C Preferred Stock convertible into (i) an aggregate of 5,580,384 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase an aggregate of 11,160,768 shares of Common Stock. The Series C Preferred Stock accrues dividends at the rate of 9% per annum.

Loss Applicable to Common Stockholders

			From 2002 to 2003	
(In thousands)	2003	2004	Change	% Change
Loss applicable to common stockholders	$ 1,480	$ 12,061	$ 10,581	714.9%

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Principally due to the increase in interest expenses relating to the recognition of expenses of our financing transactions in the first nine months of 2004 which total $6.0 million, a reduction in gross profit due to lower sales as described above and strategic charges of $2.1 million as described above, partially offset by lower advertising expenses and general and administrative expenses, our net loss applicable to common shares for the nine months ended September 30, 2004 increased $10.6 million to $12.1 million, or $.73 per diluted share as compared to a net loss applicable to common shares for the nine months ended September 30, 2003 of $1.5 million, or $.10 per diluted share of common stock.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have funded our cash requirements through sales of equity and debt securities and borrowings from financial institutions and our principal shareholders. During 2003 and the first nine months of 2004, we did not have sufficient cash to undertake marketing activities to the extent of historical levels. As a result, our member and customer bases eroded and our revenues declined significantly. Although our cash position as of September 30, 2004 improved considerably, we require additional financing to conduct sufficient marketing activities to execute our new digital strategy and the new Larry King initiatives. If we do not obtain the funds necessary to increase our advertising to acquire new members to expand our existing membership and customer bases, our revenue will continue to decline, which will continue to negatively impact our performance.

For the nine months ended September 30, 2004, cash increased by $1.0 million, as we had net cash used in operating activities of $4.3 million, used net cash of $97,000 in investing activities and had cash provided by investing activities of $5.4 million.

FINANCING ACTIVITIES:

The following is a summary of our financing activities in the first nine months of 2004:

January 2004 Convertible Debt

On January 29, 2004, we issued $4.0 million aggregate principal amount of promissory notes (the "Notes") and warrants to purchase 2,352,946 shares of common stock (the "Investor Warrants") to institutional and accredited investors (the "Offering"). The notes were due on the earlier of (i) April 30, 2005, (ii) such date on or after July 1, 2004 at such time as all of our indebtedness under our existing credit facility is either repaid or refinanced or (iii) our consummation of a merger, combination or sale of all or substantially all of our assets or the purchase by a single entity, person or group of affiliated entities or persons of 50% of the our voting stock. The notes bore interest at the rate of 6%, increasing to 9% on April 28, 2004 and 18% on July 27, 2004. On receipt of shareholder approval, which was received on April 12, 2004, in

accordance with the terms of the Notes, the principal amount of the notes automatically converted into common stock at the rate of one share of common stock at $0.75, or approximately 5,333,333 shares. In addition, accrued interest in the amount $49,000 also converted into common stock at $0.75 per share, or 64,877 shares.

In connection with the Offering, we issued to the placement agent and a broker warrants to purchase an aggregate of 245,000 shares of common stock and also issued to the placement agent warrants to purchase an additional 500,884 shares of common stock on April 12, 2004 as partial consideration for the placement agent's services. All warrants issued are exercisable until January 28, 2009 at an exercise price of $1.28 per share.

We used a portion of the proceeds of the offering to repay $1,250,000 of principal due on our prior credit Agreement with ING (U.S.) Capital, L.L.C. and Patriarch Partners, L.L.C. (the "ING Credit Agreement") and to reduce our accounts payable.

