MEDIABAY INC
Form 10-Q
November 14, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2005

OR

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

For the transition period from _________ to ________

Commission file number 1-13469

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|

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

Indicate the number of shares outstanding of each of the Registrant's classes of common equity, as of the latest practical date.

As of November 10, 2005, there were 10,439,284 shares of the Registrant's Common Stock outstanding.

MEDIABAY, INC.
Quarter ended September 30, 2005
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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

MEDIABAY, INC.
Condensed Consolidated Balance Sheets
(Dollars in thousands)
(Unaudited)

	Septe
	2
Assets	
Current Assets:	

Cash and cash equivalents	$
Accounts receivable, net of allowances for sales returns and doubtful accounts of $1,638 and $2,708 at September 30, 2005 and December 31, 2004, respectively	
Inventory	
Prepaid expenses and other current assets	
Royalty advances	

Total current assets	
Fixed assets, net	
Other intangibles	
Goodwill	

	$
	===

Liabilities and Stockholders' Equity

Current liabilities:	
Accounts payable and accrued expenses	$
Accounts payable, related party	
Short-term debt, net of original issue discount of $53 at September 30, 2005 and $54 December 31, 2004, respectively	
Preferred dividends payable	
Current portion of long-term debt	

Total current liabilities	

Long-term debt, net of original issue discount of $126 and $908 at September 30, 2005 and December 31, 2004	
Related party long-term debt including accrued interest	

Total liabilities	

Commitments and Contingencies	
Preferred stock, no par value, authorized 5,000,000 shares; no shares of Series A outstanding at September 30, 2005 and 25,000 shares of Series A outstanding at December 31, 2004; 200 shares of Series B issued and outstanding at September 30, 2005 and December 31, 2004; no shares of Series C issued and outstanding at September 30, 2005 and 43,527 shares of Series C issued and outstanding at December 31, 2004; and 21,063 shares of Series D issued and outstanding at September 30, 2005 and no shares of Series D issued and outstanding at December 31, 2004	
Common stock, no par value, authorized 300,000,000, issued and outstanding 10,439,284 as of September 30, 2005; and authorized 150,000,000 shares, issued and outstanding 4,140,663 at December 31, 2004	1
Contributed capital	
Accumulated deficit	(1

Total stockholders' equity (deficit)	

	$
	===

See accompanying notes to condensed consolidated financial statements.

MEDIABAY, INC.
Condensed Consolidated Statements of Operations
(Dollars in thousands, except per share data)
(Unaudited)

	Three months ended September 30,		Nine mo Sept
	2005	2004	2005
Sales, net of returns, discounts and allowances of $124 and $983 and $1,554 and $4,286 for the three and nine months ended September 30, 2005 and 2004, respectively	$ 1,387	$ 3,849	$ 7,012
Cost of sales	1,002	1,875	4,101
Cost of sales - strategic charges	--	2,100	305
Gross profit	385	(126)	2,606
Expenses:			
Advertising and promotion	478	1,131	1,265
General and administrative	1,708	1,559	5,295
Termination charges	--	--	697
Depreciation and amortization	15	28	58
Operating loss	(1,816)	(2,844)	(4,709)
Interest income	92	--	167
Interest expense	126	741	752
Loss on early extinguishment of debt	--	--	579
Loss before income taxes	(1,850)	(3,585)	(5,873)
Income tax expense	--	--	--
Net loss	(1,850)	(3,585)	(5,873)
Dividends on preferred stock	390	199	1,127
Deemed dividend on beneficial conversion of Series D Preferred Stock	--	--	17,423
Net loss applicable to common shares	$ (2,240)	$ (3,784)	$(24,423)
Basic and diluted loss applicable to common shares per common share:	$ (0.25)	$ (1.23)	$ (3.82)

See accompanying notes to condensed consolidated financial statements.

MEDIABAY, INC.
Condensed Consolidated Statements of Cash Flows
(Dollars in thousands)

	Ni
	200
Cash flows used in operating activities:	
Net loss applicable to common shares	$(24,
Adjustments to reconcile net loss to net cash provided by operating activities:	
Deemed dividend on beneficial conversion of Series D Preferred Stock	17,
Loss on extinguishment of debt	
Non-current accrued interest and dividends payable	
Amortization of deferred financing costs and original issue discount	
Depreciation and amortization	
Cost of sales - strategic charges	
Payment of accrued dividends through issuance of common stock	
Amortization of deferred member acquisition costs	
Non-cash beneficial conversion charge included in interest expense	-
Expense of inducement to convert	-
Non-cash stock compensation	-
Changes in asset and liability accounts, net of strategic charges:	
Decrease in accounts receivable, net	
Increase in inventory	
Increase in prepaid expenses	(
Decrease (increase) in royalty advances	
Increase in deferred member acquisition costs	-
Decrease in accounts payable, accrued expenses and preferred dividends payable	(1,
Net cash used in operating activities	(5,
Cash flows used in investing activities:	
Acquisition of fixed assets, including website development costs	(1,
Acquisition of intanglible assets	-
Net cash used in investing activities	(1,
Cash flows from financing activities:	
Net proceeds from issuance of preferred stock	31,
Proceeds from issuance of long-term debt	-
Proceeds from exercise of stock options	
Payment of long-term debt	(11,
Redemption of Series A and Series C Preferred Stock	(5,
Increase in deferred financing costs	-
Net cash provided by financing activities	13,
Net increase in cash and cash equivalents	7,
Cash and cash equivalents at beginning of period	3,
Cash and cash equivalents at end of period	$ 10,

See accompanying notes to condensed consolidated financial statements.

MEDIABAY, INC.
Notes to Consolidated Financial Statements
(Dollars in thousands, except per share data)
(Unaudited)

(1) Organization

MediaBay, Inc. ("MediaBay" or "the Company") is a Florida corporation formed on August 16, 1993. The Company is a digital media, marketing and publishing company specializing in spoken audio entertainment.

Today, the Company has two principal content libraries: (1) Audiobooks which it sells via digital download and on CD and cassette through Soundsgood.com, the Audio Book Club and third-party websites; and (2) an archive of the history of American radio which it produces and sells on CD and cassettes through its catalog, a mail order-based continuity program, retail outlets, its on-line download subscription service and third-party websites. The Company broadcasts its radio programs through a syndicated radio show on 200 commercial stations across the United States, as well as its 24-hour Radio Classics channels on Sirius and XM Satellite Radio.

(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.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts have been eliminated.

Cash and Cash Equivalents

Securities with maturities of three months or less when purchased are considered to be cash equivalents.

Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and accrued expenses approximates fair value due to the short maturity of those instruments.

The fair value of long-term debt is estimated based on the interest rates currently available for borrowings with similar terms and maturities. The carrying value of the Company's long-term debt approximates fair value.

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.

Prepaid Expenses

Prepaid expenses consist principally of deposits and other amounts being expensed over the period of benefit. All current prepaid expenses will be expensed over a period no greater than twelve months from the date of the Balance Sheet.

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 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.

SOP 93-7 requires that the realizability of the amounts of direct-response advertising reported as assets should be evaluated at each balance sheet date by comparing the carrying amounts of the assets to their probable remaining future net revenues. At September 30, 2005, we had no direct-response advertising reported as assets, since we have determined that probable future benefits from any direct advertising we have incurred would not exceed the amounts expended.

Fixed Assets, Net

Fixed assets, consisting primarily of furniture, leasehold improvements, computer equipment, and third-party web site development costs, are recorded at cost. Depreciation and amortization, which includes the amortization of equipment under capital leases, is provided by the straight-line method over the estimated useful life of three years (the lease term) for computer equipment and five years (the lease term) for sound equipment under capital leases, five years for equipment, seven years for furniture and fixtures, five years for leasehold improvements, and three years from the date the assets are put into service for Internet web site development costs. Ongoing maintenance and other recurring charges are expensed as incurred.

Other Intangibles, Net

Intangible assets, principally consisting of purchased intellectual property, which is reviewed for impairment on each reporting date, and non-compete agreements, which are being amortized over their contractual term.

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 accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets", the Company ceased amortization of goodwill as of January 1, 2002. Goodwill is 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 is more than its fair value.

Revenue Recognition

During the nine months ended September 30, 2005 and September 30, 2004, the Company derived its principal revenue through sales of audiobooks, classic radio shows and other spoken word audio products directly to consumers principally through direct mail and the Internet. The Company also sold classic radio shows to retailers either directly or through distributors. The Company derived additional revenue through rental of its proprietary database of names and addresses to non-competing third parties through list rental brokers. The Company also derived 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 or directly from the broadcaster. Allowances for future returns are based upon historical experience and evaluation of current trends.

Downloadable content revenue from the sale of individual content titles is recognized in the period when the content is downloaded and the customer's credit card is processed. Downloadable content revenue from the sale of downloadable content subscriptions is recognized pro rata over the term of the subscription period.

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 free audiobooks in the initial enrollment offer to prospective members)
- 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

In accordance with EITF No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)", the Company classifies the cost of sales incentives as a reduction of net sales.

Bad Debt Expense

The Company records an estimate of its anticipated bad debt expense based on historical experience.

