MEDIABAY INC
Form 10-Q
November 14, 2006

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, 2006

OR
o 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 (State or other jurisdiction of incorporation or organization)	65-0429858 (I.R.S. Employment Identification No.)
2 Ridgedale Avenue, Cedar Knolls, New Jersey (Address of principal executive offices)	07927 (Zip Code)

Registrant's telephone number, including area code: (973) 539-9528

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act). Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

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

As of November 10, 2006, there were 10,516,444 shares of the Registrant's Common Stock outstanding.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

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

	September 30, 2006 (Unaudited)	December 31, 2005 (1)
Assets		
Current Assets:		
Cash and cash equivalents	$ 3,062	$ 8,243
Accounts receivable, net of allowances for sales returns and doubtful accounts of $1,364 and $1,533 at September 30, 2006 and December 31, 2005, respectively	214	691
Inventory	462	763
Prepaid expenses and other current assets	480	464
Royalty advances	512	523
Total current assets	4,730	10,684
Fixed assets, net	1,427	1,785
Other intangibles, net	36	42
Goodwill	4,030	6,156
	$ 10,223	$ 18,667
Liabilities and Stockholders' Deficiency		
Current Liabilities:		
Accounts payable and accrued expenses	$ 3,742	$ 4,969
Short-term debt, net of original issue discount of $54 at September 30, 2006 and $52 at December 31, 2005	92	32
Preferred dividend and interest payable	928	319
Redeemable preferred stock	21,063	--
Total current liabilities (Note 6)	25,825	5,320
Long-term debt, net of original issue discount of $67 and $111 at September 30, 2006 and December 31, 2005, respectively	534	608
Total liabilities	26,359	5,928
Commitments and Contingencies		
Preferred stock, no par value, authorized 5,000,000 shares; 200 shares of Series B issued and outstanding at September 30, 2006 and December 31, 2005 and 21,063 shares of Series D issued and outstanding at September 30, 2006 and December 31, 2005	20	11,436
Common stock; no par value, authorized 300,000,000 shares; issued and outstanding 10,516,444 at September 30, 2006 and December 31, 2005	121,681	121,681
Contributed capital	42,637	42,637
Accumulated deficit	(180,474)	(163,015)
Total common stockholders' deficiency	(16,136)	12,739

	$	10,223	$	18,667

(1) Derived from the December 31, 2005 Audited Financial Statements.

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30 2006	Nine months ended September 30 2005
Sales, net of returns, discounts and allowances of $91 and $368 and $124 and $1,554 for the three and nine months ended September 30, 2006 and 2005, respectively	$ 904	$ 1,387	$ 3,464	$ 7,012
Cost of sales	708	1,002	2,686	4,406
Gross profit	196	385	778	2,606
Expenses:				
Advertising and promotion	194	478	909	1,265
General and administrative	1,114	1,708	4,710	5,295
Termination charges	--	--	--	697
Depreciation and amortization	149	15	449	58
Charge for impairment to Goodwill	--	--	2,126	--
Gain on settlement of litigation	--	--	(963)	--
Operating loss	(1,261)	(1,816)	(6,453)	(4,709)
Interest income	32	92	151	167
Interest expense	526	126	991	752
Accretion of discount on mandatory redeemable preferred stock	--	--	9,709	--
Loss on early extinguishment of debt	--	--	--	579
Loss before income taxes	(1,755)	(1,850)	(17,002)	(5,873)
Income tax expense	--	--	--	--
Net loss	(1,755)	(1,850)	(17,002)	(5,873)
Dividends on preferred stock	--	390	454	1,127
Deemed dividend on beneficial conversion of Series D Preferred Stock	--	--	--	17,423
Net loss applicable to common shares	$ (1,755)	$ (2,240)	$ (17,456)	$ (24,423)
Basic and diluted loss applicable to common shares per common share:	$ (0.17)	$ (0.25)	$ (1.66)	$ (3.82)

See accompanying notes to condensed consolidated financial statements.

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

	(Unaudited) Nine months ended September 30, 2006	2005
Cash flows from operating activities:		
Net loss	$ (17,002)	$ (5,873)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on early extinguishment of debt	--	579
Non-current accrued interest and dividends payable	--	154
Depreciation and amortization	449	58
Amortization of deferred financing costs and original issue discount	43	225
Amortization of deferred member acquisition costs	--	16
Charge for impairment of goodwill	2,126	--
Accretion of discount on mandatory redeemable preferred stock	9,709	--
Changes in asset and liability accounts:		
Decrease in accounts receivable, net	477	811
Decrease in inventory	301	593
Increase in prepaid expenses	(16)	(121)
Decrease in royalty advances	12	108
(Decrease) increase in accounts payable, accrued expenses and dividend and interest payable	(713)	(1,528)
Net cash used in operating activities	(4,614)	(4,978)
Cash flows from investing activities:		
Acquisition of fixed assets, including development of websites	(86)	(1,207)
Net cash used in investing activities	(86)	(1,207)
Cash flows from financing activities:		
Payment of preferred dividends	(363)	(572)
Proceeds from sale of Series D Preferred stock, net of cash fees and expenses	--	31,488
Proceeds from exercise of stock options	--	40
Payment of long-term debt, including accrued interest and dividends	(56)	(11,742)
Redemption of Series A and Series C Preferred Stock.	--	(5,789)
Increase in deferred financing costs.	(62)	--
Net cash (used in) provided by financing activities	(481)	13,425
Net (decrease) increase in cash and cash equivalents	(5,181)	7,240
Cash and cash equivalents at beginning of period	8,243	3,122
Cash and cash equivalents at end of period	$ 3,062	$ 10,362

See accompanying notes to condensed consolidated financial statements.

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

(1) Liquidity and Cash Flow

Historically, the Company has funded its cash requirements through sales of equity and debt securities and borrowings.

As of September 30, 2006, the Company had cash on hand of $3.1 million. The Company's cash balance has declined during 2006 and will continue to decline for the foreseeable future unless the Company obtains financing, as it continues to use cash in its operations.

Amper, Politziner and Mattia, P.C, the Company's independent registered public accounting firm, has included an explanatory paragraph in their report on its financial statements for the year ended December 31, 2005, which highlights that current cash balances are insufficient to support operations raising substantial doubt about the Company's ability to continue as a going concern.

In 2005, the Company implemented a strategy of selling downloadable spoken word content online. To date, its sales of digital downloads have been minimal.

In connection with implementing this strategy, which focuses on downloadable spoken word content, the Company determined not to, and has not, and will not, devote the funds necessary to acquire new Audio Book Club members to offset member attrition and in June 2006 ceased sales of hard good spoken word content to remaining Audio Book Club members. As a result, the Company will continue to generate low levels of revenue and revenue may decline further. This will continue to negatively impact the Company's performance and result in negative cash flow from operations. The Company expects this trend to continue until such time, if ever, it can generate significant revenue from the sale of downloadable spoken word content and attract and establish a meaningful customer base for its online websites or other websites it may develop.

