

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

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FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2008

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 00-10039

**MANDALAY MEDIA, INC.**

(Exact name of Registrant as Specified in Its Charter)

**Delaware**

(State or other jurisdiction of incorporation or organization )

**22-2267658**

(I.R.S. Employer Identification No.)

**2121 Avenue of the Stars, Suite 2550, Los Angeles, CA**

(Address of principal executive offices)

**90067**

(Zip Code)

**(310) 601-2500**

(Registrant's telephone number, including area code)

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 (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer

Accelerated filer

Non-accelerated filer   
(do not check if a smaller reporting company)

Smaller reporting company

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

On February 19, 2009, there were 38,965,643 shares of the Registrant's common stock, par value \$0.0001 per share, issued and outstanding.

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**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

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**Mandalay Media, Inc. and Subsidiaries**  
**Consolidated Balance Sheets**

(In thousands, except share amounts)

|  | December 31,<br>2008<br>(Unaudited) | March 31,<br>2008 |
|--|-------------------------------------|-------------------|
| <b>ASSETS</b>  |                                     |                   |
| <b>Current Assets</b>  |                                     |                   |
| Cash and cash equivalents  | \$ 6,411                            | \$ 10,936         |
| Accounts receivable, net of allowances                                   | 11,835                              | 6,162             |
| Prepaid expenses and other current assets                                | 798                                 | 531               |
| <b>Total current assets</b>  | <b>19,044</b>                       | <b>17,629</b>     |
| Property and equipment, net  | 1,266                               | 1,037             |
| Other long-term assets   | 278                                 | 301               |
| Intangible assets, net   | 20,366                              | 19,780            |
| Goodwill   | 84,124                              | 61,377            |
| <b>TOTAL ASSETS</b>  | <b>\$ 125,078</b>                   | <b>\$ 100,124</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                              |                                     |                   |
| <b>Current liabilities</b>   |                                     |                   |
| Accounts payable   | \$ 9,930                            | \$ 2,399          |
| Accrued license fees   | 2,749                               | 3,833             |
| Accrued compensation   | 674                                 | 688               |
| Current portion of long term debt  | 3                                   | 248               |
| Other current liabilities  | 6,317                               | 2,087             |
| <b>Total current liabilities</b>   | <b>19,673</b>                       | <b>9,255</b>      |
| Accrued license fees, long term portion                                  | 530                                 | 1,337             |
| Long term debt, net of current portion                                   | 23,089                              | 16,483            |
| Other long-term liabilities  | 57                                  | -                 |
| <b>Total liabilities</b>   | <b>\$ 43,349</b>                    | <b>27,075</b>     |
| <b>Commitments and contingencies (Note 14)</b>                           |                                     |                   |
| <b>Stockholders' equity</b>  |                                     |                   |
| Preferred stock  |                                     |                   |
| Series A Convertible Preferred Stock                                     |                                     |                   |
| at \$0.0001 par value; 100,000 shares authorized, issued and outstanding |                                     |                   |
| (liquidation preference of \$1,000,000 at December 31, 2008)             | 100                                 | 100               |
| Common stock, \$0.0001 par value: 100,000,000 shares authorized;         |                                     |                   |
| 38,965,643 issued and outstanding at December 31, 2008;                  |                                     |                   |
| 32,149,089 issued and outstanding at March 31, 2008;                     | 4                                   | 3                 |
| Additional paid-in capital   | 93,486                              | 76,154            |
| Accumulated other comprehensive income/(loss)                            | 340                                 | 61                |
| Accumulated deficit  | (12,201)                            | (3,269)           |
| <b>Total stockholders' equity</b>  | <b>81,729</b>                       | <b>73,049</b>     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                        | <b>\$ 125,078</b>                   | <b>\$ 100,124</b> |

The accompanying notes are an integral part of these consolidated financial statements