General and Administrative Costs

General and administrative costs include the following:

- Bad debt expense
- Payroll and related items
- Commissions

- Insurance
- Office expenses
- Telephone and postage
- Public and investor relations
- Dues and subscriptions
- Rent and utilities
- Travel and entertainment
- Bank charges
- Professional fees, principally legal and auditing fees
- Consulting

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. In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The compensation cost will be measured based on the fair value of the equity or liability instruments issued. The Statement is effective as of the beginning of the first annual period beginning after June 15, 2005. 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 months ended September 30, 2005 and 2004 would have been as follows:

	Three Months Ended September 30,		
	2005	2004	2
Net loss applicable to common shares, as reported	$ (2,240)	$ (3,784)	$(2
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)	
Pro forma net loss applicable to common shares	$ (2,240)	$ (3,990)	$(2
Net loss per share			
Basic and diluted - as reported	$ (0.25)	$ (1.23)	$
Basic and diluted - pro forma	$ (0.25)	$ (1.30)	$

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

Date	No. of Shares	Exercise Price	Assumed Volatility	Risk-free Interest Rate	Fair V S
First Nine months 2004	601,250	$5.52	97%	4.00%	
First Nine months 2005	801,667	$3.54	41%	3.35%	

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.

Royalties

The Company is liable for royalties to licensors based upon revenue earned from the respective licensed product. The Company pays certain 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.

Use of Estimates

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 estimate.

Reclassifications

Certain amounts relating to 2004 have been reclassified to conform to the current 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. Amortization expense for other intangible assets was $6 and $30 for the nine months ended September 30, 2005 and 2004, respectively. The Company estimates intangible amortization expenses of $8 in 2005:

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The following table presents details of Other Intangibles at September 30, 2005 and December 31, 2004:

	September 30, 2005			December 31, 2004		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Mailing Agreements	$ 592	$ 592	$ --	$ 592	$ 592	$ --
Customer Lists	4,380	4,380	--	4,380	4,380	--
Non-Compete Agreements	313	294	19	313	288	25
Other	25	--	25	25	--	25
Total Other Intangibles	$5,310	$5,266	$ 44	$5,310	$5,260	$ 50

Goodwill of $9,658 as of September 30, 2005 and December 31, 2004 is attributable to the Company's Radio Spirits business. The Company conducted its annual impairment test for 2004 in January 2005, utilizing the services of an independent appraiser, which did not result in an impairment loss. Any future impairment losses incurred will be reported in operating results.

(4) Debt

	As of September 30, 2005	As of December 31, 2004
Credit agreement, senior secured debt, net of original issue discount	$ --	$ 8,661
Premier debt, net of original issue discount	646	670
Related party notes and related accrued interest, net of original issue discount	--	7,750
Total debt	646	17,081
Less: current portion	(31)	(229)
Long-term debt	$ 615	$ 16,852

March Payment and Conversion of Debt

On March 23, 2005, the Company completed the March Financing described below.

Concurrently with the March Financing, the Company repaid from the net proceeds all of the principal and accrued and unpaid interest due on the Company's outstanding senior notes issued on April 28, 2004, in the aggregate amount of approximately $9,400. The Company reported a charge in the first quarter of 2005 of $579 to reflect the write-off of unamortized financing charges related to the repayment of this debt.

Also in connection with the March Financing, the Company entered into an agreement (the "Herrick Agreement") with the Herrick Entities, described below (the "Herrick Agreement"). Pursuant to the Herrick Agreement, concurrently with the Financing, among other actions, all $5,784 principal amount of the convertible notes of the Company owned by the Herrick Entities were converted into an aggregate of approximately 1.7 million shares of Common Stock, at their stated conversion rate of $3.36 per share.

The Company also paid to Norton Herrick and Huntingdon all accrued and unpaid interest dividends due to them in the amount $2,271.

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(5) Stockholders' Equity and Stock Options and Warrants

The following table presents information regarding the Company's outstanding preferred stock at September 30, 2005 and December 31, 2004:

	As of September 30, 2005	As of December 31 2004

Series A Convertible Preferred Stock	$ --	$ 2,500
Series B Convertible Preferred Stock	20	20
Series C Convertible Preferred Stock	--	4,353
Series D Convertible Preferred Stock, total outstanding at September 30, 2005 $21,063, net of cash fees and expenses of $2,048; value ascribed to investors' and advisors' warrants of $7,533	11,482	--
Total Preferred Stock	$11,502	$ 6,873

March 2005 Sale of Series D Convertible Preferred Stock and Warrants

On March 21, 2005, the Company agreed to issue an aggregate of (a) 35,900 shares (the "Offering Shares") of its Series D Convertible Preferred Stock (the "Series D Preferred") convertible into 10,878,788 shares of the Company's common stock, (b) 5,439,394 five-year common stock purchase warrants (the "Offering Warrants"), valued at $10,852 using an accepted valuation method and (c) preferred warrants (the "Over-Allotment Warrants" and, together with the Offering Shares and the Offering Warrants, the "Offering Securities") exercisable for a limited time, for additional proceeds to the Company of $8,975, to purchase (1) up to 8,975 additional shares of Series D Preferred (the "Additional Shares" and, together with the Offering Shares, the "Preferred Shares") and (2) up to 1,359,849 additional warrants identical to the Offering Warrants (the "Additional Warrants" and, together with the Offering Warrants, the "Warrants"), to accredited investors (the "Investors") for an aggregate purchase price of $35,900 (the "Financing").

Immediately prior to the Financing, holders of a majority of the Company's voting securities approved by written consent (the "Shareholder Consent") (a) an amendment to the Articles of Incorporation of the Company, increasing the number of authorized shares of the common stock of the Company ("Common Stock") from 150,000,000 to 300,000,000, (b) a change of control which may occur as a result of the Financing, and (c) the Company's issuance, in connection with the transactions contemplated by the Financing documents, of Common Stock in excess of 19.99% of the number of shares of Common Stock outstanding immediately prior to the Financing.

While such actions were approved by a majority of the shareholders prior to the Financing, the Company was not permitted to effect them until it satisfied certain information requirements to the shareholders of the Company not party to the Shareholder Consent. As a result, the Shareholder Consent did not become effective until May 3, 2005.

The Preferred Shares have a face value of $1,000 per share ("Stated Value") and are convertible at any time at the option of the holder into shares ("Conversion Shares") of common stock at the rate of $3.30 per Conversion Share, subject to certain anti-dilution adjustments, including for issuances of Common Stock for consideration below the conversion price. The Preferred Shares are also mandatorily convertible at the option of the Company, subject to its satisfaction of certain conditions, commencing June 10, 2005, which is 30 days after May 11, 2005, the effective date of the registration statement registering the shares underlying the Series D Preferred Stock. Under certain circumstances under the control of the Company, the holders will also have the right to require the Company to redeem their Preferred Shares at their Stated Value. Cumulative dividends will accrue on the Preferred Shares on an annualized basis in an amount equal to 6% of their Stated Value until they are converted or redeemed and will be payable quarterly in arrears, beginning April 1, 2005, in cash or, at the Company's option, subject to its satisfaction of certain conditions, in shares of

Common Stock ("Dividend Shares") valued at 93% of the average of the daily volume weighted average per-share price of the Common Stock for the five trading days prior to the applicable payment date. The Preferred Shares are non-voting. Subject to certain exceptions for accounts receivable and equipment and capital lease financings, the Company may not incur additional indebtedness for borrowed money or issue additional securities that are senior to or pari passu to the Preferred Shares without the prior written consent of holders of at least two-thirds of the Preferred Shares then outstanding.

Each Warrant is exercisable to purchase one share of Common Stock (collectively, the "Warrant Shares"), at an exercise price of $3.36 per share for a period of five years commencing September 23, 2005, subject to certain anti-dilution adjustments, including for issuances of Common Stock for consideration below the exercise price. In addition, once exercisable, the Warrants permit cashless exercises during any period when the Warrant Shares are not covered by an effective resale registration statement.

The Over-Allotment Warrants are exercisable until February 9, 2006 for the purchase of Additional Shares and Additional Warrants, at an exercise price equal to the Stated Value of the Additional Shares purchased, with the purchase of each Additional Share including an Additional Warrant exercisable for a number of Warrant Shares equal to 50% of the Conversion Shares underlying such Additional Share.

As part of the Financing, the Forest Hill Select Fund L.P. and related entities (the "Forest Hill Entities") exchanged 300,000 shares of Common Stock and 66,667 common stock warrants previously purchased by them from the Company in October 2004 for $900 of the Offering Securities. The Forest Hill Entities also purchased $1,000 of the Offering Securities. The Company included an additional 19,841 shares of Common Stock, as well as 8,333 shares of Common Stock underlying certain additional warrants, already beneficially owned and retained by Forest Hill Capital, for resale in the registration statement declared effective May 11, 2005.