The Company believes that its existing cash plus anticipated revenues will not be sufficient to fund its expected operations and commitments through the end of the first quarter of 2007. The Company has engaged investment bankers to help effect a sale of the Company or certain assets of the Company or a strategic merger. In the event the Company does not complete such a transaction during the next few months, it will be required to further cut back operations and delay its digital distribution strategy and may not be able to continue operations for any meaningful period thereafter. There can be no assurance that the Company will be successful in completing a transaction.

(2) Organization

MediaBay is a Florida corporation formed on August 16, 1993. The Company is a digital media, marketing and publishing company specializing in spoken audio entertainment, such as audio readings of books, newspapers, magazines, original productions and radio broadcast transcripts. Today, the Company has two principal content libraries: (1) Audiobooks which it sells via digital download through Soundsgood.com, 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 approximately 200 commercial stations across the United States, as well as its 24-hour Radio Classics channels on Sirius and XM Satellite Radio.

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(3) Significant Accounting Policies

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.

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 for Internet web site development costs. Ongoing maintenance and other recurring charges are expensed as incurred.

Costs of internal use software are accounted for in accordance with Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" and Emerging Issue Task Force Issue No. 00-02 ("EITF 00-02"), "Accounting for Website Development Costs." SOP 98-1 and EITF 00-02 require that the Company expense computer software and website development costs as they are incurred during the preliminary project stage. Once the capitalization criteria of SOP 98-1 and EITF 00-02 have been met, external direct costs of materials and services consumed in developing or obtaining internal-use software, including website development, the payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal use computer software and associated interest costs are capitalized. Capitalized costs are amortized using the straight-line method over the software's estimated useful life, estimated at three years. Capitalized internal use software and website development costs are included in Fixed Assets, net, in the accompanying balance sheets.

Other Intangibles, Net
Intangible assets, principally consists of purchased intellectual property, which is reviewed for impairment on each reporting date, and a non-compete agreement, which ise being amortized over its contractual term of five years.

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. The Company performed annual impairment tests as of December 31, 2005, 2004 and 2003 in March 2006, January 2005 and October 2003. The Company recorded an impairment charge of $3,502 at December 31, 2005 as a result of the impairment test conducted in March 2006. The Company recorded an additional impairment charge of $2,126 as a result of an impairment test conducted in July 2006 due to a change in facts and circumstances related to its radio business.

Revenue Recognition
During the nine months ended September 30, 2006 and the years ended December 31, 2005, 2004 and 2003, 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. 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).

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 customers as well as the cost to digitize content for download)
- Royalties to publishers and rightsholders
- Fulfillment costs, including shipping and handling
- Customer service
- Direct response billing, collection and accounts receivable management

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

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 123(R), “Share-Based Payment,” which replaces SFAS No. 123, “Accounting for Stock-Based Compensation” and supersedes Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees.” SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. The compensation cost will be measured based on the fair value of the equity or liability instruments issued. Under SFAS No. 123(R), the pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition.

Prior to January 1, 2006, the Company used the intrinsic value method to account for stock-based employee compensation under the recognition and measurement principles of APB No. 25, and related interpretations. Under this method, compensation cost is measured as the amount by which the market price of the underlying stock exceeds the exercise price of the stock option at the date at which both the number of options granted and the exercise price are known. SFAS No. 123 established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by SFAS No. 123, the Company elected to apply the intrinsic-value-based method of accounting described above, and adopted only the disclosure requirements of SFAS No. 123, which were similar in most respects to SFAS No. 123(R), with the exception of option forfeitures, which the Company had accounted for as they occurred.

On January 1, 2006 the Company adopted SFAS No. 123(R) using the "Modified Prospective Application Method" which requires that compensation cost be recorded, as earned, for all unvested stock options outstanding at the beginning of the first quarter of adoption of SFAS No. 123(R). The compensation cost is recognized in Selling, general and administrative expenses in the Consolidated Statements of Operations over the remaining service period after the adoption date, based on the Company's original estimate of the option's fair value. The Company's consolidated financial statements of prior fiscal years do not reflect any restated amounts. A modification to the termination provisions of outstanding options was made prior to the adoption of SFAS No. 123(R). The Company used the same valuation methodologies and assumptions in estimating the fair value of options under both SFAS No. 123(R) and the pro forma disclosures under SFAS No. 123. The Company did not change the quantity, type or payment arrangements of any share-based payment programs. Since the modified prospective application method was used there was no cumulative effect adjustment upon the adoption of SFAS No. 123(R). The Company's policy is to use newly issued shares to satisfy the exercise of stock options.

On December 30, 2005, the Board of Directors accelerated the vesting of all of the Company's unvested stock options awarded to directors, officers and employees under its various plans all of which had an exercise price greater than the closing price of the Company's common stock on the NASDAQ National Market on December 30, 2005.

The Board's decision to accelerate the vesting of these options was in response to a review of the Company's long-term incentive compensation programs in light of changes in market practices and recently issued changes in accounting rules resulting from the issuance of SFAS No. 123R, which the Company adopted January 1, 2006. The Company believed that accelerating the vesting of these options prior to the adoption of SFAS No. 123R may have resulted in the Company not having to recognize compensation expense in the then remaining vesting periods. The Company's net loss and net loss per share for the three and nine months ended September 30, 2005 had compensation expense for the Company's stock options been recognized based on the fair value on the grant date under SFAS 123 (R) is as follows:

	September 30, 2005			
	Three months Ended		Nine Month Ended	
Net loss applicable to common shares, as reported	$	(2,240)	$	(24,423)
Deduct: Total stock-based employee compensation expense determined under fair value based method for				
all awards, net of related tax effects		--		(755)
Pro forma net loss applicable to common shares	$	(2,240)	$	(25,178)
Net loss per share:				
Basic and diluted - as reported	$	(0.25)	$	(3.82)
Basic and diluted - pro forma	$	(0.25)	$	(3.93)

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 Value per Share
First Nine Months 2005	801,667	$ 3.54	41%	3.35%	$ .96

No options were issued in the nine months ended September 30, 2006.

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

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. 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. The Company determines the utilization of deferred tax assets in the future based on current year projections by management. 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.

Based on a change in Company strategy, which the Company believes will result in lower sales and continued losses for the foreseeable future, the Company has determined that it is more likely than not that it will, in the foreseeable future, be unable to realize all or part of its net deferred tax asset. The Company continues, accordingly, to provide a full valuation allowance for its net deferred tax assets.