New Credit Agreement and Related Financing Transactions

On April 28, 2004, we entered into a new credit agreement ("New Credit Agreement") by and among MediaBay and certain of its subsidiaries, the guarantors signatory thereto, Zohar CDO 2003-1, Limited ("Zohar") as lender, and Zohar, as agent, pursuant to which we and certain of our subsidiaries initially borrowed $9.5 million. The initial term of the New Credit Agreement is one year and it is extendable, at our sole option, for two additional one-year terms upon issuance of additional notes of $600,000 for the first additional year and $300,000 for the second additional year, provided there is no event of default. The loan bears interest at the rate of LIBOR plus 10%. In the first year of the loan, a fee of $900,000 has been added to the principal balance, which will be reflected as debt discount and will be accreted to interest expense over the next twelve months. We used a portion of the $8.6 million of funds received under the New Credit Agreement to satisfy all of its outstanding obligations under (i) promissory notes that it issued in October 2003 in the aggregate principal amount of $1.0 million plus accrued interest of $.2 million, (ii) the ING Credit Agreement, which had an outstanding principal balance of approximately $1.4 million and a partial payment of $1.6 million of the convertible note issued to ABC Investment, L.L.C. as described below.

Norton Herrick ("Herrick"), a principal shareholder of the Company, Huntingdon Corporation ("Huntingdon"), a company wholly-owned by Herrick, and N. Herrick Irrevocable ABC Trust (the "Trust"), of which Herrick is the beneficiary, and Howard Herrick, a principal shareholder of the Company, is the trustee, consented to the New Credit Agreement and the other transactions described above and entered into a subordination agreement with Zohar. The New Credit Agreement required the aggregate amount of principal and interest owed by MediaBay to Herrick, Huntingdon and the Trust be reduced to $6,800,000 ("Permissible Debt") by June 1, 2004, and that the Permissible Debt be further reduced by up to an additional $1,800,000 if MediaBay does not raise at least $2,000,000 in additional equity in each of the next two years.

Pursuant to an agreement dated April 28, 2004, on May 25, 2004 Herrick exchanged accrued and unpaid interest and dividends (including accrued and unpaid interest distributed by the Trust to Herrick) owed to Herrick aggregating $1,181,419 into (i) 11,814 shares of Series C Preferred Stock with a liquidation preference of $100 per share convertible into an aggregate of 1,514,615 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase 3,029,230 shares of Common Stock. The warrants are exercisable until April 28, 2014 at an exercise price of $0.53.

Pursuant to an agreement dated April 28, 2004, on May 25, 2004 Huntingdon exchanged the principal of the $500,000 principal amount note, $1,000,000 principal amount note, $150,000 principal amount note and $350,000 principal amount note held by Huntingdon, plus accrued and unpaid interest owed to Huntingdon aggregating $1,171,278 into (i) 31,713 shares of Series C Preferred Stock convertible into an aggregate of 4,065,768 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase an aggregate of 8,131,538 shares of Common Stock. The warrants are exercisable until April 28, 2014 at an exercise price of $0.53. If the amount of the Permissible Debt is required to be reduced due to MediaBay's failure to raise

the requisite additional equity, such reduction will automatically occur by the exchange of Permissible Debt held by Huntingdon for additional shares of Series C Preferred Stock in an aggregate liquidation preference equal to the amount of debt exchanged and warrants to purchase a number of shares of common stock equal to two times the number of shares of preferred stock issuable upon conversion of the Series C Preferred Stock.

Herrick and Huntingdon agreed not to demand repayment of their debt until the earlier of (i) the repayment of the New Credit Agreement or (ii) June 28, 2007.

The remaining promissory notes held by Herrick, Huntingdon and the Trust are guaranteed by certain subsidiaries of the Company and secured by a lien on the assets of the Company and certain subsidiaries of the Company.

In November 2004, the New Credit Agreement was amended to amend the definition of Adjusted EBITDA to exclude the $2.1 million of Cost of Sales - Strategic Charges discussed above and to allow us to retain the entire $900,000 received in the October Sale of Equity discussed below.

New ABC Note

Also on April 28, 2004, we repaid $1.6 million principal amount of the $3.2 million principal amount convertible note issued to ABC Investment, L.L.C. We issued a new $1.6 million note (the "New ABC Note") for the remaining principal amount. The New ABC Note extends the maturity date from December 31, 2004 to July 29, 2007. In exchange for extending the maturity date, the conversion price of the New ABC Note was reduced to $0.50. The closing sale price of our common stock on the closing date was $0.48. In October 2004, ABC Investment, L.L.C., converted $1.0 million principal amount of the New ABC Note into 2.0 million shares of Common Stock.