In connection with the Financing, the Company also entered into an agreement with Norton Herrick and certain of his affiliates (the "Herrick Entities") pursuant to which, concurrently with the Financing:

o all $5,784 principal amount of the convertible notes of the Company owned by the Herrick Entities (the "Herrick Notes") and 10,684 of their shares of the Series A Convertible Preferred Stock of the Company ("Series A Preferred") were converted into an aggregate of approximately 2.03 million shares of Common Stock (the "Herrick Shares"), at their stated conversion rate of $3.36 per share;

o the Company agreed to redeem the remaining 14,316 shares of Series A Preferred held by the Herrick Entities and all 43,527 of their shares of the Series C Convertible Preferred Stock of the Company (collectively, the "Redemption Securities") for $5,784, the aggregate stated capital of such shares, on the earlier of the effective date of the Shareholder Consent (May 3, 2005);

o the Herrick Entities waived certain of their registration rights and the Company agreed to include the Herrick Shares for resale in the registration statement declared effective May 11, 2005 so long as such Herrick Shares are owned by the Herrick Entities and not otherwise transferred, including, but not limited to, in the Herrick Financing (as defined below); and

o the Herrick Entities consented to the terms of the Financing and the agreements entered into in connection with the Financing, as the Company was required to obtain such consents pursuant to the terms of the Herrick Notes, the Series A Preferred and the Series C Preferred.

- o Herrick and Huntingdon also entered into a voting agreement and proxy with the Company pursuant to which they agreed not to take any action to contradict or negate the Shareholder Consent.

- o the Company entered into a registration rights agreement dated the date hereof with Herrick and Huntingdon in which the parties are granted "piggy-back" registration rights and, with respect to the shares of Common Stock issuable to Herrick and Huntingdon upon conversion of the Herrick Notes and Series A Preferred Stock, Herrick and Huntingdon are granted the same automatic registration rights as the Investors under the Registration Rights Agreement.

- o the Company also entered into another registration rights agreement dated March 23, 2005, with Herrick and Huntingdon in which the parties are granted "piggy-back" registration rights and, with respect to the shares of our common stock issuable to Herrick and Huntingdon upon exercise of the warrants held by Herrick and Huntingdon.

The Company received $35,000 of gross proceeds (not including the securities exchanged by the Forest Hill Entities for $900 of the purchase price) in the Financing. Merriman Curhan Ford & Co. ("Merriman") acted as a financial advisor with respect to certain of the investors in the Financing for which it received compensation from the Company of $2,625 plus a five-year warrant (the "Merriman Warrant") to purchase 1,193,182 shares of Common Stock at an exercise price of $4.14 per share commencing upon May 3, 2005, the effective date of the Shareholder Consent. Merriman also received a structuring fee from the Company with respect to the Financing in the amount of $175. In addition, the Company issued to Satellite Strategic Finance Associates, LLC and Satellite Strategic Finance Partners, Ltd., investors in the Financing, warrants to purchase an aggregate of 41,667 shares of Common Stock (identical to the Warrants), and reimbursed them $55 for expenses, for consulting services rendered by it in connection with the Financing. The Company incurred cash fees and expenses including fees paid to advisors of $3,512. Warrants issued to advisors were valued at $1,986 using an accepted valuation method.

The Preferred Shares are convertible at any time at the option of the holder into shares ("Conversion Shares") of common stock at the rate of $3.30 per Conversion Share and each Warrant is exercisable to purchase one share of Common Stock (collectively, the "Warrant Shares"), at an exercise price of $3.36 per share. The market price for the Company's common stock at March 21, 2005 was $4.14. The Company recorded as dividends an amount of $17,423 to reflect the value of the deemed dividend for beneficial conversion feature of Series D Preferred Stock.

As of September 30, 2005, 14,837 shares of Series D Preferred Stock plus accrued dividends thereon were converted into 4,521,599 shares of common stock and 21,063 shares of Series D Preferred Stock are outstanding.

Stock Options and Warrants

From January 1, 2005 to September 30, 2005, the Company issued options to purchase 801,667 shares of its common stock to employees, officers, directors and consultants under its stock incentive plans. From January 1, 2005 to

September 30, 2005, options to purchase 62,280 shares of its common stock were either cancelled or expired. The Company issued non-plan warrants to purchase 6,674,243 shares of its common stock in connection with the Financing described above. During the nine months ended September 30, 2005, the Company cancelled non-plan warrants to purchase 76,667 shares of its common stock.

(6) Cost of Goods Sold - Strategic Charges

In the second quarter of 2005, the Company changed its negative option book club and converted to a business selling audiobooks and other audio entertainment without a negative option requirement. The Company has moved its warehouse and fulfillment operations to a facility which also provides products and accordingly the Company has changed from licensing and manufacturing many of its audiobook titles to buying on a wholesale basis and accordingly has recorded a $305 write-down of royalty advances to what the Company believes is net realizable value at September 30, 2005.

The Company 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) Supplemental Cash Flow Information

No cash has been expended for income taxes for the nine months ended September 30, 2005 and 2004. Cash paid for interest expense was $2,015 and $536 for the nine months ended September 30, 2005 and 2004, respectively.

The Company had the following non-cash activities for the nine months ended September 30, 2005:

	2005
Conversions of subordinated notes into common stock	$ 5,784
Conversion of preferred shares into common stock	$14,837
Conversion of common shares and warrants into preferred stock and warrants sold in the Financing	$ 900
Issuance of warrants in connection with the Financing	$12,838

(8) Net Loss Per Share of Common Stock

Basic (loss) earnings per share was computed using the weighted average number of common shares outstanding for the three and nine months ended September 30, 2005 of 8,989,725 and 6,400,211, respectively and for the three and nine months ended September 30, 2004 of 3,077,271 and 2,738,765.

For the three months ended September 30, 2005 common equivalent shares which were not included in the computation of diluted loss per share because they would have been anti-dilutive were 49,019 common equivalent shares, as calculated under the treasury stock method and 7,820,544 common equivalent shares relating to convertible subordinated debt and convertible preferred stock calculated under the "if-converted method". Dividends on the convertible preferred stock added back to net income applicable to common stockholders would have been $390 for the three months ended September 30, 2005.

For the nine months ended September 30, 2005 common equivalent shares which were not included in the computation of diluted loss per share because they would have been anti-dilutive were 780,501 common equivalent shares, as calculated under the treasury stock method and 8,635,463 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 $1,303 for the nine months ended September 30, 2005.

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 4,170 common equivalent shares, as calculated under the treasury stock method and 4,001,458 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 $378 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 146,156 common equivalent shares, as calculated under the treasury stock method and 3,257,112 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 $786 for the nine months ended September 30, 2004.

(9) Segment Reporting

For 2005 and 2004, the Company has divided its operations into four reportable segments: Corporate; Audio Book Club ("ABC") a business selling audiobooks via 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. Inter-segment sales are recorded at prevailing sales prices.

Segment Reporting

Three Months Ended September 30, 2005

	Corporate	ABC	RSI	Mbay.
Sales, net of returns, discounts and allowances	$ --	$ 531	$ 815	$
Operating (loss) profit before depreciation and amortization	(742)	(781)	(124)	(
Depreciation and amortization	2	10	3	-
Interest (income)				
Interest expense, net	(34)	--	--	-
Dividends on preferred stock	(390)	--	--	-
Net income (loss) applicable to common shares	(1,168)	(791)	(127)	(
Total assets	--	10,850	12,932	
Acquisition of fixed assets	--	627	--	-

Three Months Ended September 30, 2004

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

Nine months Ended September 30, 2005

	Corporate	ABC	RSI	Mbay.
Sales, net of returns, discounts and allowances	--	4,093	2,786	
Operating (loss) profit before depreciation and amortization	(2,949)	(951)	(331)	(
Depreciation and amortization	7	34	17	-
Interest expense, net	(584)	--	(1)	-
Loss on early retirement of debt	(579)	--	--	-
Dividends on preferred stock	(18,550)	--	--	-
Deemed dividend on beneficial conversion of Series D Preferred Stock				
Net income (loss) applicable to common shares	(22,669)	(985)	(349)	(
Total assets	--	10,850	12,932	
Acquisition of fixed assets	--	1,207	--	-

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Nine months Ended September 30, 2004

Corporate	ABC	RSI	Mbay.

Sales, net of returns, discounts and allowances	--	9,719	4,514	
Operating (loss) profit before depreciation and amortization	(1,194)	(2,229)	501	(
Depreciation and amortization	22	66	28	-
Interest expense, net	(6,805)	--	(3)	-
Loss on early retirement of debt	(1,532)	--	--	-
Dividends on preferred stock	(378)	--	--	-
Net income (loss) applicable to common shares	(9,931)	(2,295)	470	(
Total assets	--	19,996	13,623	
Acquisition of fixed assets	--	68	9	-

(10) Recent Accounting Pronouncements

Consolidation of Variable Interest Entities

In March 2005, the FASB issued Staff Position (FSP) No. FIN 46(R)-5, Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities. This FSP clarifies that when applying the variable interest consolidation model, a reporting enterprise should consider whether it holds an implicit variable interest in a variable interest entity (VIE) or potential VIE when specific conditions exist. FSP No. FIN 46(R)-5 is effective as of April 1, 2005. The Company does not anticipate an impact from the adoption of this statement.