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 estimates.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (“FIN 48”), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in the consolidated financial statements the impact of a tax position that is more likely than not to be sustained upon examination based on the technical merits of the position. The provisions of FIN 48 will be effective for the Company as of the beginning of the Company’s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

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In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how to evaluate prior period financial statement misstatements for purposes of assessing their materiality in the current period. Correcting prior year financial statements for immaterial misstatements would not require amending previously filings; rather such corrections may be made in subsequent filings. The cumulative effect of initially applying SAB 108, if any, can be recorded as an adjustment to opening retained earnings. SAB 108 does not change the SEC staff's previous positions regarding qualitative considerations in assessing the materiality of misstatements. SAB 108 is effective for the Company beginning in the fourth quarter of this fiscal year and management does not currently anticipate any adjustments to opening retained earnings resulting from the application of SAB 108.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a common definition of fair value to be used when the Company is required to use a fair value measure for recognition or disclosure purposes under GAAP. FAS 157 is effective for the Company beginning in 2008. The Company is currently evaluating the impact the adoption of FAS 157 will have on its consolidated financial statements.

(4) Goodwill and Other Intangibles

SFAS No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”) requires the Company to perform an evaluation of goodwill impairment annually. The Company conducted its annual impairment test for 2005 in March 2006 and for 2004 in January 2005, utilizing the services of an independent appraiser, and its annual impairment tests for 2003 in October 2003. The Company recorded an impairment charge of $3,502 at December 31, 2005 as a result of the impairment test conducted in March 2006.

Based on the Company’s failure to achieve its forecasted sales targets for its radio business for the three months ended June 30, 2006, principally wholesale sales, it began analyzing and revising its current and long-term business plans related to this business significantly modifying its analysis of future cash flows. As a result, and in accordance with SFAS No. 142, the Company performed an interim test of its goodwill in July 2006 utilizing a discounted future cash flow analysis based on its new projected sales targets. The Company recorded an additional impairment charge of $2,126 as a result of this test.

The following table presents details of other intangibles at September 30, 2006 and December 31, 2005:

	September 30, 2006			December 31, 2005		
	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	302	11	313	296	17
Other	25	--	25	25	--	25
Total Other Intangibles	$ 5,310	$ 5,272	$ 36	$ 5,310	$ 5,268	$ 42

Amortization of intangible assets was $6 for both the nine months ended September 30, 2006 and 2005. The Company estimates intangible amortization expenses of $8 in 2006 and $9 in 2007.

(5) Debt

	As of September 30, 2006		December 31, 2005	
Premier debt	$	747	$	803
Less: original issue discount		(121)		(163)
Less: current portion		(92)		(32)
Long-term debt	$	534	$	608

The Company entered into a settlement agreement, dated as of April 1, 2004, with Premier Electronic Laboratories, Inc. (“Premier”). Premier had previously exercised its right to put its shares of Common Stock to MediaBay for $1,100 pursuant to a Put Agreement dated December 11, 1998. Pursuant to the settlement, among other things, the Company is paying Premier $950 as payment of the amounts due to Premier. The Company’s obligation under the Put Agreement was reduced by $150 in exchange for relinquishing certain leases for real property. The Company paid $14 on closing and is paying the remaining balance over six years in monthly payments starting at $7 in July 2004 and increasing to $19 from May 2007 through April 2010.

The future minimum loan payments are as follows:

Three months ending December 31, 2006	$	21
Year ending December 31, 2007		183
Year ending December 31, 2008		233
Year ending December 31, 2009		233
Beyond		77
Total maturities, including debt discount of $135	$	747

March 2005 Transactions

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

Concurrently with the 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 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.

(6) Stockholders’ Equity, Redeemable Preferred Stock and Stock Options and Warrants

March 2005 Sale of Series D Convertible Preferred Stock and Warrants

On March 21, 2005, the Company issued 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 were exercisable until February 9, 2006; none were exercised.

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:

- 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;

- 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);

- 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

- 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.

- 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.

- 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.

- 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 $3,635. 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, 2006, 14,837 shares of Series D Preferred Stock plus accrued dividends thereon had been converted into 4,521,592 shares of common stock and 21,063 shares of Series D Preferred Stock are outstanding.

The Company also paid to Norton Herrick and Huntingdon all accrued and unpaid interest and dividends due to them in the amount $2,271 and placed into escrow $5,784. This amount was released to redeem the portion of Series A Preferred Stock not converted and all of the Series C Preferred Stock on May 3, 2005, the 20th day after an information statement was sent to all shareholders who did not initially vote on the transaction.

Also in connection with the 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.

On May 12, 2006, the Company's Board of Directors determined to suspend the payment of dividends to holders of Series D Preferred Stock. This action triggered the right of the holders of the Series D Preferred Stock to demand redemption of the $21,063 liquidation preference amount of the series D preferred stock plus accrued and unpaid dividends thereon for cash. Accordingly, the liquidation preference amount of $21,063 has been reclassified to current liabilities and the unearned discount of $9,709 has been immediately accreted to interest expense in accordance with Statement of Financial Accounting Standards No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liability and Equity ("FASB No.150"). Additionally, dividends accrued since May 12, 2006 have been classified as interest expense also in accordance with FASB #150. The Company does not have the financial resources to redeem the preferred stock.

Stock Options and Warrants

From January 1, 2006 to September 30, 2006, no options to purchase shares of the Company's common stock were issued. The Company cancelled options to purchase 174,721 shares of its common stock pursuant to the terms of such options and options to purchase 15,169 shares of its common stock expired.

(7) Gain on settlement of Litigation

The Company entered into a settlement and mutual release agreement with each of Larry King and Larry King Enterprises (collectively, "King") and Celebrity Newsletter LLC relating to the settlement of claims under the Company's endorsement and promotion agreement with Celebrity Newsletter LLC and Larry King, pursuant to which it was intended that MediaBay launch a Larry King on-line audio entertainment and education service. In June 2005, MediaBay announced that the service was tabled due to developments beyond its control. Pursuant to the settlement agreement, MediaBay received a cash payment of $963, net of related fees and expenses, on June 21, 2006 and dismissed all claims against King and Celebrity Newsletter LLC.

(8) Net Loss Per Share of Common Stock

Basic loss per share was computed using the weighted average number of common shares outstanding for the three and nine months ended September 30, 2006 of 10,516,444 and for the three and nine months ended September 30, 2005 of 8,989,725 and 6,400,211, respectively.

For the three and nine months ended September 30, 2006, there were 11,931,126 common stock options and warrants with an average exercise price of $4.61 per share, which were not included in the computation of diluted loss per share, because they would have been anti-dilutive as calculated under the treasury stock method as the Company was in a loss position and the exercise prices of these shares were greater than the average market price of common shares during the periods and 6,387,056 common equivalent shares with an average exercise price of $3.30 per share relating to convertible preferred stock calculated under the "if-converted method" as the Company was in a loss position and the liquidation preference of preferred stock has been reclassified to current liabilities as a result of it becoming redeemable in accordance with FASB #150. See note 6 above.