Settlement of Put Obligations

We also entered into a settlement agreement with Premier Electronic Laboratories, Inc. ("Premier") dated April 1, 2004. Pursuant to the settlement, among other things, we agreed to pay Premier $950,000 in exchange for Premier waiving its right to put its shares of Common Stock to MediaBay pursuant to a Put Agreement dated December 11, 1990. MediaBay's obligation under the Put Agreement was reduced by $150,000 in exchange for relinquishing certain leases for real property. MediaBay paid $14,000 on closing and is paying the remaining balance over six years in monthly payments starting at $7,000 in July 2004 and increasing to $19,000 from May 2007 through April 2010.

October Sale of Equity

On October 11, 2004, the Company entered into a Securities Purchase Agreement pursuant to which it issued to the purchasers thereunder an aggregate of 1,800,000 shares (the "Shares") of the Company's common stock, no par value per share (the "Common Stock"), and warrants to purchase 400,000 shares of Common Stock (the "Warrants"). The purchasers paid an aggregate purchase price of $900 for the Shares and Warrants. Each Warrant is exercisable to purchase one share of the Company's Common Stock at an exercise price of $0.83 per share during the five (5)-year period commencing on October 11, 2004.

OPERATING ACTIVITY

Net cash used in operating activities principally consisted of the net loss of $12.1 million, increases in prepaid expenses and royalty advances of $40,000 and $790,000, respectively, and a decrease in accounts payable and accrued expenses of $5.7 million, partially offset by non-cash beneficial conversion charges of $4.4 million, non-cash strategic charges relating to the write-down of inventory and advances to publishers, as described above, of $2.1 million, loss on extinguishment of debt of $1.5 million, depreciation and amortization expenses of $116,000, amortization of deferred financing costs and original issue discount of $1.1 million, non-current accrued interest and dividends payable of $1.1 million, non-cash stock compensation of $82,000 decreases in accounts receivable of $2.0 million and inventory of $62,000 and a net reduction in deferred member acquisition costs of $1.9 million.

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The decrease in accounts receivable was primarily attributable to a reduction in sales as described above. The net decrease in deferred member acquisition cost is due the lack of funds to conduct new member and customer acquisition activities. The increase in royalty advances is principally due to a decline in sales and a reduction in new member acquisition activities at Audio Book Club, which results in lower royalty expense and less utilization of the advances, as well as the timing and payment of advances. During the nine months ended September 30, 2004, we reduced accounts payable and accrued expenses by $5.7 million, the majority of which were over 90 days past due.

Net cash used in investing activities consists of acquisition of fixed assets of $77,000, principally computer equipment.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation", which amends SFAS No. 123 to provide alternative methods of transaction for an entity that voluntarily changes to the fair value method of accounting for stock based compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock based employee compensation. Finally, SFAS No. 148 amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure of those effects in interim financial statements. SFAS No. 148 is effective for fiscal years ended after December 15, 2002, but early adoption is permitted. Accordingly, we have adopted the applicable disclosure requirements of this Statement within this report. The adoption of SFAS No. 148 did not have a significant impact on our financial disclosures.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities," which is effective for interim periods beginning after December 15, 2003. This interpretation changes the method of determining whether certain entities should be included in our consolidated financial statements. An entity is subject to FIN 46 and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries." A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority of the expected losses or a majority of the expected residual returns or both. We are currently evaluating FIN 46 and believe that it will have no impact on its financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 33 on Derivative Instruments and Hedging Activities", which amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities that fall within the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 149 amends SFAS No. 133 regarding implementation issues raised in relation to the application of the definition of a derivative. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for similarly. This Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on our financial position or results of operations.

On May 15, 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 provides guidance on classification and measurement of certain financial instruments with characteristics of both liabilities and equity. We reclassified certain items to debt as a result of the SFAS 150.