Share-Based Payment

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The compensation cost will be measured based on the fair value of the equity or liability instruments issued. The Statement is effective as of the beginning of the first annual period beginning after June 15, 2005. Beginning in January 2006, the value of all options granted by the Company will be recorded as compensation expense and will be reported as general and administrative expense. Currently, the value of options granted to officers and directors at or above market at the date of the grant are not recorded as expenses by the Company. We do not yet know the impact that any future share-based payment transactions will have on our financial position or results of operations.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS 151 amends ARB No. 43, "Inventory Pricing", to clarify the accounting for certain costs as period expense. The Statement is effective for fiscal years beginning after September 15, 2005; however, early adoption of this Statement is permitted. The Company does not anticipate an impact from the adoption of this statement.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154 "Accounting Changes and Error Corrections--A Replacement of APB Opinion No. 20 and FASB Statement No. 3". This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement does not change the guidance for reporting the correction of an error in previously issued financial statements or a change in accounting estimate. The provisions of this Statement shall be effective for accounting changes

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and correction of errors made in fiscal years beginning after December 15, 2005. The Company is not able to assess at this time the future impact of this Statement on its consolidated financial position or results of operations.

(11) Subsequent Events

The Company effected a one for six reverse stock split effective October 25, 2005. All references in the financial statements and notes thereto to the number of shares outstanding, per share amounts, and stock option, warrant and convertible security data relating to the Company's commons shares have been restated to reflect the effect of the stock split for all periods presented.

On November 9, 2005, the period to exercise warrants to purchase additional shares of the Series D Preferred Stock granted to the investors in the March sale of Series D Convertible Preferred Stock was further extended to February 9, 2006.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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 ability to implement and the success of our new strategy and transition our business and the risks related thereto: our history of losses and declining revenues; our ability to license and sell new spoken word content, anticipate and respond to changing customer preferences, license and produce desirable content, protect our databases and other intellectual property from unauthorized access, and collect receivables; dependence on third-party providers, suppliers and distribution channels; competition; the costs and success of our marketing strategies, product returns, attrition; and risks relating to our capital structure. 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 digital media and publishing company specializing in spoken word audio entertainment. We maintain a library of more than 75,000 hours of audio content, which we distribute through our consumer brands, Soundsgood.com, AudioBookClub, Radio Spirits and Radio Classics. Our content is distributed on the internet via our digital download subscription services, our websites, mail order, some of the nation's largest retailers, and to cell phones via our ring tone offering. We are also MSN Music's exclusive provider of spoken word products for downloading via the Web, and have a growing list of digital distribution partners that include Real Networks, Loudeye, and XM and Sirius Satellite Radio. During our 12 years of operations, MediaBay has serviced 2.9 million customers that have purchased our spoken word products.

Today we have three principal content libraries; (1) Thousands of best selling Audiobooks, educational courses, university lectures, theatre plays, self improvement courses, television soundtracks, stand-up comedy, children's storytelling, parenting advice and study guides which we sell via digital download and on CD and cassette, through Soundsgood.com, the Audio Book Club and third-party websites; (2) a proprietary archive of the history of American radio which we produce and sell on CD and cassettes through our catalog, a mail order based continuity program, retail outlets, and our on-line download subscription service and third-party websites, and (3) a library of classic television shows and movies. We also broadcast our radio programs through a syndicated radio show on more than 200 commercial stations across the United States, as well as our 24-hour Radio Classics channels number 133 on Sirius and 164 on XM Satellite Radio.

We are transitioning our business from primarily selling hard goods (CD's and cassettes) via our negative option, mail order AudioBookClub to digital distribution via wireless and Internet downloads. Our digital distribution strategy is two pronged: (1) to operate our own downloadable content stores and subscription services which are co-branded via partnerships with celebrities and corporate affiliates: and (2) to wholesale our audio content to the leading music services, broadband portals, cell phone, satellite radio and television companies, both domestically and internationally. Marketing partners are selected based on

their ability to drive large numbers of customers to our audio stores with specific customer demographics that we can match to our vast library of audio content. We believe this approach will reduce our customer acquisition costs and accelerate our entry into the digital distribution marketplace.

In addition to our growing list of marketing partners, we also intend to use various organic means to market our downloadable content stores, including marketing to our existing customer list of approximately 2.9 million audio buyers that participated in the AudioBookClub or have purchased from Radio Spirits. We also anticipate working with manufacturers of digital music players, smart phones, and PDAs to include samples of our audio content on those devices for consumers to preview when they purchase these new devices, with the hope that these samples will attract consumers to our content stores.

In October 2005, we launched our new digital storefront and technology platform, www.Soundsgood.com. Soundsgood.com is a fully enabled digital download service that offers thousands of digital audiobooks, classic radio shows and other spoken word audio content on an ala carte basis or as part of a monthly subscription. The service offers users audio content that can be downloaded directly to the users personal computer, burned to CD or transferred to any Window's Media compatible device that plays secured WMA (Windows Media Audio) files. There over 70 digital devices on the market today that are "PlaysforSure"(TM) compliant and we are working closely with Microsoft Corporation to ensure that our content works seamlessly on these devices and the many new smart cellular phones that will run the new Windows Mobile 5.0 operating system. In addition, some of our audio newspapers and radio shows are or will be distributed in MP3 format which work on iPods, and a multitude of MP3 music players and cell phones.

We recently have executed several agreements to expand the digital distribution of our audio content: an exclusive distribution agreement with Microsoft's MSN Music to provide our spoken word content to the MSN audience, which has 350 million unique monthly visitors. A content distribution agreement with Real Networks, which operates Rhapsody, the largest music subscription service in the United States, and Loudeye to act as our digital sales agent in distributing our catalog of products to potentially 70 music services for which they host and source content. In addition, we have executed a promotional agreement with WFAN and the Imus in the Morning Show to promote Soundsgood.com nationally on close to 100 radio stations across the country and is simulcast on MSNBC television five days a week. Imus program listeners will be directed to SoundsGood.com following interviews with authors who appear on the show. SoundsGood.com will be branded as the show's exclusive bookseller via a "Soundsgood Minute", and listeners will be informed how they can access audiobooks and our other audio programs, via digital downloads or on traditional media such as CDs and cassette tapes. We have also executed distribution agreements for our growing library of classic radio ring tones which will soon be, or are available on Nextel, Verizon, Alltell, T-Mobile Alltel, nTelos, Midwest Wireless, Verizon Wireless and Verizon Wireless Puerto Rico services.

We have acquired the rights to distribute digital audiobooks from substantially all of the major publishing houses in the United States and have a growing number of titles with various international rights of distribution. Our content library consists of all genres of audiobooks, classic American radio shows, educational courses, university lectures, theatre plays, self improvement courses, television soundtracks, stand-up comedy, children's storytelling, parenting advice and study guides.

Today, some of our largest digital content partners include BBC, Blackstone, Brilliance Audio, CBS Radio, Harper Collins, Hay House, Oasis, Penguin Group USA Audio, Random House, Simon & Schuster, Sound Room Publishers, Time Warner Audio and Zondervan. In addition to Audio Book Club, we distribute our content through proprietary web sites soundsgood.com and radiospirits.com, as well as through partner channels including Loudeye, MSN Music, Sirius Satellite Radio and XM Satellite Radio.

March 2005 Equity Financing

On March 23, 2005, pursuant to an agreement executed on March 21, 2005, we received an infusion of gross cash proceeds of $35 million in private equity financing from several institutional investors. We retired all of our borrowings and increased our cash reserves.

The Preferred Shares are convertible at any time at the option of the holder into shares ("Conversion Shares") of common stock at the rate of $3.30 per Conversion Share and each Warrant is exercisable to purchase one share of Common Stock (collectively, the "Warrant Shares"), at an exercise price of $3.36 per share. The market price for our common stock at March 21, 2005 was $4.14. We recorded as a non-cash deemed dividend an amount of $17,423 to reflect the value of the beneficial conversion feature of the Series D Preferred Stock and increased contributed capital by $17,423. The recording of the deemed dividend had no effect on our cash or net equity.

Strategy

In response to the music industry's recent success in creating a market for legal digital downloads using digital rights management solutions that are intended to prevent piracy of copyrighted content, we intend to become a leading distributor for downloadable, spoken word audio entertainment. We intend to build this new distribution channel by utilizing our nearly twelve years of experience operating the Audio Book Club and our old-time radio business. During those twelve years, we have serviced approximately 2.9 million customer accounts and plan to leverage this list of audio buyers to attract new digital shoppers.

We intend to use the Windows Media Digital Rights Management (DRM) system, and other easy to use, rights management technologies that may evolve over time. Beginning this past Christmas season, 70 new digital devices that support the Microsoft "PlaysforSure(TM)" digital rights management and device platform became available for sale by many of the leading device manufacturers. Examples of companies offering a "PlaysforSure(TM)" device include Hewlett Packard, Dell, Creative, Rio, i-River and Samsung. Many of these devices have large file storage capacities and make, what we believe, could be a perfect match for our content, which is typically one half hour in length for our classic radio shows, to an average of 6 to 10 hours for an audiobook.

In addition, the rapid evolution of cell and smart phones with hard drives and media players presents a large potential user base of digital devices for our content, as more than 500 million new handsets are sold each year in the market place. These portable devices, coupled with the ubiquitous installed base of personal computers with CD burners and USB port memory discs are making digital audio content portable and more accessible to users.