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 convertible preferred stock added back to net loss applicable to common shares 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 loss applicable to common shareholders would have been $1,303 for the nine months ended September 30, 2005.

The Company's Board of Directors and shareholders approved a one for six share 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 common shares have been restated to reflect the effect of the stock split for all periods presented.

(9) Supplemental Cash Flow Information

No cash has been expended for income taxes for the nine months ended September 30, 2006 and 2005. Cash paid for interest expense was $3 and $2,127 for the nine months ended September 30, 2006 and 2005, respectively.

For the nine months ended September 30, 2006, the Company reclassified the liquidation preference on its series D preferred stock of $21,063 to current liabilities. See note 6 above.

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

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(10) Segment Reporting

For the three and nine months ended September 30, 2006 and 2005, the Company operated in three reportable segments: Corporate; Audio Book Club ("ABC") a membership-based club selling audiobooks via direct mail and on the Internet including digital downloads and Radio Spirits ("RSI") which produces, sells, licenses and syndicates old-time radio programs. 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, 2006

	Corporate	ABC	RSI	Inter-segment	Total
Sales, net of returns, discounts and allowances	$ --	$ 82	$ 822	$ --	$ 904
Depreciation and amortization	17	132	--	--	149
Operating (loss) profit	(837)	(333)	(91)	--	(1,261)
Interest expense, net	494	--	--	--	494
Accretion of discount on preferred stock	--	--	--	--	--
Net loss	(1,331)	(333)	(91)	--	(1,755)
Dividends on Preferred Stock	--	--	--	--	--
Net (loss) income applicable to common shares	(1,331)	(333)	(91)	--	(1,755)
Total assets	--	3,678	6,545	--	10,223
Acquisition of fixed assets	$ --	$ 6	$ --	$ --	$ 6

Segment Reporting
Three Months Ended
September 30, 2005

	Corporate	ABC	RSI	Inter-segment	Total
Sales, net of returns, discounts and allowances	$ ---	$ 531	$ 856	$ --	$ 1,387
Depreciation and amortization	2	10	3	--	15
Operating (loss) profit	(744)	(791)	(285)	4	(1,816)
Interest expense, net	34	--	--	--	34
Net loss	(778)	(791)	(285)	4	(1,850)
Dividends on Preferred Stock	390	--	--	--	390
Net (loss) income applicable to common shares	(1,168)	(791)	(285)	4	(1,850)
Total assets	--	10,859	12,932	(46)	23,745
Acquisition of fixed assets	$ --	$ 627	$ --	$ --	$ 627

Segment Reporting
Nine Months Ended September 30, 2006

	Corporate	ABC	RSI	Inter-segment	Total
Sales, net of returns, discounts and allowances	$ --	$ 767	$ 2,697	$ --	$ 3,464

Depreciation and amortization		52		397		--		--	449
Operating (loss) profit		(2,462)		(1,737)		(2,254)		--	(6,453)
Interest expense, net		840		--		--		--	840
Accretion of discount on preferred stock		9,709		--		--		--	9,709
Net loss		(13,011)		(1,737)		(2,254)		--	(17,002)
Dividends on Preferred Stock		(454)		--		--		--	(454)
Net (loss) income applicable to common shares		(13,465)		(1,737)		(2,254)		--	(17,456)
Total assets		--		3,678		6,545		--	10,223
Acquisition of fixed assets	$	--	$	84	$	2	$	-- $	86

Segment Reporting Nine Months Ended September 30, 2005		**Corporate**		**ABC**		**RSI**		**Inter-segment**		**Total**
Sales, net of returns, discounts and allowances	$	--	$	4,093	$	2,919	$	--	$	7,012
Depreciation and amortization		6		34		17		--		57
Operating (loss) profit		(2,956)		(985)		(777)		9		(4,709)
Interest expense, net		585		--		--		--		585
Loss on early retirement of debt		579		--		--		--		579
Net loss		(4,120)		(985)		(777)		9		(5,873)
Dividends on Preferred Stock		1,127		--		--		--		1,127
Deemed dividend for beneficial conversion feature of Series D Preferred Stock		17,423								17,423
Net (loss) income applicable to common shares		(22,670)		(985)		(777)		9		(24,423)
Total assets		--		10,859		12,932		(46)		23,745
Acquisition of fixed assets	$	--	$	1,207	$	--	$	--	$	1,207

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(11) Related Party Transactions

On January 31, 2006, Patricia G. Campbell resigned her position as Chief Operating Officer of the Company. Ms. Campbell agreed to continue to provide services to the Company for a period of six (6) months (the "Term"), during which she agreed to devote her full time for the first three (3) months and half of her time to the Company's business during the second three (3) months. The Company agreed to pay Ms. Campbell at the rate equal to her base salary when she was employed by the Company of $215 (per annum) during the first three (3) months and at the rate of $108 (per annum) during the second three (3) months. Certain stock options previously granted to Ms. Campbell will remain exercisable for their full term, and certain other stock options are no longer exercisable and terminated as of January 31, 2006. Ms. Campbell agreed not to compete or engage in a business competitive with the Company's business during the Term and for a period of two years thereafter.

The Company subleased two offices in New York, New York from a company partially owned by its Chairman. The lease commenced on August 1, 2005 and ended on July 31, 2006. The lease amount was $3 per month. The lease payments in 2006 were $21.

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

Results of Operations

Forward-looking Statements

Certain statements in this Form 10-Q constitute "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included in this report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of our management for future operations are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "believe," or "continue" or the negative thereof or variations thereon or similar terminology. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. These forward looking statements involve certain known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any results, performances or achievements expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from our expectations, include, without limitation our in ability to implement our strategy, the decision to seek strategic alternatives and the risks related thereto: our history of losses and declining revenues; our ability to obtain additional financing and restructure our existing capitalization, 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, member attrition; risks relating to our capital structure and the other risk factors set forth in our other filings with the SEC. Undue reference should not be placed on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to update any forward-looking statements.

Introduction

We are a seller of spoken audio and nostalgia products, including audiobooks and old-time radio shows, through direct response, retail and Internet channels. Our content and products are sold in multiple formats, including physical (cassette and compact disc) and secure digital download formats. Historically, the Company has funded its cash requirements through sales of equity and debt securities and borrowings from financial institutions and its principal shareholders.

As of September 30, 2006, we had cash on hand of $3.1 million. Our cash balance has declined since our financing in March 2005 and will continue to decline for the foreseeable future unless we obtain financing, as we continue to use cash in our operations.

Because we began pursuing a strategy, which focused on downloadable spoken word content, we have not, and will not, devote the funds necessary to acquire new Audio Book Club members to offset member attrition and in June 2006 we ceased sales of hard good spoken word content to remaining Audio Book Club members. As a result, we will continue to generate low levels of revenue and revenue may decline further, which will continue to negatively impact our performance and result in negative cash flow from operations. We expect this trend to continue until such time, if ever, we can generate significant revenue from the sale of downloadable spoken word content and attract and establish a meaningful customer base for our online websites or other websites we may develop.

