

DESTINY MEDIA TECHNOLOGIES INC
Form 10QSB
July 14, 2006

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

FORM 10-QSB

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended May 31, 2006

OR

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

For the transition period from _____ to _____

Commission file number: 0-028259

DESTINY MEDIA TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

COLORADO

(State or other jurisdiction of
incorporation or organization)

84-1516745

(IRS Employer Identification No.)

**1055 West Hastings Street, Suite 1040, Vancouver,
British Columbia Canada V6E 2E9**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (604) 609-7736

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 past 12 months and (2)
has been subject to the above filing requirements for the past 90 days.

Yes [] No []

State the number of shares outstanding of each of the issuer's classes of common stock, as of
the latest practicable date: **40,936,223 Shares of \$0.001 par value common stock
outstanding as of May 31, 2006.**

Transitional small business disclosure format (check one):

Yes [] No []

PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

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Consolidated Financial Statements

Destiny Media Technologies Inc.

(Unaudited)

Three and nine months ended May 31, 2006

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Destiny Media Technologies Inc.

CONSOLIDATED BALANCE SHEETS

(Expressed in United States dollars)
 [See Note 3 - Going Concern Uncertainty]
 Unaudited

As at

| | May 31, 2006 | August 31, 2005 |
|--|-------------------------|----------------------------|
| | \$ | \$ |
| ASSETS | | |
| Current | | |
| Cash | 42,271 | 30,576 |
| Accounts and other receivables, net of allowance for doubtful accounts of \$776 [2005 - \$7,000] [note 9] | 149,089 | 46,437 |
| Inventory | 1,364 | 2,246 |
| Prepaid expenses | 9,072 | 2,327 |
| Total current assets | 201,796 | 81,586 |
| Software development costs, net of accumulated amortization of \$54,354 [2005 - \$18,890] | 38,823 | 58,693 |
| Property and equipment, net of accumulated amortization of \$251,499 [2005 - \$216,202] | 68,195 | 65,863 |
| Total assets | 308,814 | 206,142 |
| LIABILITIES AND STOCKHOLDERS DEFICIENCY | | |
| Current | | |
| Accounts payable [note 8(d)] | 142,979 | 277,512 |
| Accrued liabilities | 119,266 | 91,573 |
| Shareholder loans payable [note 5] | - | 337,773 |
| Deferred revenue | 30,082 | 32,329 |
| Total current liabilities | 292,327 | 739,187 |
| Deferred leasehold inducements, net of accumulated amortization of \$43,914 [2005 - \$22,104] | 41,416 | 58,594 |
| Obligation for share settlement [note 6] | 100,000 | 100,000 |
| Total liabilities | 433,743 | 897,781 |
| Commitments and contingencies [note 8] | | |
| Stockholders deficiency [note 7] | | |
| Common stock, par value \$0.001 | | |
| Authorized: 100,000,000 shares | | |
| Issued and outstanding: 40,936,223 shares | | |
| August 31, 2005 36,434,223 shares] | 40,938 | 36,436 |
| Issued and held for settlement: 133,333 shares | | |
| Additional paid-capital | 4,892,063 | 4,022,123 |
| Deficit | (4,950,483) | (4,635,958) |
| Accumulated other comprehensive loss | (107,447) | (114,240) |
| Total stockholders deficiency | (124,929) | (691,639) |

| | | |
|--|---------|---------|
| Total liabilities and stockholders deficiency | 308,814 | 206,142 |
|--|---------|---------|

See accompanying notes

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Destiny Media Technologies Inc.

CONSOLIDATED STATEMENT OF OPERATIONS

(Expressed in United States dollars)

Unaudited

| | Three Months Ended May 31, 2006 | Three Months Ended May 31, 2005 | Nine Months Ended May 31, 2006 | Nine Months Ended May 31, 2005 |
|--|--|--|---|---|
| | \$ | \$ | \$ | \$ |
| | | [As restated - note 4] | | [As restated - note 4] |
| Revenue <i>[note 9]</i> | 278,520 | 154,678 | 685,291 | 575,103 |
| Operating expenses | | | | |
| General and administrative | 122,692 | 101,187 | 385,337 | 299,098 |
| Sales and marketing | 132,996 | 86,148 | 330,490 | 294,271 |
| Research and development | 89,649 | 101,536 | 283,682 | 314,537 |
| Amortization | 14,212 | 15,181 | 39,884 | 41,521 |
| | 359,549 | 304,052 | 1,039,393 | 949,427 |
| Loss from operations | (81,029) | (149,374) | (354,102) | (374,324) |
| Other earnings (expenses) | | | | |
| Gain on settlement of accounts payable <i>[note 8(d)]</i> | 56,965 | | 56,965 | |
| Interest and other expense | (4,373) | (2,957) | (17,388) | (8,144) |
| Net loss | (28,437) | (152,331) | (314,525) | (382,468) |
| Net loss per common share, basic and diluted | (0.01) | (0.01) | (0.01) | (0.01) |
| Weighted average common shares outstanding, basic and diluted | 40,753,712 | 36,381,723 | 38,402,761 | 35,866,274 |

See accompanying notes

Destiny Media Technologies Inc.