CERTAIN TRANSACTIONS

In addition, to the financing transactions described above under "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources", in connection with the Offering described above, Norton Herrick and Huntingdon Corporation ("Huntingdon"), of which Norton Herrick is the sole shareholder, entered into a letter agreement (the "Letter Agreement") with the purchasers of Notes in the Offering pursuant to which they granted to the holders of the Notes in the event of an Event of Default (as defined in the Notes) the rights to receive payment under certain secured indebtedness owed by us to Norton Herrick and Huntingdon and to exercise their rights under security agreements securing such secured indebtedness. Pursuant to the Letter Agreement, Norton Herrick and Huntingdon also executed Powers of Attorney in favor of a representative of the Noteholders pursuant to which such representative may, following an Event of Default, take actions necessary to enforce the Note holders rights under the Letter Agreement, including enforcing Norton Herrick's and Huntingdon's rights under the security agreements. The January 2004 Notes were converted into common stock on April 12, 2004.

On April 28, 2004, we entered into a new credit agreement. Norton Herrick, Huntingdon and N. Herrick Irrevocable ABC Trust (the "Trust"), of which Norton Herrick is the beneficiary, consented to the new credit agreement and the other transactions described above and entered into a subordination agreement with Zohar. The new credit agreement required the aggregate amount of principal and interest owed by MediaBay to Herrick, Huntingdon and the Trust be reduced to $6.8 million ("Permissible Debt") by June 1, 2004, and that the Permissible Debt be further reduced by up to an additional $1.8 million if we do not raise at least $2.0 million in additional equity in the two calendar years following the execution of the new credit agreement. As of November 12, 2004, the Company has raised $900,000 of additional equity.

Pursuant to an agreement dated April 28, 2004, on May 25, 2004, Norton Herrick exchanged accrued and unpaid interest and dividends (including accrued and unpaid interest distributed by the Trust to Herrick) owed to Herrick aggregating $1,181,419 into (i) 11,814 shares of Series C Convertible Preferred Stock with a liquidation preference of $100 per share convertible into an aggregate of 1,514,615 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase 3,029,230 shares of Common Stock. The warrants are exercisable until April 28, 2014 at an exercise price of $0.53.

Pursuant to an agreement dated April; 28, 2004, on May 25, 2004, Huntingdon exchanged the principal of the $500,000 principal amount note, $1,000,000 principal amount note, $150,000 principal amount note and $350,000 principal amount note held by Huntingdon, plus accrued and unpaid interest owed to Huntingdon aggregating $1,171,278 into (i) 31,713 shares of Series C Convertible Preferred Stock convertible into an aggregate of 4,065,768 shares of Common Stock at an effective conversion price of $0.78, and (ii) warrants to purchase an aggregate of 8,131,538 shares of Common Stock. The warrants are exercisable until April 28, 2014 at an exercise price of $0.53. If the amount of the Permissible Debt is required to be reduced due to the Company's failure to raise the requisite additional equity, such reduction will automatically occur by the exchange of Permissible Debt held by Huntingdon for additional shares of Series C Convertible Preferred Stock in an aggregate liquidation preference equal to the amount of debt exchanged and warrants to purchase a number of shares of Common Stock equal to two times the number of shares of Common Stock issuable upon conversion of the Series C Convertible Preferred Stock.

Herrick and Huntingdon agreed not to demand repayment of their debt until the earlier of (i) the repayment of the New Credit Agreement or (ii) June 28, 2007.

The remaining promissory notes held by Herrick, Huntingdon and the Trust are guaranteed by certain of our subsidiaries and secured by a lien on our assets and certain of our subsidiaries of the Company.