We believe that our existing cash plus anticipated revenues will not be sufficient to fund our expected operations and commitments through the end of the first quarter 2007. We have engaged investment bankers to help effect a sale of the Company or certain assets of the Company or a strategic merger. In the event we do not complete such a transaction during the next few months, we will be required to further cut back operations or delay our digital distribution strategy and may not be able to continue operations for any meaningful period thereafter. There can be no assurance that we will be successful in completing a transaction.

On May 12, 2006, the Company’s Board of Directors determined to suspend the payment of dividends to holders of Series D Preferred Stock. This action triggered the right of the holders of the Series D Preferred Stock to demand redemption of the $21,063,000 liquidation preference amount of the Series D Preferred stock plus accrued and unpaid dividends thereon for cash. Accordingly, the liquidation preference amount of $21,063,000 has been reclassified to current liabilities and the unearned discount of $9,709,000 has been immediately accreted to interest expense in accordance with Statement of Financial Accounting Standards No. 150 “Accounting for Certain Financial Instruments with Characteristics of both Liability and Equity (“FASB No. 150”). Additionally, dividends accrued since May 12, 2006 have been classified as interest expense also in accordance with FASB No.150. The Company does not have the financial resources to redeem the preferred stock.

Our financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We have not made any adjustments to the financial statements as a result of the outcome of the uncertainty described above.

We report financial results on the basis of three business segments; Corporate, Audio Book Club, including downloadable spoken word, and Radio Spirits. Except for corporate, each segment serves a unique market segment within the spoken word audio industry. For the nine months ended September 30, 2006, our Audio Book Club segment had net sales of approximately $767,000 and our Radio Spirits segment had net sales of approximately $2,697,000.

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 and the Internet. We also sell classic radio shows to retailers either directly or through distributors. We derive a small amount of additional revenue through rental of our proprietary database of names and addresses to non-competing third parties through list rental brokers. We also derive a small amount of revenue from advertisers who advertise on our nationally syndicated classic radio shows.

In October 2005, we launched our digital distribution strategy through the launch of Soundsgood.com, our fully enabled digital storefront and technology platform. We also continue to enter into strategic agreements to license content and to distribute downloads to consumers. In December 2005, we launched our co-branded digital storefront with Microsoft at msn.soundsgood.com. We have also entered into distribution agreements with Real Network's Rhapsody, MusicNet and Blish.

To date, our sales of digital downloads have been minimal. Our sales will continue to decline until such time as we generate significant sales from the implementation of our digital strategy.

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

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

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. For example, a one percent increase in returns as a percentage of gross sales for the nine months ended September 30, 2006, assuming a constant gross profit percentage and all other expenses unchanged, would have resulted in a decrease in net sales of $35,000 and an increase in net loss available to common shares of $8,000. A one percent increase in bad debt expense as a percentage of net sales, assuming all other expenses were unchanged, would have resulted in an increase in bad debt expenses and corresponding increase in net loss available to common shares of $35,000.

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 continued losses for the foreseeable future, we have determined that it is more likely than not that we will, in the foreseeable future, be unable to realize all or part of our net deferred tax asset. Accordingly, we continue to provide a full valuation allowance for our net deferred tax assets.

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. We conducted our annual impairment test for 2005 in March 2006 and for 2004 in January 2005, utilizing the services of an independent appraiser, and our annual impairment tests for 2003 in October 2003. We recorded an impairment charge of $3,502,000 at December 31, 2005 as a result of the impairment test conducted in March 2006.

Based on our failure to achieve our forecasted sales targets for our radio business for the three months ended June 30, 2006, principally wholesale sales, we began analyzing and revising our current and long-term business plans related to this business significantly modifying our analysis of future cash flows. As a result, and in accordance with SFAS No. 142, we performed an interim test of our goodwill in July 2006 utilizing a discounted future cash flow analysis based on our new projected sales targets. We recorded an additional impairment charge of $2,126,000 as a result of this test.

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,		Nine Months September June 30,	
	2006	2005	2006	2005
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	78.3	72.2	77.5	62.8
Gross profit	21.7	27.8	22.5	37.2
Advertising and promotion	21.4	34.5	26.2	18.1
General and administrative expense	123.2	123.1	136.0	75.5
Termination charges	--	--	--	10.0
Depreciation and amortization expense	16.5	1.1	13.0	0.8
Charge for impairment to goodwill	--	--	61.4	--
Gain on settlement of litigation	--	--	(27.8)	--
Interest (income)	(3.5)	(6.6)	(4.4)	(2.4)
Interest expense	58.2	9.1	28.6	10.7
Accretion of discount on mandatory redeemable preferred stock	--	--	280.3	--
Loss on early extinguishment of debt	--	--	--	8.3
Income tax expense (benefit)	--	--	--	--
Net (loss)	(194.1)	(133.4)	(490.8)	(83.8)
Dividends on preferred stock	--	28.1	13.1	16.1
Deemed dividends on beneficial conversion of preferred stock	--	--	--	248.4
Net (loss) applicable to common shares	(194.1)%	(161.5)%	(503.9)%	(348.3)%

Results of Operations
Three months ended September 30, 2006 compared to three months ended September 30, 2005:

Net Sales

($000's)	2005	2006	Change from 2005 to 2006	% Change
Audio Book Club	$ 531	$ 82	$ (449)	(84.6)%
Radio Spirits				
Catalog	553	707	154	27.8%
Wholesale	176	94	(82)	(46.6)%
Continuity	127	21	(106)	(83.5)%
	856	822	(34)	(4.0)%
	$ 1,387	$ 904	$ (483)	(34.8)%

Audio Book Club sales decreased principally due to a decrease in club membership as a result of a substantial reduction in our advertising expenditures for new members and our inability to date to generate significant revenue from the sale of downloadable spoken word content and attract and establish a meaningful customer base for our online websites or other websites. Effective June 2006, we ceased selling spoken word hard content to Audio Book Club members.

The increase in Radio Spirits catalog sales is principally attributable to the timing of catalog mailings. Wholesale sales of old-time radio products decreased principally due to a decrease in sales to our major customers. Sales of our World's Greatest Old-Time Radio Shows ("WGOTRS) continuity program decreased principally due to a decrease in continuity buyers as a result of a discontinuation of advertising expenditures for new customers. This continuity program was discontinued in August 2006.