CONSOLIDATED STATEMENT OF STOCK HOLDERS DEFICIENCY

(Expressed in United States dollars)

Unaudited

| | Common stock | | Additional | | Accumulated | |
|---|--------------|--------|------------|-------------|---------------|--------------|
| | Shares | Amount | Paid-in | Deficit | Other | Total |
| | # | \$ | Capital | \$ | Comprehensive | Stockholders |
| | | | \$ | \$ | Loss | Deficiency |
| | | | | | \$ | \$ |
| Balance, August 31, 2005 | 36,434,223 | 36,436 | 4,022,123 | (4,635,958) | (114,240) | (691,639) |
| Net loss | | | | (314,525) | | (314,525) |
| Foreign currency translation loss | | | | | 6,793 | 6,793 |
| | | | | | | (307,732) |
| Comprehensive loss | | | | | | |
| Common stock issued for services rendered | 120,000 | 120 | 23,880 | | | 24,000 |
| Common stock issued on options exercised | 992,000 | 992 | 166,558 | | | 167,550 |
| Common stock issue on extinguishment of loan | 1,500,000 | 1,500 | 298,500 | | | 300,000 |
| Common stock issued through private placement | 1,890,000 | 1,890 | 348,110 | | | 350,000 |
| Stock based compensation - non-employees | | | 32,892 | | | 32,892 |
| Balance, May 31, 2006 | 40,936,223 | 40,938 | 4,892,063 | (4,950,483) | (107,447) | (124,929) |

See accompanying notes

Destiny Media Technologies Inc.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Expressed in United States dollars)

Unaudited

| | Nine Months Ended May 31, 2006 \$ | Nine Months Ended May 31, 2005 \$ |
|--|--|--|
| | | [As restated - note 4] |
| OPERATING ACTIVITIES | | |
| Net loss | (314,525) | (382,468) |
| Items not involving cash: | | |
| Amortization | 39,884 | 41,521 |
| Amortization of deferred lease inducement | (20,728) | (15,953) |
| Stock-based compensation - non-employees | 32,892 | 10,535 |
| Common stock issued for services rendered | 24,000 | |
| Changes in non-cash working capital: | | |
| Accounts and other receivables | (94,217) | 59,442 |
| Inventory | 1,007 | 1,339 |
| Short term investments | | 9,204 |
| Prepaid expenses | (6,245) | 17,789 |
| Accounts payable and accrued liabilities | (98,242) | (171,545) |
| Deferred revenue | (4,553) | (14,733) |
| Net cash used in operating activities | (440,727) | (444,869) |
| INVESTING ACTIVITIES | | |
| Purchase of equipment | (14,736) | (6,723) |
| Net cash used in investing activities | (14,736) | (6,723) |
| FINANCING ACTIVITIES | | |
| Proceeds from issuance of common stock | 350,000 | |
| Proceeds from exercise of stock options | 167,550 | 293,177 |
| Advances (repayments) of shareholder loans | (76,696) | 138,330 |
| Net cash provided by financing activities | 440,854 | 431,507 |
| Effect of foreign exchange rate changes on cash | 26,304 | 3,226 |
| Net increase (decrease) in cash | 11,695 | (16,859) |
| Cash, beginning of period | 30,576 | 17,523 |
| Cash, end of period | 42,271 | 664 |
| Supplementary disclosure | | |
| Cash paid for interest | 5,211 | 5,254 |
| Shareholder loans extinguished with common stock | 270,000 | |
| Accounts payable extinguished with common stock | 30,000 | |
| <i>See accompanying notes</i> | | |

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

1. ORGANIZATION

Destiny Media Technologies Inc. (the Company) was incorporated in August 1998 under the laws of the State of Colorado. The Company develops technologies that allow for the distribution over the Internet of digital media files in either a streaming or digital download format. The technologies are proprietary. The Company operates out of Vancouver, BC, Canada and serves customers predominantly located in the United States and Canada.

2. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with Item 310(b) of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended May 31, 2006 are not necessarily indicative of the results that may be expected for the year ended August 31, 2006.

The balance sheet at August 31, 2005 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended August 31, 2005.

3. GOING CONCERN UNCERTAINTY

The interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**

(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

3. GOING CONCERN UNCERTAINTY (cont d.)

The Company incurred a net loss of \$314,525 for the nine months ended May 31, 2006 [nine months ended May 31, 2005 - \$382,468] and as at May 31, 2006 has incurred cumulative losses of \$4,950,483, has a working capital deficiency of \$90,531 and has a stockholders' deficiency of \$124,929 that raises substantial doubt about its ability to continue as a going concern. Management has been able, thus far, to finance the operations through a series of equity financings and shareholder loans. Management expects to manage operating costs as cash is available through operating and financing activities. There are no assurances that the Company will be successful in achieving these goals.