**Mandalay Media, Inc. and Subsidiaries**  
**Consolidated Statement of Operations (Unaudited)**

(In thousands, except per share amounts)

|   | <u>3 Months Ended<br/>December 31,<br/>2008</u> | <u>3 Months Ended<br/>December 31,<br/>2007</u> | <u>9 Months Ended<br/>December 31,<br/>2008</u> | <u>9 Months Ended<br/>December 31,<br/>2007</u> |
|---|---|---|---|---|
| Revenues  | \$ 11,005                                       | \$ -  | \$ 21,354                                       | \$ -  |
| Cost of revenues  |   |   |   |   |
| License fees  | 1,670   | -   | 5,604   | -   |
| Other direct cost of revenues                                 | <u>2,264</u>                                    | <u>-</u>  | <u>2,468</u>                                    | <u>-</u>  |
| Total cost of revenues  | <u>3,934</u>                                    | <u>-</u>  | <u>8,072</u>                                    | <u>-</u>  |
| Gross profit  | <u>7,071</u>                                    | <u>-</u>  | <u>13,282</u>                                   | <u>-</u>  |
| Operating expenses  |   |   |   |   |
| Product development   | 1,563   | -   | 5,130   | -   |
| Sales and marketing   | 4,243   | -   | 6,526   | -   |
| General and administrative                                    | 2,173   | 1,278   | 7,545   | 2,189   |
| Amortization of intangible assets                             | <u>177</u>                                      | <u>-</u>  | <u>451</u>                                      | <u>-</u>  |
| Total operating expenses                                      | <u>8,156</u>                                    | <u>1,278</u>                                    | <u>19,652</u>                                   | <u>2,189</u>                                    |
| Loss from operations  | <u>(1,085)</u>                                  | <u>(1,278)</u>                                  | <u>(6,370)</u>                                  | <u>(2,189)</u>                                  |
| Interest and other income/(expense)                           |   |   |   |   |
| Interest income   | 21  | 91  | 141   | 256   |
| Interest (expense)  | (465)   | -   | (1,417)   | -   |
| Foreign exchange transaction gain (loss)                      | (418)   | -   | (345)   | -   |
| Other (expense)   | <u>(276)</u>                                    | <u>-</u>  | <u>(463)</u>                                    | <u>-</u>  |
| Interest and other income/(expense)                           | <u>(1,138)</u>                                  | <u>91</u>                                       | <u>(2,084)</u>                                  | <u>256</u>                                      |
| Loss before income taxes                                      | <u>(2,223)</u>                                  | <u>(1,187)</u>                                  | <u>(8,454)</u>                                  | <u>(1,933)</u>                                  |
| Income tax provision  | (350)   | 1   | (497)   | 2   |
| Minority interest in consolidated subsidiaries                | <u>19</u>                                       | <u>-</u>  | <u>19</u>                                       | <u>-</u>  |
| Net loss  | <u>\$ (2,554)</u>                               | <u>\$ (1,186)</u>                               | <u>\$ (8,932)</u>                               | <u>\$ (1,931)</u>                               |
| Basic and Diluted net loss per common share                   | <u>\$ (0.07)</u>                                | <u>\$ (0.05)</u>                                | <u>\$ (0.26)</u>                                | <u>\$ (0.09)</u>                                |
| Comprehensive loss  | <u>\$ (2,159)</u>                               | <u>\$ (1,186)</u>                               | <u>\$ (8,653)</u>                               | <u>\$ (1,931)</u>                               |
| Weighted average common shares outstanding, basic and diluted | <u>37,366</u>                                   | <u>21,730</u>                                   | <u>34,028</u>                                   | <u>21,902</u>                                   |