We believe the proliferation of broadband Internet service, the Microsoft digital rights management solution, and an expanding user base of portable devices have created an inflection point where downloads are a better way to distribute audio than traditional CDs and tapes via a retail store or by mail order. Broadband Internet and ubiquitous wireless networks means companies like MediaBay can deliver audio files quickly and affordably. Downloads provide consumers a more convenient way to purchase audio in real time and provides incredible opportunity for broad choice since there are no inventory requirements. This distribution is better for the environment and most importantly, provides real savings for the consumer.

We have determined that future investment in our mail order, hard goods based, Audio Book Club would not provide the returns adequate to justify future expenditures. Accordingly, in 2004, we discontinued marketing to attract new

Audio Book Club members and are developing plans to transition current members to new programs including encouraging existing members to begin downloading spoken word.

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.

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.

Downloadable content revenue from the sale of individual content titles is recognized in the period when the content is downloaded and the customer's credit card is processed. Content revenue from the sale of content subscriptions is recognized pro rata over the term of the subscription period. Rebates and refunds are recorded as a reduction of revenue in the period in which the rebate or refund is paid in accordance with Emerging Issues Task Force Issue No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products).

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. We determine the utilization of deferred tax assets in the future based on current year projections by management.

Based on a change in our strategy, which we believe will result in lower sales and losses in the near term, but ultimately will be more profitable, we have determined that it is "not more likely than not" that we will, in the foreseeable future, be able to realize all or part of our net deferred tax asset. We have accordingly made an adjustment to the deferred tax asset recording an increase to the valuation allowance, resulting in a deferred tax expense charged against income in the fourth quarter of 2004, the period when such determination was made.

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 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.

SOP 93-7 requires that the realizability of the amounts of direct-response advertising reported as assets should be evaluated at each balance sheet date by comparing the carrying amounts of the assets to their probable remaining future net revenues. At September 30, 2005, we had no direct-response advertising reported as assets, since we have determined that probable future benefits from any direct advertising we have incurred would not exceed the amounts expended. We do not expect to capitalize any marketing costs until we have determined probable future benefits based on buying patterns of future customers.

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 December 31, 2004, we had $9.7 million of goodwill, all of which relates to our Radio Spirits operations. We completed our annual impairment test as of January 2005, utilizing the services of an independent third-party appraiser, which did not result in an impairment loss. However, if conditions or circumstances were to change resulting in a deterioration of our Radio Spirits business, a future impairment of goodwill could be necessary.

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, 2005	Three Months Ended September 30, 2004	Nine months Ended September 2005	
Sales	100.0%	100.0%	100.0%	1
Cost of sales	72.2	48.7	58.5	
Cost of sales - strategic charges	--	54.6	4.3	
Gross profit	27.8	(3.3)	37.2	
Advertising and promotion	34.5	29.4	18.0	
General and administrative expense	123.2	40.5	75.5	
Termination charges	--	--	10.0	
Depreciation and amortization expense	1.0	0.7	0.8	
Interest (income)	6.6	--	(2.4)	
Interest expense	9.0	19.3	10.7	
Loss on early extinguishment of debt	--	--	8.3	
Income tax expense (benefit)	--	--	--	
Net (loss)	(133.4)	(93.1)	(71.5)	(
Dividends on preferred stock	28.1	(5.2)	16.1	
Deemed dividends on beneficial conversion of preferred stock	--	--	248.5	
Net (loss) applicable to common shares	(161.4)%	(98.3)%	(348.3)%	(

Results of Operations

Three months ended September 30, 2005 compared to three months ended September 30, 2004:

Net Sales
(In thousands)

	2004	2005	Change from 2004 to 2005	% Change
Audio Book Club	$ 2,654	$ 531	$(2,123)	(80.0%)
Radio Spirits				
Catalog	515	512	(3)	(0.6%)
Wholesale	287	176	(111)	(38.6%)
Continuity	341	126	(215)	(63.1%)
	1,143	814	(329)	(28.8%)
MediaBay.com	52	42	(10)	(19.8%)
	$ 3,849	$ 1,387	$(2,462)	(64.0%)

Audio Book Club sales decreased principally due to a decrease in club membership as a result of substantially discontinuing our advertising expenditures for new customers.

In the second quarter of 2005, we changed our negative option book club and converted to a business selling audiobooks and other audio entertainment without a negative option requirement. As a result of this change, we anticipate lower returns from our customers in future periods.

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Wholesale sales of old-time radio products decreased principally due to reduced sales to our major customers. Sales of our World's Greatest Old-Time Radio continuity program decreased principally due to the lack of advertising expenditures for new customers.

Cost of Sales
(In thousands)

	2004		2005		
	$	As a % Of Net Sales	$	As a % Of Net Sales	Fro Change
Audio Book Club	$1,275	48.0%	$ 527	99.3%	$ 748
Radio Spirits					
Catalog	242	47.0%	207	40.4%	35
Wholesale	229	79.8%	213	121.1%	16
Continuity	129	37.8%	55	43.4%	74
Total Radio Spirits	600	52.5%	475	58.3%	125
MediaBay.com	--	--	--	--	--

Cost of sales	1,875	48.7%	1,002	72.2%	873
Cost of sales - strategic charge	2,100	54.6%	--	--	2,100
	$3,975	103.3%	$1,002	--	$2,973

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 80.0% as described above. Cost of sales as a percentage of sales at Audio Book Club for the three months ended September 30, 2005 was 99.3%, compared to 48.0% for the same period in 2004. The increase in cost of sales as a percentage of sales is principally due to moving our warehouse and fulfillment operations to a facility which allows us to drop ship from its inventory and accordingly we have changed from licensing and manufacturing our audiobook titles to buying on a wholesale basis. Under our new buying arrangement we are buying products at a fixed percentage off of manufacturer's suggested retail price. Cost of sales as a percentage of sales at Audio Book Club also increased due to an increase in fulfillment costs as a percentage of sales due to the fixed cost of fulfillment being allocated over lower sales, as well as one-time programming and transition costs associated with the change in our fulfillment operations and the move from a negative option book club to a business selling audiobooks and other audio entertainment without a negative option requirement.

Cost of Radio Spirits catalog sales decreased as a percentage of sales to 40.4% for the three months ended September 30, 2005 as compared to 47.0% for the three months ended September 30, 2004 principally due to the mix of product sold to higher margin products and less discounting in the catalogs. The cost of Radio Spirits wholesale sales as percentage of sales increased to 121.1% for the three months ended September 30, 2005 as compared to 79.8% for the three months ended September 30, 2004 principally due to a greater portion of fixed costs (allocated obsolescence and product development costs, the fixed cost of warehousing and fulfillment and royalty advances) in relation to the lower sales volume. The cost of World's Greatest Old-Time Radio continuity sales as a percentage of sales increased to 43.4% from 37.8% principally due to the fixed cost associated with warehousing and fulfillment in relation to the lower sales volume as we have not marketed for new customers.

In third quarter of 2004 we recorded $2,100 in strategic charges for the write-down of inventory and royalty advances.

Advertising and Promotion

			From 2004 to 2005	
	2004	2005	Change	% Change
(In thousands)				
Audio Book Club				
New Customer	$ 110	$ --	$ 110	100.0%
Current Customer	251	151	100	39.8%

Total Audio Book Club	361	151	210	58.2%
Radio Spirits				
Catalog	203	199	4	1.8%
Wholesale	8	13	(5)	(59.7%
Continuity	--	--	--	83.2%
Total Radio Spirits	211	212	(1)	0.4%
New Projects	47	112	(65)	(138.3%
Total Spending	619	475	144	23.3%
Amount Capitalized	(96)	--	96	(100.0%
Amount Amortized	608	3	605	99.5%
Advertising and Promotion Expense	$ 1,131	$ 478	$ 653	57.7%

Advertising and promotion expenses decreased $653,000 to $478,000 for the three months ended September 30, 2005 as compared to $1.1 million in the prior comparable period, principally due to lower amortization of deferred customer acquisition costs. In the fourth quarter of 2004, based on the change in our strategy, as described above, we determined that the future net revenue from our Audio Book Club would not support the carrying amount of the direct-response advertising reported as assets relating to the Audio Book Club. Accordingly, we wrote-off the carrying amount of the asset in the fourth quarter for 2004 resulting in an increase in advertising expense in 2004 and lower expense in 2005. The decrease in spending was due to the lack of new customer marketing for Audio Book Club new customers due to our change in strategy as described above and decreased advertising to existing customers due to the reduction in Audio Book Club customers because of customer attrition with no marketing to replace leaving customers. During the three months ended September 30, 2005, we incurred $112,000 related to new projects, principally marketing tests related to the download business.