In view of these conditions, the ability of the Company to continue as a going concern is in substantial doubt and dependent upon achieving a profitable level of operations and on the ability of the Company to obtain necessary financing to fund ongoing operations. These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

4. RESTATEMENT OF COMPARATIVE INTERIM FINANCIAL STATEMENTS

In connection with its preparation of the consolidated financial statements for the fiscal year ended August 31, 2005, management of the Company determined that the previously issued interim financial statements contained in the Company's Quarterly Reports on Form 10-QSB for the quarters ended November 30, 2004, February 28, 2005 and May 31, 2005 should be restated to correct errors in those financial statements for the inappropriate capitalization of software development costs which occurred after the product was released to a customer.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

4. RESTATEMENT OF COMPARATIVE INTERIM FINANCIAL STATEMENTS (cont d.)

The following table summarizes the effect of the restatement on the comparative three and nine months period ending May 31, 2005:

| | Three Months Ended May 31, 2005 | | Nine Months Ended May 31, 2005 | |
|---|------------------------------------|-------------------|-----------------------------------|-------------------|
| | As Reported \$ | As Restated \$ | As Reported \$ | As Restated \$ |
| Consolidated Statement of Operations | | | | |
| Research and development | 88,782 | 101,536 | 264,267 | 314,537 |
| Depreciation | 19,341 | 15,181 | 49,513 | 41,521 |
| Net Loss | (142,737) | (152,331) | (340,190) | (382,468) |
| Net loss per common share, basic and diluted | | | | |
| | (0.01) | (0.01) | (0.01) | (0.01) |
| Comprehensive loss | | | (351,950) | (393,565) |
| Consolidated Statement of Cash Flows | | | | |
| Net cash used in operating activities | | | (394,599) | (444,869) |
| Net cash used in investing activities | | | (56,993) | (6,723) |

5. SHAREHOLDER LOANS PAYABLE

| | May 31, 2006 \$ | August 31, 2005 \$ |
|---|-----------------------|--------------------------|
| Loans payable, due to shareholders, unsecured, due on demand, non-interest bearing | | 328,357 |
| Loans payable, due to shareholder, unsecured, due on demand, interest bearing at 18.9% | | 9,416 |
| | | 337,773 |

On November 23, 2005, \$270,000 of non-interest bearing shareholder loans were extinguished by the issuance of 1,350,000 common shares with a fair value of \$270,000.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

6. OBLIGATION FOR SHARE SETTLEMENT

During the fiscal year ended August 31, 2003, the Company issued 133,333 common shares to be delivered in settlement for proceeds of \$100,000 received in respect of a private placement that did not complete in August of 2000. As the private placement did not complete and although management expects that the amount ultimately will be settled through the release of the shares, the obligation for share settlement is recorded as a liability until settlement results between the Company and parties involved in the August 2000 private placement.

7. SHARE CAPITAL

[a] Common shares issued

During the nine months ended, the Company issued 120,000 common shares for services rendered with a fair market value of \$24,000, 1,350,000 common shares in settlement of a shareholder loan with a fair market value of \$270,000, 150,000 common shares in settlement of an advance from our marketing representative with a fair market value of \$30,000, 992,000 common shares for proceeds of \$167,550 pursuant to the exercise of stock options, and 1,890,000 common shares for proceeds of \$350,000 in connection with a private placement. The private placement included an 8% finders fee which represents 140,000 of the 1,890,000 common shares. The private placement also included the issuance of 1,750,000 warrants exercisable into common shares at \$0.25 expiring August 24, 2007.

[b] Stock option plan

Pursuant to a stock option plans amended March 29, 2004, and April 26, 2006, the Company has reserved 6,250,000 common shares for future issuance under its stock option plan. The options generally vest over a range of periods from the date of grant, some are immediate, others are 12 or 24 months. Any options that do not vest as the result of a grantee leaving the Company are forfeited and the common shares underlying them are returned to the reserve. The options generally have a contractual term of five years.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

7. SHARE CAPITAL (cont d.)

Stock option activity is presented below:

| | Shares Available for Grant # | Number of Options # | Weighted Average Exercise Price \$ |
|-------------------------------------|---|------------------------------------|---|
| Outstanding, August 31, 2005 | 465,375 | 2,104,000 | 0.38 |
| Additional allotment | 2,500,000 | | |
| Granted | (1,042,000) | 1,042,000 | 0.22 |
| Exercised | | (992,000) | 0.17 |
| Forfeited | 860,000 | (860,000) | 0.43 |
| Outstanding, May 31, 2006 | 2,783,375 | 1,294,000 | 0.37 |

Of the total options outstanding at May 31, 2006, 920,000 [August 31, 2005 1,630,000] were granted to employees and 374,000 [August 31, 2005 474,000] were granted to non-employees of the Company. The compensation expense related to options granted to non-employees was \$3,624 and \$32,892 for the three and nine months ending May 31, 2006 respectively [three and nine months ending May 31, 2005 \$4,214 and \$10,535 respectively].