Cost of Sales

$ (000's)	2005		2006		From 2005 to 2006	
	$	As a % of Net Sales	$	As a % of Net Sales	Change	% Change
Audio Book Club	$ 527	99.2%	$ 153	186.6%	$ 374	71.0%
Radio Spirits						
Catalog	207	37.4%	341	48.2%	(134)	(64.7)%
Wholesale	213	121.0%	194	206.4%	19	8.9%
Continuity	55	43.3%	20	95.2%	35	63.6%
Total Radio Spirits	475	55.5%	555	67.5%	(80)	(9.2)%
	$ 1,002	72.2%	$ 708	78.3%	$ 294	29.3%

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 84.6 % as described above. The increase in cost of sales as a percentage of sales is principally due to an increase in fulfillment costs as a percentage of sales (accounting for 60.0% of the increase) due to the fixed cost of fulfillment being allocated over lower sales and the cost associated with the wind down of hard content sales to Audio Book Club customers discussed above. Additionally, product costs as a percentage of sales increased (accounting for 40.0% of the increase) due to the cost of encoding of the digital files allocated over a low sales base. Cost of Radio Spirits catalog sales increased principally due to the higher sales and higher product and related royalty costs as a percentage of sales due to the fixed portion of royalty advances. The cost of wholesale sales as percentage of sales increased principally due to an increase in product cost (accounting for 25.1% of the decrease) due to the a higher portion of fixed costs in relation to the lower sales, the fixed cost of warehousing and fulfillment (accounting for 29.1% of an increase) and the fixed portion of royalty advances (accounting for 45.8% of an increase). The cost of World's Greatest Old-Time Radio continuity sales as a percentage of sales increased principally due to the fixed cost associated with warehousing and fulfillment in relation to the lower sales volume as discussed above.

Advertising and Promotion

$ (000's)

			From 2005 to 2006	
	2005	**2006**	**Change**	**% Change**
($000's)				
Audio Book				
Total Audio Book	$ 151	$ 34	$ 117	77.5%
Radio Spirits				
Catalog	199	158	41	20.6%
Wholesale	13	2	11	84.6%
Continuity	--	--	--	--
Total Radio Spirits	212	160	52	24.5%
New Projects	112	--	112	100.0%
Total Spending	475	194	281	59.2%

Amount Capitalized		--		--		--	--
Amount Amortized		3		--		3	100.0%
Advertising and Promotion Expense	$	478	$	194	$	284	59.4%

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Advertising and promotion expenses at Audio Book Club decreased principally due to the ceasing of hard good content sales as discussed above and lower direct marketing related to the promotion of digital downloads of spoken word entertainment due to cash constraints. Advertising and promotion expenses at Radio Spirits direct mail declined due to fewer mailed catalogs. The decline in wholesale was because of lower cooperative advertising placements in the period. 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

General and administrative expenses for the three months ended September 30, 2006 decreased $594,000, or 53.3%, to $1.1 million as compared to $1.7 million for the three months ended September 30, 2005 principally due to decreases in payroll and related expenses of $260,000, professional fees of $225,000, bad debts of $55,000 and public company expenses of $54,000. The decrease in payroll is principally due to decreased personnel including costs for website development and maintenance. The decrease in professional fees is due to a reduction in legal and consulting fees related to the development of the digital strategy. The decrease in bad debts is due to the ceasing of hard good audio book content sales and the discontinuation of the Worlds Greatest Old Time Radio Shows continuity program discussed above. The decrease in public company expenses is principally due to a reduction in fees paid for investor relations and corporate communications.

Depreciation and Amortization

		2005		2006
$ (000's)				
Depreciation	$	13		147
Amortization		2		2
Total depreciation and amortization	$	15	$	149

The increase in depreciation and amortization expenses for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 is primarily attributable to depreciation on 2005 fixed asset additions and website development costs, principally computer equipment and the cost of the development of the new websites offering downloadable audio content.

Interest Income

Interest income decreased by $60,000 to $32,000 for the three months ended September 30, 2006 from the three months ended September 30, 2005 due to the decrease in our cash balance.

Interest Expense

		2005		2006
$ (000's)				
Interest expensed	$	111	$	2
Amortization of deferred financing costs and original issue discount		15		14
Financing costs		--		30
Dividends on redeemable preferred stock classified as interest expense		--		338
Penalties accrued on redeemable preferred stock		--		142
Total interest expense	$	126	$	526

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The increase in interest expenses is principally due to the classification of dividends on redeemable preferred stock as interest expense since May 12, 2006, the day the preferred stock issued in the March 2005 Financing (defined below) became redeemable, as well as the accrual of penalties under the preferred stock agreement. See discussion above. Additionally, we incurred fees and expenses related to our seeking strategic alternative initiatives discussed above.

Preferred Stock Dividends

$ (000's)		**2005**		**2006**
Dividends accrued on Series B Preferred Stock	$	1	$	--
Dividends accrued on Series D Preferred Stock		389		--
Total dividends accrued on preferred stock	$	390	$	--

The decrease in the accrual of preferred stock dividends for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 is due to the classification of Series D Preferred Stock dividends as interest expense since May 12, 2006, the date the preferred stock became redeemable. During the third quarter of 2005, $13.7 million of principal amount of the Series D Preferred Stock was converted to common stock.

Loss Applicable to Common Stockholders
$ (000's)

					From 2005 to 2006		
$ (000's)		**2005**		**2006**		**Change**	**% Change**
Loss applicable to common stockholders	$	2,240	$	1,755	$	485	21.7%

Principally due to lower advertising and general and administrative expenses partially offset by lower sales and gross profit and higher net interest and dividend expenses, our net loss applicable to common shares for the three months ended September 30, 2006 decreased $0.5 million to $1.7 million, or $.17 per diluted share, as compared to a net loss applicable to common shares for the three months ended September 30, 2005 of $2.2 million, or $0.25 per diluted share of common stock.

Nine months ended September 30, 2006 compared to nine months ended September 30, 2005:

Net Sales

($000's)		**2005**		**2006**		**Change from 2005 to 2006**	**% Change**
Audio Book Club	$	4,093	$	767	$	(3,326)	(81.3)%
Radio Spirits							
Catalog		1,863		1,981		118	6.3%
Wholesale		615		574		(41)	(6.7)%
Continuity		441		142		(299)	(67.8)%
		2,919		2,697		(222)	(7.6)%
	$	7,012	$	3,464	$	(3,548)	(50.6)%

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Audio Book Club sales decreased principally due to a decrease in club membership as a result of a substantial reduction in our advertising expenditures for new members and our inability to date to generate significant revenue from the sale of downloadable spoken word content and attract and establish a meaningful customer base for our online websites or other websites. Effective June 2006, we ceased selling spoken word hard content to Audio Book Club members.

The slight increase in Radio Spirits catalog sales is principally attributable to the timing of catalog mailings partially offset by fewer customers. Wholesale sales of old-time radio products decreased slightly principally due to a decrease in sales to our major customers. Sales of our World's Greatest Old-Time Radio continuity program decreased principally due to a decrease in continuity buyers as a result of a discontinuation of advertising expenditures for new customers. This continuity program was discontinued in August 2006.