The accompanying notes are an integral part of these consolidated financial statements



|  |                   |             |                |               |                  |               |                                    |
|--|-------------------|-------------|----------------|---------------|------------------|---------------|------------------------------------|
| net of issuance costs                    | 1,685,394         | 0           |                | 4,354         |                  | 4,354         |                                    |
| Foreign currency translation gain/(loss) |                   |             |                | 395           |                  | 395           | 395                                |
| Stock-based compensation                 |                   |             |                | 621           |                  | 621           |                                    |
| Comprehensive loss                       |                   |             |                |               |                  |               | \$ (2,159)                         |
| Balance at December 31, 2008             | <u>38,965,643</u> | <u>\$ 4</u> | <u>100,000</u> | <u>\$ 100</u> | <u>\$ 93,486</u> | <u>\$ 340</u> | <u>\$ (12,201)</u> <u>\$81,729</u> |

The accompanying notes are an integral part of these consolidated financial statements

**Mandalay Media, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows (Unaudited)**

(In thousands)

|   | 9 Months Ended<br>December 31,<br>2008 | 9 Months Ended<br>December 31,<br>2007 |
|---|--|--|
| <b>Cash flows from operating activities</b>                                 |  |  |
| Net loss  | \$ (8,932)                             | \$ (1,931)                             |
| Adjustments to reconcile net loss to net cash used in operating activities: |  |  |
| Depreciation and amortization   | 1,060                                  | -                                      |
| Allowance for doubtful accounts   | 50                                     | -                                      |
| Stock-based compensation  | 2,587                                  | 1,036                                  |
| (Increase) / decrease in assets:  |  |  |
| Accounts receivable   | 3,424                                  | -                                      |
| Prepaid expenses and other  | (24)                                   | -                                      |
| Increase / (decrease) in liabilities:                                       |  |  |
| Accounts payable  | (2,721)                                | 399                                    |
| Accrued license fees  | (1,064)                                | -                                      |
| Accrued compensation  | (14)                                   | -                                      |
| Other liabilities   | 43                                     | -                                      |
| Net cash used in operating activities                                       | <u>(5,591)</u>                         | <u>(496)</u>                           |
| <b>Cash flows from investing activities</b>                                 |  |  |
| Purchase of property and equipment  | (101)                                  | -                                      |
| Transaction costs   | (812)                                  | (141)                                  |
| Cash used in acquisition of subsidiary                                      | (5,470)                                | -                                      |
| Cash acquired with purchase of subsidiary                                   | <u>3,020</u>                           | <u>-</u>                               |
| Net cash used in investing activities                                       | <u>(3,363)</u>                         | <u>(141)</u>                           |
| <b>Cash flows from financing activities</b>                                 |  |  |
| Proceeds from the sale of common stock<br>(net of issuance costs)           | 4,354                                  | 2,473                                  |
| Instalment payments related to prior acquisition                            | <u>(54)</u>                            | <u>-</u>                               |
| Net cash provided by financing activities                                   | <u>4,300</u>                           | <u>2,473</u>                           |
| Effect of exchange rate changes on cash and cash equivalents                | <u>129</u>                             | <u>-</u>                               |
| <b>Net increase/(decrease) in cash and cash equivalents</b>                 | <b>(4,525)</b>                         | <b>1,836</b>                           |
| <b>Cash and cash equivalents, beginning of period</b>                       | <b><u>10,936</u></b>                   | <b><u>5,418</u></b>                    |
| <b>Cash and cash equivalents, end of period</b>                             | <b><u>\$ 6,411</u></b>                 | <b><u>\$ 7,254</u></b>                 |
| <b>Supplemental disclosure of cash flow information:</b>                    |  |  |
| Taxes paid  | <u>(270)</u>                           | <u>-</u>                               |
| <b>Noncash investing and financing activities:</b>                          |  |  |
| Acquisition of subsidiary   | <u>16,790</u>                          | <u>-</u>                               |

The accompanying notes are an integral part of these consolidated financial statements