[c] Pro-forma disclosure of stock based compensation

Pro forma information regarding results of operations and earnings (loss) per share is required by SFAS 123, as amended by SFAS 148, for stock-based awards to employees as if the Company had accounted for such awards using the fair value method.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

7. SHARE CAPITAL (cont d.)

For pro-forma purposes, the estimated value of the Company's stock-based awards to employees is amortized over the vesting period of the underlying options. The effect on the Company's net loss and loss per share of applying FAS 123 to the Company's stock-based awards to employees would approximate the following:

| | Three Months Ended May 31, | | Nine Months Ended May 31 | |
|---|-------------------------------|--|-----------------------------|---|
| | 2006 \$ | 2005 \$ As restated - note 4] | 2006 \$ | 2005 \$ [As restated - note 4] |
| Net loss as reported | (28,437) | (152,331) | (314,525) | (382,468) |
| Compensation expense based on fair value method | (5,628) | (4,926) | (16,884) | (8,267) |
| Pro-forma net loss | (34,065) | (157,257) | (331,409) | (390,735) |
| Net loss per common share, basic and diluted: | | | | |
| As reported | (0.01) | (0.01) | (0.01) | (0.01) |
| Pro-forma | (0.01) | (0.01) | (0.01) | (0.01) |

The fair value of the Company's stock-based awards granted to employees is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Three Months Ended May 31, | | Nine Months Ended May 31 | |
|---|-------------------------------|--------|-----------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Risk-free interest rate | - | 5.5% | 5.5% | 5.5% |
| Volatility | - | 99% | 97% | 99% |
| Expected lives | - | 1.06 | 2.42 years | 1.06 |
| Per share weighted - average fair value of stock options granted | - | \$0.09 | \$0.11 | \$0.09 |

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

8. CONTINGENCIES

- [a] On June 6, 2001, a wholly owned subsidiary of the company Destiny Software Productions Inc. ("Destiny Software") commenced legal proceedings in the Supreme Court of British Columbia (Action No. SO13166) against Impatica.com Inc., ("Impatica") for payment of approximately \$512,500 in unpaid technology licensing fees. Impatica filed a counterclaim against Destiny Software seeking return of \$162,500 advanced to Destiny Software on an alleged "good faith" agreement. On March 31, 2006, the parties agreed to settle the outstanding dispute and enter into a mutual release. A consent dismissal order without costs has been filed with the court registry. Destiny Software paid \$6,500 (\$7,500 CDN) to Impatica as consideration for the settlement.
- [b] On September 14, 2004, a statement of claim was filed against the Company by its former solicitor for fees and accrued interest of \$145,978 CDN relating to legal services provided in connection with a failed transaction in 2001 and other general corporate matters. On April 18, 2006, the parties agreed to settle the outstanding dispute and enter into a mutual release. A consent dismissal order without costs will be filed with the court registry. As consideration for settlement, a wholly owned subsidiary of the Company (Destiny Software) will pay a total of \$90,000 CDN (approximately \$80,000 USD) to the plaintiff over a period of 14 months ending July 1, 2007. At May 31, 2006, \$44,500 CDN of the settlement has been paid and the remaining \$45,500 CDN will be paid at the rate of \$3,500 CDN per month for 13 months following the quarter.
- [c] On July 25, 2005 the Company was issued a letter on behalf of Musicrypt Inc. (Musicrypt) indicating a possible infringement of a biometric security system patent. The Company has denied any patent infringement and believes the allegations are without merit. On March 7, 2006 the Company filed a statement of claim in the Federal Court of Canada against Musicrypt to assert that the company s technology does not infringe on the stated patent owned by Musicrypt and to further declare the Musicrypt s patent is invalid. On June 7, 2006, Destiny s counsel received a statement of defense and counterclaim from the defendants. The statement of defense includes a counterclaim, requesting specified damages or audited Canadian profits from the Promo Only system if it is offered in Canada. Management does not believe that the outcome of this matter will have an adverse impact on its result of operations and financial condition.
- [d] The total accounts payable of \$142,979 includes approximately \$56,843 of amounts the company has disputed and approximately \$41,000 (\$45,500 CDN) payable pursuant to the settlement arrangement discussed in paragraph (b) above payable over the next 13 months. Management plans to resolve these balances in the current year, however the outcome of these negotiations is not determinable.

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Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

8. CONTINGENCIES (cont d.)

[d] (cont d.)

The gain on settlement of accounts payable of \$56,965 includes a gain on settlement of the legal services dispute outlined in (b) above of approximately \$23,500, net of a loss on \$6,500 (\$7,500 CDN) on settlement of our dispute with Impatica outlined in (a) above.

9. SEGMENTED INFORMATION AND ECONOMIC DEPENDENCE

The Company operates solely in the digital media software segment and all revenue from its products and services are made in this segment.

Revenue from external customers, by location of customer, is as follows:

| | Three Months Ended May 31, | | Nine Months Ended May 31 | |
|----------------------|---------------------------------------|-------------|-------------------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| United States | 203,430 | 112,973 | 500,518 | 420,040 |
| Canada | 18,677 | 10,372 | 45,954 | 38,565 |
| Other | 56,413 | 31,333 | 138,819 | 116,498 |
| Total revenue | 278,520 | 154,678 | 685,291 | 575,103 |

During the nine months ended May 31, 2006, one customer represented 25% of the total revenue balance [May 31, 2005 - no single customer represented more than 10%].