Cost of Sales

$ (000's)	2005		2006		From 2005 to 2006	
	$	As a % of Net Sales	$	As a % of Net Sales	Change	% Change
Audio Book Club	$ 2,863	69.9%	$ 948	123.6%	$ 1,915	66.9%
Radio Spirits						
Catalog	762	40.9%	975	49.2%	(213)	(28.0)%
Wholesale	594	96.6%	669	116.6%	(75)	(12.6)%
Continuity	187	42.4%	94	66.2%	93	49.7%
Total Radio Spirits	1,543	52.9%	1,738	64.4%	(195)	(12.6)%
	$ 4,406	62.8%	$ 2,686	77.5%	$ 1,720	39.0%

The principal reason for the decline in cost of sales at Audio Book Club was a reduction in sales of 81.3 % as described above. The increase in cost of sales as a percentage of sales is principally due to an increase in product and related royalty costs as a percentage of sales (accounting for 42.6% of the increase) since a smaller active membership required us to purchase finished goods rather than license and manufacture product due to lower sales and our inability to meet manufacturing minimums and recoup advances to publishers. In the second quarter of 2005 we moved our warehouse and fulfillment operations to a facility, which allowed us to drop ship from its inventory, and accordingly we changed from licensing and manufacturing our audiobook titles to buying on a wholesale basis. Under this buying arrangement we bought products at a fixed percentage off of manufacturer's suggested retail price. This increase was offset by the write-off of unearned publisher advances in the prior period of $305,000 (accounting for a 13.7% decrease). In June 2006, we ceased the sale of hard good spoken word product to Audio Book Club members. Additionally, an increase in fulfillment costs as a percentage of sales (accounting for 71.1% of the increase) due to the fixed cost of fulfillment being allocated over lower sales and costs associated with the wind down of hard content sales to Audio Book Club customers discussed above..

Cost of Radio Spirits catalog sales increased principally due to higher product and related royalty costs as a percentage of the sales due to the fixed portion of royalty advances and to a lesser extent the fixed portion of fulfillment costs in relation to sales. The cost of wholesale sales as a percentage of sales increased principally due to an increase in product cost (accounting for 20.3% of the increase) due to the higher sales of discounted product and product mix, the fixed portion of royalty advances (accounting for 62.6% of the increase) and the fixed portion of warehousing and fulfillment (accounting for 17.1% of the increase). The cost of World's Greatest Old-Time Radio continuity sales as a percentage of sales increased principally due to the fixed cost associated with warehousing and fulfillment in relation to the lower sales volume as discussed above.

Advertising and Promotion
$ (000's)

	2005	2006	From 2005 to 2006 Change	% Change
($000's)				
Audio Book Club				
Total Audio Book Club	$ 386	$ 481	$ (95)	(24.6)%
Radio Spirits				
Catalog	580	425	155	26.7%
Wholesale	39	3	36	92.3%
Continuity	--	--	--	--
Total Radio Spirits	619	428	191	30.9%
New Projects	244	--	244	100.0%
Total Spending	1,249	909	340	27.2%
Amount Capitalized	--	--	--	--
Amount Amortized	16	--	16	100.0%
Advertising and Promotion Expense	$ 1,265	$ 909	$ 356	28.1%

Advertising and promotion expenses at Audio Book Club increased principally due to direct marketing related to the promotion of digital downloads of spoken word entertainment. Advertising and promotion expenses at Radio Spirits direct mail declined due to fewer mailed catalogs. The decline in radio spirits wholesale was due to lower cooperative advertising placement in the period. 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

General and administrative expenses for the nine months ended September 30, 2006 decreased by $585,000 to $4.7 million as compared to the nine months ended September 30, 2005. The decrease was mainly attributable to a decrease in payroll and related expenses of $67,000, a decrease in bad debts of $139,000, a decrease in professional fees of $314,000 and a decrease in public company expenses of $65,000. The decrease in payroll and related expense is principally due to a net decrease in personnel including costs for website development and maintenance. The decrease in bad debts is related to the decrease in audio book club and WGOTRS continuity discussed above. The decrease in professional fees is due to a reduction in legal and consulting fees related to the development of the digital strategy. The decrease in public company expenses is principally due to fees paid for investor relations and corporate communications.

Termination Costs

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, was also terminated. We made aggregate settlement payments totaling $697,000 through March 2006.

Depreciation and Amortization

$ (000's)		2005		2006
Depreciation	$	51		443
Amortization		7		6
Total depreciation and amortization	$	58	$	449

The increase in depreciation and amortization expenses for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 is primarily attributable to depreciation on 2005 fixed asset additions and website development costs, principally computer equipment and the cost of the development of the new websites offering downloadable audio content.

Charge for impairment of Goodwill

We recorded an additional impairment charge of $2,126,000 in the second quarter of 2006 as a result of an impairment test conducted in July 2006 due to a change in facts and circumstances related to our radio business.

Gain on Settlement of Litigation

We entered into a settlement and mutual release agreement with each of Larry King and Larry King Enterprises (collectively, "King") and Celebrity Newsletter LLC relating to the settlement of claims under the our endorsement and promotion agreement with Celebrity Newsletter LLC and Larry King, pursuant to which it was intended that we launch a Larry King on-line audio entertainment and education service. In June 2005, we announced that the service was tabled due to developments beyond its control. Pursuant to the settlement agreement, we received a cash payment of $962,714 net of related fees and expenses on June 21, 2006 and dismissed all claims against King and Celebrity Newsletter LLC.

Interest Income

Interest income decreased by $16,000 to $151,000 for the nine months ended September 30, 2006 from the nine months ended September 30, 2005 due to the net decrease in our cash balances during that period.

Interest Expense

$ (000's)		2005		2006
Interest expensed	$	527	$	3
Amortization of deferred financing costs and original issue discount		225		43
Financing costs		--		100
Dividends on redeemable preferred stock classified as interest expense		--		511
Penalties accrued on redeemable preferred stock		--		334
Total interest expense	$	752	$	991

The increase in interest expenses is principally due to the classification of dividends on redeemable preferred stock as interest expense since May 12, 2006 the date the preferred stock issued in the March 2005 Financing became redeemable as well as the accrual of penalties under the preferred stock agreement and fees and expenses related to our seeking strategic alternative initiatives partially offset by the payment of the senior debt facility and related party debt in connection with the March 2005 Financing. See above for further discussion of these items.

Accretion of discount on Mandatory Redeemable Preferred Stock

On May 12, 2006 the Company's Board of Directors determined to suspend the payment of dividends to holders of Series D Preferred Stock. This action triggered the right of the holders of the Series D Preferred Stock to demand redemption of their shares for cash. Although none of the holders have demanded redemption, the liquidation preference amount of $21,063,000 has been reclassified to current liabilities and the unearned discount of $9,709,000 has been immediately accreted to interest expense in accordance with Statement of Financial Accounting Standards No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liability and Equity ("FASB No.150"). Additionally, dividends accrued since May 12, 2006 have been classified as interest expense also in accordance with FASB No.150. The Company does not have the financial resources to redeem the preferred stock.