In connection with Norton Herrick and Huntingdon consenting to the New Credit Agreement, we agreed to pay to Herrick accounts payable and accrued expenses due to him as of March 31, 2004 in the amount of approximately $672,000. Such amounts are being paid to him at the rate of $40,500 per month. XNH Consulting Services, Inc. ("XNH"), a company wholly-owned by Norton Herrick, and the Company also modified a termination agreement, in which we had agreed

among other things to pay XNH a fee of $7,500 per month for 16 months commencing on January 1, 2004 and Herrick agreed to provide consulting services at his sole discretion. The modification eliminated our obligation to make the monthly payments and our ability to request consulting services from XNH. All other terms of the termination agreement were unchanged.

On April 28, 2004, the Company repaid $1.6 million principal amount of the $3.2 million principal amount convertible note issued to ABC Investments, L.L.C., a principal shareholder of the Company. We issued a new $1.6 million note (the "New ABC Note") for the remaining principal amount. The New ABC Note extends the maturity date from December 31, 2004 to July 29, 2007. In exchange for extending the maturity date, the conversion price of the New ABC Note was reduced to $0.50. The closing sale price of our common stock on the closing date was $0.48. During October 2004, ABC Investments, L.L.C. converted $1,000,000 principal amount of the New ABC into shares of Common Stock pursuant to the terms of the note.

QUARTERLY FLUCTUATIONS

Our operating results vary from period to period as a result of purchasing patterns of members, the timing, costs, magnitude and success of direct mail campaigns and Internet initiatives and other new member recruitment advertising, member attrition, the timing and popularity of new audiobook releases and product returns.

The timing of new member enrollment varies depending on the timing, magnitude and success of new member advertising, particularly Internet advertising and direct mail campaigns. We believe that a significant portion of our sales of old-time radio and classic video programs are gift purchases by consumers. Therefore, we tend to experience increased sales of these products in the fourth quarter in anticipation of the holiday season and the second quarter in anticipation of Fathers' Day.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES OF MARKET RISK

We are exposed to market risk for the impact of interest rate changes. Historically, we have not entered into derivative transactions for hedging, trading or speculative purposes.

The Company's exposure to market risk for changes in interest rates relates to its variable rate debt. The Company has total debt outstanding, not including debt discount, as of November 12, 2004 of $18.4 million, of which $6.5 million is at fixed rates, $9.4 million bears interest at LIBOR plus 10% and $2.5 million bears interest at prime plus 2.5%. If the prime rate or LIBOR were to increase the Company's interest expense would increase, however a hypothetical 10% change in interest rates would not have had a material impact on its fair values, cash flows, or earnings for the three and nine months ended September 30, 2004.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective at the reasonable assurance level to timely alert them of information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934. During the nine months ended September 30, 2004 there were no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

ITEM 2: CHANGES IN SECURITIES AND USE OF PROCEEDS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

During the three months ended September 30, 2004, we issued plan options to purchase 907,500 shares of its common stock our officers, employees, directors and consultants. The options have exercise prices ranging from $0.33 to $0.39 vest at various times and have a five-year exercise period. These securities were issued pursuant to an exemption from the registration requirements offered by Section 3(a)(9) of the Securities Act of 1933. Also during the three months ended September 30, 2004, options to purchase 39,000 shares of Common Stock expired.

ITEM 6: EXHIBITS

10.1 Employment Agreement between the Registrant and Joseph R. Rosetti
10.2 Employment Agreement between the Registrant and John F. Levy
10.3 Consent and Amendment No. 1 dated November 12, 2004, to the Credit Agreement dated as of April 28, 2004
31.1 Chief Executive Officer Certification Pursuant to Section 302 of

the Sarbanes-Oxley Act of 2002.

31.2 Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Jeffrey Dittus, Chief Executive Officer of MediaBay, Inc., pursuant to 18 U.S.C Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of John Levy, Vice Chairman and Chief Financial Officer of MediaBay, Inc., pursuant to 18 U.S.C Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 20

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, MediaBay, Inc. has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MediaBay, Inc.

Dated: November 15, 2004 By: /s/ Jeffrey Dittus

Jeffrey Dittus
Chief Executive Officer

Dated November 15, 2004 By: /s/ John F. Levy

John F. Levy
Vice Chairman and Chief Financial Officer
(principal accounting and financial officer)

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