General and Administrative

(In thousands)	2004		2005		From 2004 to 2005	
	$	As a % of Net Sales	$	As a % of Net Sales	Change	% Change
Audio Book Club	$ 735	27.7%	$ 521	98.2%	$ 214	29.1%
Radio Spirits	321	28.1%	249	30.6%	72	22.4%
MediaBay.com	151	291.5%	196	471.7%	(45)	(29.8%)
Corporate	352	--	742	--	(390)	(110.8%)
	$1,559	40.5%	$1,708	123.1%	$ (149)	(9.6%)

The increase in general and administrative expenses of $149,000 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is principally due to increases in professional fees, public and investor relations (including directors fees) related to being a public company and travel and entertainment, partially offset by a decline in bad debt expense at Audio Book Club. The principal reason for the decline in bad debt expense at Audio Book Club was lower bad debts from remaining core Audio Book Club members who historically have been very good paying customers. The increase in professional fees was mainly attributable to legal and consulting fees incurred to build the new digital download business. The increase in investor and public relations costs was attributable to fees paid to directors as well as an increase in public relations activity related to the download strategy. The increase in travel and entertainment expenses relates mainly to business development travel incurred to build the new digital download business.

Depreciation and Amortization

(In thousands)	2004	2005
Depreciation		
Audio Book Club	$17	$10
Radio Spirits	9	3
Total depreciation	26	13
Amortization		
Corporate	2	2
Total depreciation and amortization	$28	$15

The decrease in depreciation and amortization expenses for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is principally attributable to reductions in the amortization of intangibles, which had been fully amortized or written off during the year ended December 31, 2004 and certain equipment, which was fully depreciated in 2004.

Interest Expense

(In thousands)	2004	2005	Change	% Change
Total interest paid, net	$307	$111	$196	63.8%
Accrued interest paid this period	--	--	--	--
Current interest paid	307	111	196	63.8%
Interest accrued	--	--	--	--
Interest included in debt	165	--	165	100.0%
Amortization of deferred financing costs and				

original issue discount	269	15	254	94.5%
Total interest expense	$741	$126	$615	83.0%

The decrease in interest expenses is principally due to the conversion of debt into preferred stock and common stock in 2004 and the payment of the senior debt facility and related party debt in connection with the March Financing in March 2005 described below.

Preferred Stock Dividends

$ (000's)	2004	2005
Dividends on Series A Preferred Stock	$ 57	$
Dividends on Series B Preferred Stock	8	1
Dividends on Series C Preferred Stock	134	--
Dividends on Series D Preferred Stock	--	389
Total dividends on preferred stock	$199	$390

The increase in preferred stock dividends for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is due to dividends payable on the Series D Preferred Stock issued in March 2005, as described in the Liquidity and Capital Resources section below.

During the second quarter of 2005, 1,180 shares of Series D Preferred Stock and related dividends were converted into 361,700 shares of common stock and during the third quarter an additional 13,657 shares of Series D Preferred Stock and related dividends were converted into 4,159,822 shares of common stock. These conversions and future conversions, if any, will reduce the preferred stock dividend in future periods.

Loss Applicable to Common Stockholders

(In thousands)	2004	2005	Ch
Loss applicable to common stockholders	$ (3,784)	$ (2,240)	$

Principally due to lower interest expense, net of interest income and advertising expense in 2005 and the strategic charge in 2004, partially offset by lower gross profit due to decreased sales and higher preferred dividends during the three months ended September 30, 2005, our net loss applicable to common shares for the three months ended September 30, 2005 decreased $1.6 million to $2.2 million, or $0.25 per diluted share, as compared to a net loss applicable to common shares for the three months ended September 30, 2004 of $3.8 million, or $1.26 per diluted share of common stock, for the three months ended September 30, 2004.

Nine months ended September 30, 2005 compared to nine months ended September 30, 2004:

Net Sales
(In thousands)

	2004	2005	$ Change	% Change
Audio Book Club	$ 9,719	$ 4,093	$(5,626)	(57.9%)
Radio Spirits				
Catalog	2,125	1,730	(395)	(18.6%)
Wholesale	1,270	615	(655)	(51.5%)
Continuity	1,062	441	(622)	(58.5%)
	4,457	2,786	(1,672)	(37.5%)
MediaBay.com	158	133	(25)	(16.1%)
	$14,334	$ 7,012	$(7,322)	(51.1%)

Audio Book Club sales decreased principally due to a decrease in club membership as a result of discontinuing our advertising expenditures for new members.

In the second quarter of 2005, we changed our negative option book club and converted to a business selling audiobooks and other audio entertainment without a negative option requirement. As a result of this change, we anticipate lower returns from our customers in future periods.

The decrease in Radio Spirits catalog sales is principally attributable to fewer customers, as we have not incurred marketing expenditures to attract new members, and greater discounting in our catalogs. Wholesale sales of old-time radio products decreased principally due to reduced sales to our major customers. Sales of our World's Greatest Old-Time Radio continuity program decreased principally due to the lack of advertising expenditures for new customers.

Cost of Sales
(In thousands)

	2004		2005		From 2004 to 2005	
	$	As a % of Net Sales	$	As a % of Net Sales	Change	% Change
Audio Book Club	$4,500	46.3%	$2,558	62.5%	$1,942	43.2%
Radio Spirits						
Catalog	921	43.3%	762	44.1%	159	17.2%
Wholesale	834	65.7%	594	96.5%	240	28.8%
Continuity	416	39.2%	187	42.5%	230	55.1%
Total Radio Spirits	2,171	48.7%	1,543	55.4%	629	29.0%
MediaBay.com	1	0.6%	--	0.0%	1	100.0%
Cost of Sales	6,672	46.5%	4,101	58.5%	2,571	38.5%

Cost of sales - strategic charges	2,100	14.7%	305	4.3%	1,795	85.5%
	$8,772	61.2%	$4,406	62.8%	$4,366	49.8%

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 57.9% as described above. Cost of sales as a percentage of sales at Audio Book Club for the nine months ended September 30, 2005 was 62.5%, compared to 46.3% for the same period in 2004. 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 a smaller active membership requires us to purchase finished goods from publishers rather than the licensing and manufacturing 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 and higher manufacturing costs due to lower volumes until in the second quarter of 2005 we moved our warehouse and fulfillment operations to a facility which allows us to drop ship from its inventory and accordingly we have changed from licensing and manufacturing our audiobook titles to buying on a wholesale basis. Under our new buying arrangement we are buying products at a fixed percentage off of manufacturer's suggested retail price. The cost of the new arrangement will be dependent on future sales volume. Additionally, an increase in fulfillment costs as a percentage of sales due to the fixed cost of fulfillment being allocated over lower sales as well as one time programming and transition costs associated with the change in our fulfillment operations and the move from a negative option book club to a business selling audiobooks and other audio entertainment without a negative option requirement contributed to the increase in cost of sales as a percentage of sales at Audio Book Club.

Cost of Radio Spirits catalog sales increased as a percentage of sales to 44.1% for the nine months ended September 30, 2005 as compared to 43.3% for the nine months ended September 30, 2004 principally due to higher royalty and fulfillment costs as a percentage of the lower sales volume due to the fixed portion of royalty advances and warehousing and fulfillment costs. The cost of wholesale sales as percentage of sales increased to 96.5% for the nine months ended September 30, 2005 as compared to 65.7% for the nine months ended September 30, 2004 principally due to a greater portion of fixed costs (allocated obsolescence and product development costs, the fixed cost of warehousing and fulfillment and royalty advances) in relation to the lower sales volume. The cost of World's Greatest Old-Time Radio continuity sales as a percentage of sales increased to 42.5% from 39.2% principally due to the fixed cost associated with warehousing and fulfillment in relation to the lower sales volume as we have not marketed for new customers.

In the second quarter of 2005, due to the change in strategy for our audiobook club we recorded a $305 write-down of royalty advances to what we believe is net realizable value at September 30, 2005. In third quarter of 2004 we recorded $2,100 in strategic charges for the write-down of inventory and royalty advances.

Advertising and Promotion

(In thousands)	2004	2005	From 2004 to 2005 Change	% Change
Audio Book Club				
New Customer	$ 382	$ --	$ 382	100.0%
Current Customer	885	386	499	56.4%
Total Audio Book Club	1,267	386	881	69.6%
Radio Spirits				
Catalog	543	580	24	6.8%
Wholesale	19	39	(20)	(102.6%)
Continuity	6	--	6	97.3%
Total Radio Spirits	$ 568	$ 619	$ 10	9.0%
New Projects	61	244	(183)	(300.0%)
Total Spending	1,896	1,249	648	34.1%
Amount Capitalized	(341)	--	341	(100.0%)
Amount Amortized	2,203	16	2,186	99.3%
Advertising and Promotion Expense	$ 3,758	$ 1,265	$ 2,492	66.3%

Advertising and promotion expenses decreased $2.5 million to $1,265,000 for the nine months ended September 30, 2005 as compared to $3.8 million in the prior comparable period, principally due to lower amortization of deferred customer acquisition costs. In the fourth quarter of 2004, based on the change in our strategy, described above, we determined that the future net revenue from our Audio Book Club would not support the carrying amount of the direct-response advertising reported as assets relating to the Audio Book Club. Accordingly, we wrote-off the carrying amount of the asset in the fourth quarter for 2004 resulting in an increase in advertising expense in 2004 and lower expense in 2005. The decrease in spending was due to the lack of new customer marketing for Audio Book Club new customers due to our change in strategy as described above and decreased advertising to existing customers due to the reduction in Audio Book Club customers because of customer attrition with no marketing to replace leaving customers. During the nine months ended September 30, 2005 we incurred $244,000 related to new projects, principally marketing tests related to the download business.