As at May 31, 2006, three customers represented 58% of the trade receivables balance of \$149,089 [August 31, 2005 two customers represented 71%].

The Company has substantially all its assets in Canada and its current and planned future operations are, and will be, located in Canada.

Destiny Media Technologies Inc.

**NOTES TO INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**
(Expressed in United States dollars)

Three and Nine months ended May 31, 2006

Unaudited

10. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued Statement of Financial Accounting Standards 123R Share-Based Payment, a revision to FAS 123. FAS 123R replaces existing requirements under FAS 123 and APB 25, and requires public companies to recognize the cost of employee services received in exchange for equity instruments, based on the grant-date fair value of those instruments, with limited exceptions. FAS 123R also affects the pattern in which compensation cost is recognized, the accounting for employee share purchase plans, and the accounting for income tax effects of share-based payment transactions. For small-business filers, FAS 123R will be effective for annual periods beginning after December 15, 2005. The Company expects to adopt FAS 123R on September 1, 2006. As permitted by FAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, the adoption of FAS 123R's fair value method will have a significant impact on the Company's statement of operations, although it will have no impact on the Company's overall financial position. The impact of adoption of FAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted FAS 123R in prior periods, the impact of that standard would have approximated the impact of FAS 123 as described in the disclosure of pro forma net loss and loss per share in Note 7[c] to these unaudited interim consolidated financial statements.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with the accompanying financial statements and notes thereto included within this Quarterly Report on Form 10-QSB. In addition to historical information, the information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding the Company's capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as *may*, *will*, *should*, *expect*, *Intend*, *anticipate*, *believe*, *estimate*, *predict*, *potential* or *continue*, the negative of such terms or other terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors described in this Quarterly Report, including the risk factors accompanying this Quarterly Report, and, from time to time, in other reports the Company files with the Securities and Exchange Commission. These factors may cause the Company's actual results to differ materially from any forward-looking statement. The Company disclaims any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

OVERVIEW

Destiny Media Technologies Inc. (the "Company", *Destiny Media* or *we*) is a holding company which owns 100% of the outstanding shares of Destiny Software Productions, Inc. *Destiny Software Productions, Inc.* is the operating company. The *Company*, *Destiny* or *we* refers to the consolidated activities of both companies.

The company is the developer and marketer of innovative technologies which facilitate the distribution of digital media content. All four technologies discussed below are commercially mature and ready for market.

Clipstream Our *Clipstream* family of software products enables our customers to deliver audio and video streaming media via the Internet without requiring the viewer to install software media players or requiring the customer to deploy server technology.

MPE Our *MPE* software is an audio and video media distribution system that enables artists and other media rights owners to securely distribute their media through the Internet. All electronic content is locked to the digital fingerprint of the destination computer.

Currently the system is being used to instantly distribute individual songs from various record labels. If the songs are exported to CD, a digital watermark is invisibly embedded into the song, so the originating computer can be identified. Our system supports the distribution of music, but it may be adopted to move video, software, research reports, or other electronic media.

RadioDestiny Broadcaster Our *RadioDestiny Broadcaster* software enables our customers to broadcast a professional Internet radio station from the customer's personal computer.

Destiny Media Player Our Destiny Media Player software enables a customer to listen to MP3 music files and to listen to RadioDestiny Internet broadcasts on their personal computer.

All four technologies are proprietary and were developed by the company.

In October 2004, the company released an adapted version of MPE which facilitates the transfer of music from the recording industry to radio stations and trusted users. We have recognized revenue associated with this new version of MPE during fiscal 2005 and the first three quarters of Fiscal 2006. We anticipate that revenues will grow significantly as the system gains acceptance by the industry.

Pirate Radio sales are also expected to continue and management is pursuing retail distribution of the Pirate Radio software.

We are a publicly traded company. Our common stock trades on the OTC Bulletin board under the symbol DSNY and on the Berlin exchange in Germany under the symbol DME .

Our corporate website is located on the Internet at <http://www.dsnyc.com>.

PLAN OF OPERATIONS

During our fiscal year ending August 31, 2006, management will focus on upgrading the functionality of our three product lines: Clipstream , Pirate Radio and MPE . New audio and video codecs are being developed for Clipstream and Pirate Radio , which will significantly improve the quality of the user experience. Clipstream Live has been improved to support IP TV, including the ability to change channels from a remote location. We will continue to improve this product to meet customer demand. Promo Only MPE , a security system for delivering pre-release music to radio stations and other trusted users is being improved interactively through consultation with the record labels and radio recipients. This evolutionary approach ensures that Promo Only MPE meets the needs of our customers.

The company is also introducing a new product based on the MPE security system, PODDS. This product enables customers to purchase and download music directly to their computers. We have established licenses through the Audio Video Licensing Association and the major Canadian labels to sell music to Canadian commercial users.