Loss on Early Extinguishment of Debt

Concurrently with the March 2005 Financing we repaid from 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 $9,400,000. The Company reported a charge in the first quarter of 2005 of $579,000 to reflect the write-off of unamortized financing charges related to the repayment of this debt.

Preferred Stock Dividends

$ (000's)		2005		2006
Dividends accrued on Series A Preferred Stock	$	51	$	--
Dividends accrued on Series B Preferred Stock		1		--
Dividends accrued on Series C Preferred Stock		100		--
Dividends accrued on Series D Preferred Stock		975		454
Deemed dividend for beneficial conversion feature of Series D Preferred Stock		17,423		--
Total dividends deemed or accrued on preferred stock	$	18,550	$	454

The decrease in the accrual of preferred stock dividends for the nine months ended September 30, 2006 as compared to the nine months ended June 30, 2005 is principally due to the classification of series D dividends as interest expense since May 12, 2006 the date the preferred stock became redeemable.

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 the first quarter of 2005 in an amount of $17,423,000 to reflect the value of the beneficial conversion feature of the Series D Preferred Stock and increased contributed capital by $17,423,000. The recording of the dividend had no effect on our cash or net equity.

Loss Applicable to Common Stockholders

$ (000's)

$ (000's)	2005	2006	From 2005 to 2006 Change	% Change
Loss applicable to common stockholders	$ 24,423	$ 17,456	$ 6,967	28.5%

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Principally due to the deemed dividend for beneficial conversion of Series D Preferred Stock of $17,423,000 recorded in 2005 and the gain on settlement of litigation recorded in 2006 partially offset by the accretion of discount on Series D Preferred Stock and the charge for impairment to goodwill as well as lower sales and gross profit in 2006, our net loss applicable to common shares for the nine months ended September 30, 2006 decreased by approximately $7.0 million to $17.5 million, or $1.66 per diluted share, as compared to a net loss applicable to common shares for the nine months ended September 30, 2005 of $24.4 million, or $3.82 per diluted share of common stock.

Liquidity and Capital Resources

Overview
Historically, we have funded our cash requirements through sales of equity and debt securities and borrowings.

Amper, Politziner and Mattia, P.C, our independent registered public accounting firm, has included an explanatory paragraph in their report on our financial statements for the year ended December 31, 2005, which highlights that current cash balances are insufficient to support operations raising substantial doubt about the Company's ability to continue as a going concern.

As described above, we believe that our existing cash plus anticipated revenues will not be sufficient to fund our expected operations and commitments through the end of the first quarter 2007. We have engaged investment bankers to help effect a sale of the Company or certain assets of the Company or a strategic merger. In the event we do not complete such a transaction, during the next few months, we will be required to further cut back operations or delay our digital distribution strategy and may not be able to continue operations for any meaningful period thereafter. There can be no assurance that we will be successful in completing a transaction.

Activity during the nine months ended September 30, 2006

For the nine months ended September 30, 2006, cash decreased by $5.2 million, as we had net cash used in operating activities of $4.6 million, used net cash of $86,000 in investing activities and had cash used in investing activities of $0.5 million. Net cash used in operating activities principally consisted of the net loss of $17.0 million, a decrease in accounts payable and accrued expenses of $713,000, partially offset by, depreciation and amortization expenses of $449,000, a charge for the impairment of goodwill of $2.1 million described above, accretion of discount on mandatory redeemable preferred stock of $9.7 million described above, a decrease in accounts receivable of $477,000, and a decrease in inventory of $301,000.

The decreases in accounts receivable, inventory and accounts payable are primarily attributable to the reduction in sales described above.

Net cash used in investing activities consists of acquisition of fixed assets of $86,000, principally computer equipment.

Net cash used in financing activities consists of the payment of dividends on preferred stock of $363,000, payment of deferred financing costs of $62,000 and payment of long tem debt of $63,000.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 ("FIN 48"), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in the consolidated financial statements the impact of a tax position that is more likely than not to be sustained upon examination based on the technical merits of the position. The provisions of FIN 48 will be effective for us as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how to evaluate prior period financial statement misstatements for purposes of assessing their materiality in the current period. Correcting prior year financial statements for immaterial misstatements would not require amending previously filings; rather such corrections may be made in subsequent filings. The cumulative effect of initially applying SAB 108, if any, can be recorded as an adjustment to opening retained earnings. SAB 108 does not change the SEC staff's previous positions regarding qualitative considerations in assessing the materiality of misstatements. SAB 108 is effective for us beginning in the fourth quarter of this fiscal year and management does not currently anticipate any adjustments to opening retained earnings resulting from the application of SAB 108.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a common definition of fair value to be used when the Company is required to use a fair value measure for recognition or disclosure purposes under GAAP. FAS 157 is effective for the Company beginning in 2008. We are currently evaluating the impact the adoption of FAS 157 will have on its consolidated financial statements.

Certain Transactions

On January 31, 2006, Patricia G. Campbell resigned her position as our Chief Operating Officer. Ms. Campbell agreed to continue to provide services to us for a period of six (6) months (the "Term"), during which she agreed to devote her full time for the first three (3) months and half of her time to our business during the second three (3) months. We agreed to pay Ms. Campbell at the rate equal to her base salary when she was employed by us of $215,000 (per annum) during the first three (3) months and at the rate of $107,500 (per annum) during the second three (3) months. Certain stock options previously granted to Ms. Campbell will remain exercisable for their full term, and certain other stock options are no longer exercisable and terminated as of January 31, 2006. Ms. Campbell agreed not to compete or engage in a business competitive with our business during the Term and for a period of two years thereafter.

We subleased two offices in New York, New York from a company partially owned by our Chairman. The lease commenced on August 1, 2005 and ended on July 31, 2006. The lease amount was $3,000 per month. The lease payments in 2006 were $21,000.

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

We are not subject to exposure to market risk for changes in interest rates. We have total gross amount of debt outstanding as of November 10, 2006 of $747,000, 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, 2006.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2006, our disclosure controls and procedures are effective at a reasonable assurance level to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2006, 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 1: Legal Proceedings

The Company is not a defendant in any litigation. In the normal course of business, the Company is subject to threats of litigation. The Company does not believe that the potential impact of any threatened litigation, if ultimately litigated, will have a material adverse effect on the Company.

Item 5: Other Information

None.

Item 6: Exhibits

Item 6. Exhibits

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 2002

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Signatures

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

MediaBay, Inc.

Date: November 14, 2006

By: /s/ Jeffrey Dittus

Jeffrey Dittus
Chief Executive Officer

Date: November 14, 2006

By: /s/ Robert Toro

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