General and Administrative

	2004	2005	From 2004 to 2005

(In thousands)	$	As a % Of Net Sales	$	As a % Of Net Sales	Change	% Change
Audio Book Club	$ 2,560	26.3%	$ 1,552	37.9%	$ 1,008	39.4%
Radio Spirits	804	18.0%	879	31.6%	(75)	(9.3%)
MediaBay.com	473	299.4%	561	423.2%	(88)	(18.6%)
Corporate	1,194	--	2,302	--	(1,108)	(92.8%)
	$ 5,031	35.1%	$ 5,294	75.5%	$ (263)	(5.2%)

The increase in general and administrative expenses of $263,000 for the nine months ended September 30, 2005 as compared to the nine months ended September 30, 2004 is principally due to increases in payroll and related costs, public and investor relations (including directors fees) related to being a public company, travel and entertainment and professional fees, partially offset by lower bad debt expense. The principal reason for the decline in bad debt expense at Audio Book Club was lower bad debts from remaining core Audio Book Club members who historically have been good paying customers. The increase in payroll was mainly attributable to various bonuses paid in the second quarter of 2005 and the hiring, retention and promotion of key employees. The increase in investor and public relations costs was attributable to fees paid to directors, as well as an increase in public relations activity related to the download strategy. The increase in travel and entertainment expenses relates mainly to business development travel incurred to build the new digital download business. The increase in professional fees was mainly attributable to legal and consulting fees associated with the transition to the new download business strategy.

Termination costs

(In thousands)	2004	2005
Termination costs	$ --	$ 697

In the second quarter of 2005, the employment of one senior executive who had an employment agreement was terminated and the employment of several employees, one of which had an employment agreement, were also terminated. We agreed to make aggregate settlement payments totaling $697,000 payable through March 2006.

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Depreciation and Amortization

	2004	2005
(In thousands)		
Depreciation		
Audio Book Club	$ 67	$ 34
Radio Spirits	28	17

Total depreciation	$ 95	$ 51
Amortization		
Corporate	21	7
Total depreciation and amortization	$116	$ 58

The decrease in depreciation and amortization expenses for the nine months ended September 30, 2005 as compared to the nine months ended September 30, 2004 is principally attributable to reductions in the amortization of intangibles, which had been fully amortized or written off during the year ended December 31, 2004 and certain equipment, which was fully depreciated in 2004.

Interest Expense

	2004	2005	Change
(In thousands)			
Total interest paid	$ 852	$ 2,126	$(1,274)
Accrued interest paid this period	74	1,599	(1,525)
Current interest paid	778	527	251
Interest included in debt	602	--	602
Amortization of deferred financing costs and original issue discount	1,058	225	833
Beneficial conversion expenses of January 2004 Notes	3,991	--	3,991
Expense of inducement to convert, related party debt	390	--	390
Total interest expense	$ 6,808	$ 752	$ 7,009

The decrease in interest expenses is principally due to the conversion of debt into preferred stock and common stock in 2004 and the payment of the senior debt facility and related party debt in connection with the March Financing described below.

Preferred Stock Dividends

	2004	2005
(In thousands)		
Dividends on Series A Preferred Stock	$ 171	$ 51
Dividends on Series B Preferred Stock	23	1
Dividends on Series C Preferred Stock	184	100
Dividends on Series D Preferred Stock	--	975
Deemed dividend for beneficial conversion feature of Series D Preferred Stock	--	17,423
Total dividends deemed or accrued on preferred stock	$ 378	$18,550

The Series D Preferred Shares are convertible at any time at the option of the holder into shares of our common stock at the rate of $3.30 per share and each warrant is exercisable to purchase one share of our common stock at an exercise price of $3.36 per share. The market price for our common stock at March 21, 2005 was $4.14. We recorded as a non-cash deemed dividend in an amount of $17,423 to reflect the value of the beneficial conversion feature of the Series D Preferred Stock and increased contributed capital by $17,423. The recording of the dividend had no effect on our cash or net equity.

The increase in preferred stock dividends for the nine months ended September 30, 2005 as compared to the nine months ended September 30, 2004 is due to dividends for the Series D Preferred Stock issued in March 2005, as described in the Liquidity and Capital Resources section below.

During the second quarter of 2005, 1,180 shares of Series D Preferred Stock were converted into 361,700 shares of common stock and during the third quarter an additional 13,657 shares of Series D Preferred Stock and related dividends were converted into 4,159,822 shares of common stock. These conversions and future conversions, if any, will reduce the preferred stock dividend in future periods.

Loss Applicable to Common Stockholders

			From 2004 to 2005	
	2004	2005	Change	% Change
(In thousands)				
Loss applicable to common stockholders	$(12,061)	$(24,423)	$(12,361)	102.5%

Principally due to the deemed dividend for beneficial conversion of Series D Preferred Stock of $17,423, lower sales and a loss on early extinguishment of debt of $579 the strategic charge, termination costs and higher preferred dividends, partially offset by lower advertising expenses as described above, our net loss applicable to common shares for the nine months ended September 30, 2005 increased $12.4 million to $24.4 million, or $3.82 per diluted share, as compared to a net loss applicable to common shares for the nine months ended September 30, 2005 of $12.1 million, or $4.38 per diluted share of common stock, for the nine months ended September 30, 2004.

Liquidity and Capital Resources

As of September 30, 2005, we had cash on hand of $10.4 million, which is substantially greater than the $1.7 million cash on hand at September 30, 2004, as a result of the March 2005 financing described below. We believe that we have sufficient cash to operate the business for a minimum of twelve months.

March 2005 Equity Financing

On March 23, 2005, pursuant to an agreement executed on March 21, 2005, we issued an aggregate of (a) 35,900 shares (the "Offering Shares") of our Series D Convertible Preferred Stock (the "Series D Preferred") convertible into 10,878,788 of our common stock, (b) 5,439,394 five-year common stock purchase warrants (the "Offering Warrants") and (c) preferred warrants (the "Over-Allotment Warrants" and, together with the Offering Shares and the Offering Warrants, the "Offering Securities") exercisable for a limited time, for additional proceeds to us of $8.975 million, to purchase (1) up to 8,975 additional shares of Series D Preferred (the "Additional Shares" and, together with the Offering Shares, the "Preferred Shares") and (2) up to 1,359,849 additional warrants identical to the Offering Warrants (the "Additional Warrants" and, together with the Offering Warrants, the "Warrants"), to accredited investors (the "Investors") for an aggregate purchase price of $35.9 million (the "March Financing").

Immediately prior to the March Financing, holders of a majority of our voting securities approved by written consent (the "Shareholder Consent") (a) an amendment to our Articles of Incorporation, increasing the number of our authorized shares of the common stock ("Common Stock") from 150,000,000 to 300,000,000,

(b) a change of control which may occur as a result of the Financing, and (c) our issuance, in connection with the transactions contemplated by the Financing documents, of Common Stock in excess of 19.99% of the number of shares of Common Stock outstanding immediately prior to the Financing.

While such actions were approved by a majority of our shareholders prior to the financing, we were not permitted to effect them until we satisfied certain information requirements to our shareholders not party to the Shareholder Consent. As a result, the Shareholder Consent did not become effective until May 3, 2005.

The Preferred Shares have a face value of $1,000 per share ("Stated Value") and are convertible at any time at the option of the holder into shares ("Conversion Shares") of common stock at the rate of $3.30 per Conversion Share, subject to certain anti-dilution adjustments, including for issuances of Common Stock for consideration below the conversion price. The Preferred Shares are also mandatorily convertible at our option, subject to satisfaction of certain conditions, commencing September 10, 2005, which is 30 days following the effective date of the registration statement registering the common shares underlying the Series D Preferred Stock. Under certain limited circumstances within our control, the holders will also have the right to require us to redeem their Preferred Shares at their Stated Value. Cumulative dividends will accrue on the Preferred Shares on an annualized basis in an amount equal to 6% of their Stated Value until they are converted or redeemed and will be payable quarterly in arrears, beginning April 1, 2005, in cash or, at our option, subject to satisfaction of certain conditions, in shares of Common Stock ("Dividend Shares") valued at 93% of the average of the daily volume weighted average per-share price of the Common Stock for the five trading days prior to the applicable payment date. The Preferred Shares are non-voting. Subject to certain exceptions for accounts receivable and equipment and capital lease financings, we may not incur additional indebtedness for borrowed money or issue additional securities that are senior to or pari passu to the Preferred Shares without the prior written consent of holders of at least two thirds of the Preferred Shares then outstanding.

Each Warrant is exercisable to purchase one share of Common Stock (collectively, the "Warrant Shares"), at an exercise price of $3.36 per share for a period of five years commencing September 23, 2005, subject to certain anti-dilution adjustments, including for issuances of Common Stock for consideration below the exercise price. In addition, once exercisable, the Warrants permit cashless exercises during any period when the Warrant Shares are not covered by an effective resale registration statement.

The Over-Allotment Warrants were initially exercisable until August 9, 2005 for the purchase of Additional Shares and Additional Warrants, at an exercise price equal to the Stated Value of the Additional Shares purchased, with the purchase of each Additional Share including an Additional Warrant exercisable for a number of Warrant Shares equal to 50% of the Conversion Shares underlying such Additional Share.