We will continue to sell Clipstream directly through direct telephone sales and through resellers located around the world. The Clipstream license is protected by a code key which restricts the technology to authorized websites. In Japan, we are selling Clipstream as a boxed product, through retail channels.

We sell Pirate Radio through an automated online credit card processing system.

We have signed license agreements with six record labels (including Universal Music Group (UMG)) and subsidiaries of other major labels. These record labels use the Promo Only MPE system to securely distribute new music tracks to radio and trusted users. We expect to continue to sign additional license agreements with record labels during fiscal 2006 and 2007 as we increase the exposure of the MPE system. Currently, record labels send their music both digitally and through a physical CD, delivered by courier. Revenues will remain modest until the labels are able to secure the savings associated with digital only delivery. This is expected to occur by the end of calendar 2006.

The PODDS product has been integrated with an internet enabled jukebox. We will market PODDS to commercial users in Canada (DJ s, restaurant and night club owners, etc.) and to our jukebox partner.

OPERATING RESULTS**May 31, 2006****OPERATING RESULTS****Revenue**

Revenue for the nine months ending May 31, 2006 has increased 19% to \$685,291 from \$575,103 for the nine months ending May 31, 2005 on the strength of increased third quarter revenue. For the quarter ended May 31, 2006, revenue increased 23% from the quarter ending February 28, 2006, 53% from the quarter ending November 30, 2006 and 80% over the same quarter in fiscal 2005.

The increase to revenue is the result of a number of items including a 36% increase to the Promo Only MPE (www.promoonlympe.com) access and delivery fees from the second quarter of fiscal 2006. Although, revenue is at modest levels as we continue to focus on promoting the system as the standard for the industry, we continue to expand the number of record labels under contract for delivery, which has resulted in growth in revenue from the system. We also began using the MPE system to deliver music digitally to jukeboxes which represents 5% of our total MPE revenue for the nine months ending May 31, 2006.

We experienced an increase of 55% in revenue from our Clipstream suite of products in the third quarter ending May 31, 2006 from the quarter ending February 28, 2006. The increase is due in part to the commencement of retail sales of Clipstream through our Japanese reseller which represents 5% of our total Clipstream sales for the quarter. We also experienced a small rebound in sales to our market research customers and realized one large license agreement sale which represented approximately 25% of our total Clipstream sales for the third quarter.

We experienced a small decline in our Pirate Radio sales. This decline represents 0.3% of our total sales for the quarter. Total Pirate Radio sales represent 4% of our total revenue for the nine months ending May 31, 2006.

Operating Expenses

The majority of our expenditures are in Canadian dollars while the majority of our sales are in US dollars. As a result, the decline in value of the US dollar to the Canadian dollar represents a significant impact to our bottom line.

Our general and administrative expenses consist primarily of salaries and related personnel costs including overhead, professional fees, and other general corporate and office expenditures.

| General and administrative (unaudited) | May 31, 2006 (9 months) \$ | May 31, 2005 (9 months) \$ | \$ Change |
|---|---|---|----------------------|
| Wages and benefits | 171,652 | 131,724 | 39,928 |
| Rent | 24,476 | 19,325 | 5,151 |
| Telecommunications | 14,249 | 7,511 | 6,738 |
| Bad debt | 1,410 | 23,623 | (22,213) |
| Office and miscellaneous | 82,207 | 41,988 | 40,219 |
| Professional fees | 91,343 | 74,927 | 16,416 |
| | 385,337 | 299,098 | 86,239 |

General and administrative expenses increased to \$385,337 for the nine months ended May 31, 2006 from \$299,098 for the same period in 2005. The increase in office and miscellaneous expense is due in part to non-cash stock compensation expenses, foreign exchange losses, and an increase in professional fees. The increase in professional fees relates in part to costs associated with new contract negotiations with record labels, costs associated with the settlement of two outstanding legal claims discussed in Note 8 of the financial statements.

Sales and marketing expenses consist primarily of salaries and related personnel costs including overhead, sales commissions, advertising, promotional fees and travel costs.

| Sales and marketing (unaudited) | May 31, 2006 (9 months) | May 31, 2005 (9 months) As restated | \$ Change |
|---|---|--|----------------------------|
| | \$ | \$ | |
| Wages and benefits | 203,955 | 169,256 | 34,699 |
| Rent | 24,476 | 19,325 | 5,151 |
| Telecommunications | 14,249 | 7,511 | 6,738 |
| Meals and entertainment | - | 1,419 | (1,419) |
| Travel | 6,884 | 25,619 | (18,735) |
| Advertising and marketing | 80,926 | 71,141 | 9,785 |
| | 330,490 | 294,271 | 36,219 |

Sales and marketing expenses increased to \$330,490 for the nine months ended May 31, 2006 from \$294,271 for the same period in 2005. The increase in salaries and wages corresponds to an increase in commission costs, advertising and marketing fees for our MPE system.