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **1. Organization**

Mandalay Media, Inc. (the Company), formerly Mediavest, Inc. (“Mediavest”), was originally incorporated in the state of Delaware on November 6, 1998 under the name eB2B Commerce, Inc. On April 27, 2000, it merged into DynamicWeb Enterprises Inc., a New Jersey corporation, the surviving company, and changed its name to eB2B Commerce, Inc. On April 13, 2005, the Company changed its name to Mediavest, Inc. Through January 26, 2005, the Company and its former subsidiaries were engaged in providing business-to-business transaction management services designed to simplify trading between buyers and suppliers. The Company was inactive from January 26, 2005 until its merger with Twistbox Entertainment, Inc., February 12, 2008 (Note 6). On September 14, 2007, the Company was re-incorporated in the state of Delaware as Mandalay Media Inc.

On November 7, 2007, the Company merged into its wholly-owned, newly formed subsidiary, Mandalay, with Mandalay as the surviving corporation. Mandalay issued: (1) one new share of common stock in exchange for each share of Mediavest’s outstanding common stock and (2) one new share of preferred stock in exchange for each share of Mediavest’s outstanding preferred stock as of November 7, 2007. Mandalay’s preferred and common stock had the same status and par value as the respective stock of Mediavest and Mandalay acceded to all the rights, acquired all the assets and assumed all of the liabilities of Mediavest.

On February 12, 2008, the Company completed a merger (the “Merger”) with Twistbox Entertainment, Inc. (“Twistbox”) through an exchange of all outstanding capital stock of Twistbox for 10,180 shares of common stock of the Company. In connection with the Merger, the Company assumed all the outstanding options under Twistbox’s Stock Incentive Plan by the issuance of options to purchase 2,463 shares of common stock of the Company, including 2,145 vested and 319 unvested options.

After the Merger, Twistbox became a wholly-owned subsidiary of the Company, and the company’s only active subsidiary at that time. Twistbox Entertainment Inc. (formerly known as The WAAT Corporation) is incorporated in the State of Delaware.

Twistbox is a global publisher and distributor of branded entertainment content, including images, video, TV programming and games, for Third Generation (3G) mobile networks. Twistbox publishes and distributes its content in a number of countries. Since operations began in 2003, Twistbox has developed an intellectual property portfolio that includes mobile rights to global brands and content from leading film, television and lifestyle content publishing companies. Twistbox has built a proprietary mobile publishing platform that includes: tools that automate handset portability for the distribution of images and video; a mobile games development suite that automates the porting of mobile games and applications to multiple handsets; and a content standards and ratings system globally adopted by major wireless carriers to assist with the responsible deployment of age-verified content. Twistbox has distribution agreements with many of the largest mobile operators in the world. Twistbox is headquartered in the Los Angeles area and has offices in Europe and South America that provide local sales and marketing support for both mobile operators and third party distribution in their respective regions.

On October 23, 2008 the Company completed an acquisition of 100% of the issued and outstanding share capital of AMV Holding Limited, a United Kingdom private limited company (“AMV”), and 80% of the issued and outstanding share capital of Fierce Media Ltd (“Fierce”).

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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In consideration for the shares, and subject to adjustment as set forth in the Agreement, the aggregate purchase price (the "Purchase Price") consisted of: (a) \$5,375 in cash (the "Cash Consideration"); (b) 4,500 fully paid shares of Common Stock (the "Stock Consideration"); (c) a secured promissory note in the aggregate original principal amount of \$5,375 (the "Note"); and (d) additional earn-out amounts, if any, if the Acquired Companies achieve certain targeted earnings for each of the periods from October 1, 2008 to March 31, 2009, April 1, 2009 to March 31, 2010, and April 1, 2010 to September 30, 2010, as determined in accordance with the Agreement. The Purchase Price is subject to certain adjustments based on the working capital of AMV, to be determined initially within 75 days of the closing, and subsequently within 60 days following June 30, 2009. Any such adjustment of the Purchase Price will be made first by means of an adjustment to the principal sum due under the Note, as set forth in the Agreement.