As part of the March Financing, Forest Hill Select Fund L.P. and related entities (the "Forest Hill Entities") exchanged the 300,000 shares of Common Stock and 66,667 October Warrants previously purchased by them in October 2004 for $900,000 of the Offering Securities.

In connection with the March Financing, we also entered into an agreement (the "Herrick Agreement") with Herrick and Huntingdon (collectively, the "Herrick Entities"), pursuant to which, concurrently with the March Financing:

- all $5.784 million principal amount of our convertible notes owned by the Herrick Entities (the "Herrick Notes") and 10,684 of their shares of our Series A Preferred Stock were converted into an aggregate of approximately 2.03 million shares of Common Stock (the "Herrick Shares"), at their stated conversion rate of $3.36 per share;

- we also agreed to redeem the remaining 14,316 shares of Series A Preferred Stock held by the Herrick Entities and all 43,527 of their shares of our Series C Convertible Preferred Stock of the Company (collectively, the "Redemption Securities") for $5.8 million, the aggregate stated capital of such shares, on the earlier of the effective date of the Shareholder Consent and September 1, 2005, and both the Redemption Securities and the redemption price were placed into escrow pending such date;

- the Herrick Entities waived certain of their registration rights and we agreed to include the Herrick Shares for resale in the Financing Registration Statement, so long as such Herrick Shares are owned by the Herrick Entities and not otherwise transferred, including, but not limited to, in the Herrick Financing (as defined below); and

- the Herrick Entities consented to the terms of the Financing and the agreements entered into in connection with the Financing, as we were required to obtain such consents pursuant to the terms of the Herrick Notes, the Series A Preferred Stock and the Series C Preferred Stock.

- Herrick and Huntingdon also entered into a voting agreement and proxy with us pursuant to which they agreed not to take any action to contradict or negate the Shareholder Consent.

We received $35 million of gross proceeds (not including the securities exchanged by the Forest Hill Entities for $900,000 of the purchase price) in the March Financing. Merriman Curhan Ford & Co. ("Merriman") acted as a financial advisor with respect to certain of the investors in the March Financing for which it received compensation from us of $2,625,000 plus a five-year warrant to purchase 1,193,182 shares of Common Stock at an exercise price of $4.14 per share, the market price of our common stock on March 21, 2005, commencing on May 3, 2005, the effective date of the Shareholder Consent. Merriman also received a structuring fee from us with respect to the Financing in the amount of $175,000. In addition, we issued to Satellite Strategic Finance Associates, LLC and Satellite Finance Partners. Ltd., investors in the Financing, warrants to purchase an aggregate of 41,667 shares of our common stock (identical to the

Warrants), and reimbursed them $55,000 for expenses, for consulting services rendered by it in connection with the Financing. We also incurred legal, accounting and other costs of $657,000.

Concurrently with the March Financing, we repaid from net March Financing proceeds all of the principal and accrued and unpaid interest due on our outstanding senior notes issued on April 28, 2004, in the aggregate amount of approximately $9.4 million. We reported a loss on early extinguishment of debt of $579,000 in the first quarter of 2005 to reflect the write-off of unamortized finance charges related to the repayment of this debt.

We used approximately $2,271,000 of the proceeds from the Financing to pay all accrued and unpaid interest to the Herrick Entities on convertible notes and the Series A Preferred Stock and Series C Preferred Stock.

As of November 10, 2005, 14,837 shares of Series D preferred Stock plus accrued dividends thereon have been converted into 4,521,599 shares of common stock and 21,063 shares of Series D Preferred Stock are outstanding.

On November 9, 2005, the period to exercise warrants to purchase additional shares of the Series D Preferred Stock granted to the investors in the March sale of Series D Convertible Preferred Stock was further extended to February 9, 2006.

Activity during the nine months ended September 30, 2005.

For the nine months ended September 30, 2005, cash increased by $7.2 million, as we had net cash used in operating activities of $5.6 million, used net cash of $1.2 million in investing activities and had cash provided by financing activities of $14.0 million. Net cash used in operating activities principally consisted of the net loss of $24.4 million, an increase in prepaid expenses of $121,000, and a decrease in accounts payable, accrued expense and preferred dividends payable of $1.5 million which were partially offset by the non-cash charges consisting of the deemed dividend for beneficial conversion feature of Series D preferred Stock of $17.4 million, the loss on early extinguishment

of debt of $579,000, depreciation and amortization expenses of $58,000, cost of sales strategic charges of $305,000, amortization of deferred financing costs and original issue discount of $225,000, non-current accrued interest and dividends payable of $306,000; payment of accrued dividends through issuance of common stock of $85,000; as well as decreases in accounts receivable, inventory and royalty advances of $811,000, $593,000 and $108,000. The decreases in accounts receivable and inventory are primarily attributable to the reduction in sales as described above and the remaindering of manufactured audio book inventory under license due to the change in strategy discussed above. The increase in prepaid expenses is principally due to the timing of payments of marketing costs and other costs related to the download business and certain Radio Spirit's catalog costs. The decrease in accounts payable and accrued expenses is principally due to the payment of back royalties to publishers. The decrease in royalty advances relates to the change in strategy for our Audio Book Club, as we are no longer licensing and manufacturing products as described above. The Company recorded as dividends an amount of $17,423 to reflect the value of the deemed dividend for beneficial conversion feature of Series D Preferred Stock.

Net cash used in investing activities consists of the acquisition of fixed assets and website development costs of $1.2 million, principally computer equipment and the cost of the development of the new websites offering downloadable audio.

During the nine months ended September 30, 2005, we received net cash proceeds from the sale of Series D Preferred Stock of $31.5 million, as described above, repaid debt in the amount of $9.4 million, repaid accrued interest, dividends and fees relating to the debt of $2.4 million and redeemed Series A and Series C Preferred Stock in the amount of $5.8 million.

Recent Accounting Pronouncements

Consolidation of Variable Interest Entities

In March 2005, the FASB issued Staff Position (FSP) No. FIN 46(R)-5, Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities. This FSP clarifies that when applying the variable interest consolidation model, a reporting enterprise should consider whether it holds an implicit variable interest in a variable interest entity (VIE) or potential VIE when specific conditions exist. FSP No. FIN 46(R)-5 is effective as of April 1, 2005. The Company does not anticipate an impact from the adoption of this statement.

Share-Based Payment

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The compensation cost will be measured based on the fair value of the equity or liability instruments issued. The Statement is effective as of the beginning of the annual period beginning after September 15, 2005. We do not yet know the impact that any future share-based payment transactions will have on our financial position or results of operations.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS 151 amends ARB No. 43, "Inventory Pricing", to clarify the accounting for certain costs as period expense. The Statement is effective for fiscal years beginning after September 15, 2005; however, early adoption of this Statement is permitted. The Company does not anticipate an impact from the adoption of this statement.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154 "Accounting Changes and Error Corrections--A Replacement of APB Opinion No. 20 and FASB Statement No. 3". This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement does not change the guidance for reporting the correction of an error in previously issued financial statements or a change in accounting estimate. The provisions of this Statement shall be effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The Company is not able to assess at this time the future impact of this Statement on its consolidated financial position or results of operations.

Quarterly Fluctuations

Our operating results vary from period to period as a result of purchasing patterns of our members and customers, member attrition, the timing and popularity of new audiobook releases and product returns.

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

The Company has no exposure to market risk for changes in interest rates. The Company has total debt outstanding as of November 10, 2005 of $646,000, all of which is at fixed rates. Changes in the prime rate or LIBOR would not have an impact on our fair values, cash flows, or earnings for the nine months ended September 30, 2005.

Item 4. Controls and Procedures

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, as amended (the Act), beginning with our Annual Report on Form 10-K for the fiscal year ending December 31, 2007, we will be required to furnish a report by our management on our internal control over financial reporting. This report will contain, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not any material weakness in our internal control over financial reporting identified by management. If we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert our internal control over financial reporting is effective. This report will also contain a statement that our independent registered pubic accountants have issued an attestation report on management's assessment of such internal controls and a conclusion on the operating effectiveness of those controls.

Management acknowledges its responsibility for internal controls over financial reporting and seeks to continually improve those controls. In order to achieve compliance with Section 404 of the Act within the prescribed period, we are currently performing the system and process documentation and evaluation needed to comply with Section 404, which is both costly and challenging. We believe our process, which we began in the first quarter of 2005 and, we believe, will continue through 2006 for documenting, evaluating and monitoring our internal control over financial reporting is consistent with the objectives of Section 404 of the Act.

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 quarter ended September 30, 2005 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 5: Other Information

On November 9, 2005, the period to exercise warrants to purchase additional shares of the Series D Preferred Stock granted to the investors in the March sale of Series D Convertible Preferred Stock was extended to February 9, 2006.

Item 6: Exhibits

Exhibits

3.1 Amendment to Articles of Incorporation

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 Robert Toro, 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

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 11, 2005 By: /s/ Jeffrey Dittus

Jeffrey Dittus
Chief Executive Officer

Dated: November 11, 2005 By: /s/ Robert Toro

Robert Toro
Chief Financial Officer
(principal accounting and
financial officer)