Research and development costs consist primarily of salaries and related personnel costs including overhead and consulting fees with respect to product development and deployment

| Research and development (unaudited) | May 31, 2006 (9 months) As Restated | May 31, 2005 (9 months) As restated | \$ Change |
|--|--|--|----------------------------|
| | \$ | \$ | |
| Wages and benefits | 231,253 | 260,698 | (29,445) |
| Rent | 32,975 | 38,649 | (5,674) |
| Telecommunications | 19,454 | 15,190 | 4,264 |
| Repairs and maintenance | - | - | - |
| | 283,682 | 314,537 | (30,855) |

Research and development expenses decreased to \$283,682 for the nine months ended May 31, 2006 from \$314,537 for the same period in 2005. The decline in costs was mitigated by increases to salaries and wages during the third quarter from the expansion of our development team. We anticipate that these increased research and development costs will result in significant improvements to all of our products.

We also experienced increases to bandwidth costs, reflected in the increase to telecommunications costs, due to the expanded use the MPE system. Digital deliveries continue to grow significantly resulting in

increases to bandwidth costs. In addition, the company has set up a secondary hosting facility to ensure reliability of the system.

| Amortization (unaudited) | May 31, 2006 (9 months As Restated | May 31, 2005 (9 months As restated | Change |
|------------------------------------|---|---|---------------|
| | \$ | \$ | \$ |
| Amortization | 39,884 | 41,521 | (1,637) |

Interest and other charges

Interest and other charges increased to \$17,388 for the nine months ended May 31, 2006 from \$8,211 over the same period in the prior year as a result of higher balances on interest bearing credit facilities such as credit cards and shareholder loans.

Net Loss

Loss from operations for the nine months ended May 31, 2006 was \$314,525 compared to \$382,468 for same period ending May 31, 2005.

Revenue associated with MPE has begun to grow but is still at preliminary levels and was insufficient to generate a positive net income for the period.

LIQUIDITY AND FINANCIAL CONDITION

We had cash of \$42,271 as at May 31, 2006 compared to cash of \$30,576 as at August 31, 2005. We had a working capital deficiency of \$90,531 as at May 31, 2006 compared to \$657,601 as at August 31, 2005. We had a shareholders deficiency of \$124,929 as at May 31, 2006 compared to shareholders deficiency of \$691,639 as at August 31, 2005.

CASHFLOWS

Operating

Net cash used in operating activities decreased to \$440,727 for the nine months ending May 31, 2006, compared to \$444,869 for the nine months ended May 31, 2005.

Investing

Net cash used in investing activities increased to \$14,736 during the quarter ended May 31, 2006, as compared with \$6,723 of investing activities for the same quarter in 2005.

Financing

Net cash provided from financing activities increased to \$441,604 during the period ended May 31, 2006, as compared to \$431,507 over the same period in the prior year. On November 23, 2005, \$270,000 of shareholder loans were extinguished by the agreement to issue 1,350,000 common shares with a fair value of \$270,000. Also, the company received \$167,550 of proceeds from the exercise of 992,000 stock options. Also during the quarter the company received \$350,000 in a private placement.

Going Concern

We have incurred recurring losses from operations and we have a working capital deficiency and a shareholder's equity deficiency. As a result, substantial doubt exists about the company's ability to continue as a going concern. Our operating losses to date have been primarily financed by equity transactions and shareholder loans. Depending on our ability to continue to grow sales and related cash flows, we may need additional capital through public or private financings that may not be available on reasonable terms. Accordingly, we may require the continued financial support from our shareholders and creditors until we are able to generate sufficient cash flows from operations on a sustained basis. There can be no assurances that we will be successful. If we are not, we will be required to reduce operations or liquidate assets. Our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern. Our independent auditors have referred to the substantial doubt about our ability to continue as a going concern in their audit report on our financial statements included with our Annual Report on Form 10-KSB for our fiscal year ended August 31, 2005.

RESTATEMENT OF COMPARATIVE INTERIM FINANCIAL STATEMENTS

In connection with its preparation of the consolidated financial statements for the fiscal year ended August 31, 2005, management of the Company determined that the previously issued interim financial statements contained in the Company's Quarterly Reports on Form 10-QSB for the quarters ended November 30, 2004, February 28, 2005 and May 31, 2005 should be restated to correct errors in those financial statements for the inappropriate capitalization of software development costs which occurred after the product was released to a customer.

The following table summarizes the effect of the restatement on the comparative nine month period ending May 31, 2005:

| | Nine months ending May 31, 2005 | |
|--|--|------------------------|
| | As Reported | As Restated |
| | \$ | \$ |
| Consolidated Statement of Operations | | |
| Research and development | 264,267 | 314,537 |
| Depreciation | 49,513 | 41,521 |
| Net Loss | (340,190) | (382,468) |
| Net loss per common share, basic and diluted | (0.01) | (0.01) |
| Comprehensive loss | (351,950) | (393,565) |
| Consolidated Statement of Cash Flows | | |
| Net cash used in operating activities | (394,599) | (444,869) |
| Net cash used in investing activities | (56,993) | (6,723) |

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, and make estimates and assumptions that affect our reported amounts of assets, liabilities, revenue and expenses, and the related disclosures of contingent liabilities. We base our estimates on historical experience and other assumptions that we believe are reasonable in the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements.

- The consolidated financial statements have been prepared on the going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of operations. If we were not to continue as a going concern, we would likely not be able to realize on our assets at values comparable to the carrying value or the fair value estimates reflected in the balances set out in the preparation of the consolidated financial statements. There can be no assurances that we will be successful in generating additional cash from equity or other sources to be used for operations. The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.
- We recognize revenue when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, collection is reasonably assured, and there are no substantive performance obligations remaining. Our revenue recognition policies are in conformity with AICPA's Statement of Position No. 97-2, Software Revenue Recognition, as amended (SOP 97-2). We generate revenue from software arrangements involving multiple element sales arrangements. Revenue is allocated to each element of the arrangement based on the relative fair value of the elements and is recognized as each element is delivered and we have no significant remaining performance obligations. If evidence of fair value for each element does not exist, all revenue from the arrangement is recognized over the term of the arrangement. To-date, evidence of fair value for each element has not been available on sales arrangements. Changes in our business priorities or model in the future could materially impact our reported revenue and cash flow. Although such changes are not currently contemplated, they could be required in response to industry or customer developments.
- Costs incurred internally to develop computer software products and the costs to acquire externally developed software products (which have no alternative future use) to be sold, leased or otherwise marketed are charged to expense until the technological feasibility of the product has been established. After technological feasibility is established and until the product is available for general release, software development, product enhancements and acquisition costs are capitalized and amortized on a product-by-product basis.
- We account for stock-based employee compensation arrangements using the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and comply with the disclosure provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS 123) as amended by Statement of Financial Accounting Standards No. 148 Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123". The pro forma disclosure of stock-based compensation is included in Note 7(c) our unaudited interim financial statements. Under APB 25, compensation expense for employees is based on the difference between the fair value of our stock and the exercise price if any, on the date of the grant. We account for stock issued to non-employees at fair value in accordance with FAS 123. We use the Black-Scholes option pricing model to determine the fair value of stock options granted to non-employees.

ITEM 3. CONTROLS AND PROCEDURES.

As required by Rule 13a-15 under the Exchange Act, we have carried out an evaluation of the effectiveness of the design and operation of our company's disclosure controls and procedures as of the end of the period covered by this quarterly report, being May 31, 2006. This evaluation was carried out under the supervision and with the participation of our company's management, including our company's chief financial officer and chief executive officer. Based upon that evaluation, our company's chief financial officer and chief executive officer concluded that our company's disclosure controls and procedures are effective. There have been no significant changes in our company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date we carried out our evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our company's reports filed under the Exchange Act is accumulated and communicated to management, including our company's president and chief executive officer as appropriate, to allow timely decisions regarding required disclosure.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

On March 7, 2006 we filed a Statement of Claim in the Federal Court of Canada against Musicrypt Inc. to assert that our MPE system, as marketed under Promo Only MPE, does not infringe on Canadian Patent No. 2,407,774, owned by Musicrypt, Inc. (MCT-TSX). The action commenced by us also seeks a declaration that this patent is invalid.

On June 7, 2006, Destiny's counsel received a statement of defense and counterclaim from the defendants. The statement of defense includes a counterclaim, requesting specified damages or audited Canadian profits from the Promo Only system if it is offered in Canada. Management does not believe that the outcome of this matter will have an adverse impact on its result of operations and financial condition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During our fiscal quarter ended May 31, 2006, the Company issued 270,000 common shares for proceeds of \$50,000 in connection with a private placement. The private placement included an 8% finders fee which represents 20,000 of the 270,000 common shares. The private placement also included the issuance of 250,000 warrants exercisable into common shares at \$0.25 expiring August 24, 2007. The Company also issued 150,000 shares in settlement of an advance from our marketing representative for total proceeds of \$30,000.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of securities holders during the quarter ended May 31, 2006.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

EXHIBIT NUMBER DESCRIPTION

| | |
|-----------|--|
| <u>31</u> | <u>Certification 302 of Steve Vestergaard, Chief Executive Officer and Chief Financial Officer</u> <u>(1)</u> |
| <u>32</u> | <u>Certification 906 of Steve Vestergaard, Chief Executive Officer and Chief Financial Officer</u> <u>(1)</u> |

(1) Filed as an exhibit to this Quarterly Report on Form 10-QSB

(b) Reports on Form 8-K.

During the quarter we filed Form 8-K on March 3, 2006 announcing a new stock compensation plan.

On March 31, 2006 we filed Form 8-K outlining the terms of settlement with Impatica.com Inc which is outlined in Note 8 (a) to the interim financial statements.

On April 26, 2006 we filed Form 8-K outlining the terms of settlement with its former solicitor as outlined in Note 8 (b) to the interim financial statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DESTINY MEDIA TECHNOLOGIES INC.

Dated: July 14, 2006

/s/ Steven Vestergaard

Steven Vestergaard, Chief Executive Officer
and Chief Financial Officer