AMV is a leading mobile media and marketing company delivering games and lifestyle content directly to consumers in the United Kingdom, Australia, South Africa and various other European countries. AMV markets its well established branded services through a unique Customer Relationship Management (CRM) platform that drives revenue through mobile internet, print and TV advertising. AMV is headquartered in Marlow, outside of London in the United Kingdom.

## **2. Summary of Significant Accounting Policies**

### **Basis of Presentation**

The accompanying consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K/T, filed with the Securities and Exchange Commission. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, which the Company believes are necessary for a fair statement of the Company's financial position as of December 31, 2008 and its results of operations for the three months and the nine months ended December 31, 2008 and 2007, respectively. These consolidated financial statements are not necessarily indicative of the results to be expected for the entire year. The consolidated balance sheet presented as of December 31, 2008 has been derived from the unaudited consolidated financial statements as of that date, and the consolidated balance sheet presented as of March 31, 2008 has been derived from the audited consolidated financial statements as of that date.

### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and our wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

### **Revenue Recognition**

The Company's revenues are derived primarily by licensing material and software in the form of products (Image Galleries, Wallpapers, video, WAP Site access, Mobile TV) and mobile games. License arrangements with the end user can be on a perpetual or subscription basis.

A perpetual license gives an end user the right to use the product, image or game on the registered handset on a perpetual basis. A subscription license gives an end user the right to use the product, image or game on the registered handset for a limited period of time, ranging from a few days to as long as one month.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

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The Company either markets and distributes its products directly to consumers, or distributes products through mobile telecommunications service providers (carriers), in which case the carrier markets the product, images or games to end users. License fees for perpetual and subscription licenses are usually billed upon download of the product, image or game by the end user. In the case of subscriber licenses, many subscriber agreements provide for automatic renewal until the subscriber opts-out, while others provide opt-in renewal. In either case, subsequent billings for subscription licenses are generally billed monthly. Twistbox applies the provisions of Statement of Position 97-2, *Software Revenue Recognition*, as amended by Statement of Position 98-9, Modification of SOP 97-2, *Software Revenue Recognition, With Respect to Certain Transactions*, to all transactions.

Revenues are recognized from the Company's products, images and games when persuasive evidence of an arrangement exists, the product, image or game has been delivered, the fee is fixed or determinable, and the collection of the resulting receivable is probable. For both perpetual and subscription licenses, management considers a signed license agreement to be evidence of an arrangement with a carrier and a "clickwrap" agreement to be evidence of an arrangement with an end user. For these licenses, the Company defines delivery as the download of the product, image or game by the end user.

The Company estimates revenues from carriers in the current period when reasonable estimates of these amounts can be made. Most carriers only provide detailed sales transaction data on a one to two month lag. Estimated revenue is treated as unbilled receivables until the detailed reporting is received and the revenues can be billed. Some carriers provide reliable interim preliminary reporting and others report sales data within a reasonable time frame following the end of each month, both of which allow the Company to make reasonable estimates of revenues and therefore to recognize revenues during the reporting period when the end user licenses the product, image or game. Determination of the appropriate amount of revenue recognized involves judgments and estimates that the Company believes are reasonable, but it is possible that actual results may differ from the Company's estimates. The Company's estimates for revenues include consideration of factors such as preliminary sales data, carrier-specific historical sales trends, volume of activity on company monitored sites, seasonality, time elapsed from launch of services or product lines, the age of games and the expected impact of newly launched games, successful introduction of new handsets, growth of 3G subscribers by carrier, promotions during the period and economic trends. When the Company receives the final carrier reports, to the extent not received within a reasonable time frame following the end of each month, the Company records any differences between estimated revenues and actual revenues in the reporting period when the Company determines the actual amounts. Revenues earned from certain carriers may not be reasonably estimated. If the Company is unable to reasonably estimate the amount of revenues to be recognized in the current period, the Company recognizes revenues upon the receipt of a carrier revenue report and when the Company's portion of licensed revenues are fixed or determinable and collection is probable. To monitor the reliability of the Company's estimates, management, where possible, reviews the revenues by country by carrier and by product line on a regular basis to identify unusual trends such as differential adoption rates by carriers or the introduction of new handsets. If the Company deems a carrier not to be creditworthy, the Company defers all revenues from the arrangement until the Company receives payment and all other revenue recognition criteria have been met.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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In accordance with Emerging Issues Task Force, or EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the Company recognizes as revenues the amount the carrier reports as payable upon the sale of the Company's products, images or games. The Company has evaluated its carrier agreements and has determined that it is not the principal when selling its products, images or games through carriers. Key indicators that it evaluated to reach this determination include:

- wireless subscribers directly contract with the carriers, which have most of the service interaction and are generally viewed as the primary obligor by the subscribers;
- carriers generally have significant control over the types of content that they offer to their subscribers;
- carriers are directly responsible for billing and collecting fees from their subscribers, including the resolution of billing disputes;
- carriers generally pay the Company a fixed percentage of their revenues or a fixed fee for each game;
- carriers generally must approve the price of the Company's content in advance of their sale to subscribers, and the Company's more significant carriers generally have the ability to set the ultimate price charged to their subscribers; and
- The Company's limited risks, including no inventory risk and limited credit risk.

For direct to consumer business, revenue is earned by delivering a product or service directly to the end user of that product or service. In those cases the Company records as revenue the amount billed to that end user and recognizes the revenue when persuasive evidence of an arrangement exists, the product, image or game has been delivered, the fee is fixed or determinable, and the collection of the resulting receivable is probable.

#### **Net Income (Loss) per Common Share**

Basic income (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share is computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding for the period plus dilutive common stock equivalents, using the treasury stock method. Potentially dilutive shares from stock options and warrants and the conversion of the Series A preferred stock for the three months ended December 31, 2008 and December 31, 2007 consisted of 1,630 and 2,690 shares, respectively, and for the nine months ended December 31, 2008 and 2007 consisted of 1,986 and 1,947 shares, respectively, and were not included in the computation of diluted loss per share as they were anti-dilutive in each period.

#### **Comprehensive Income/(Loss)**

Comprehensive income/(loss) consists of two components, net income/(loss) and other comprehensive income/(loss). Other comprehensive income/(loss) refers to gains and losses that under generally accepted accounting principles are recorded as an element of stockholders' equity but are excluded from net income/(loss). The Company's other comprehensive income/(loss) currently includes only foreign currency translation adjustments.

#### **Cash and Cash Equivalents**

The Company considers all highly liquid short-term investments purchased with a maturity of three months or less to be cash equivalents.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **Content Provider Licenses**

##### ***Content Provider License Fees and Minimum Guarantees***

The Company's royalty expenses consist of fees that it pays to branded content owners for the use of their intellectual property in the development of the Company's games and other content, and other expenses directly incurred in earning revenue. Royalty-based obligations are either accrued as incurred and subsequently paid, or in the case of longer term content acquisitions, paid in advance and capitalized on the balance sheet as prepaid royalties. These royalty-based obligations are expensed to cost of revenues either at the applicable contractual rate related to that revenue or over the estimated life of the prepaid royalties. Advanced license payments that are not recoupable against future royalties are capitalized and amortized over the lesser of the estimated life of the branded title or the term of the license agreement.

The Company's contracts with some licensors include minimum guaranteed royalty payments, which are payable regardless of the ultimate volume of sales to end users. Each quarter, the Company evaluates the realization of its royalties as well as any unrecognized guarantees not yet paid to determine amounts that it deems unlikely to be realized through product sales. The Company uses estimates of revenues, and share of the relevant licensor to evaluate the future realization of future royalties and guarantees. This evaluation considers multiple factors, including the term of the agreement, forecasted demand, product life cycle status, product development plans, and current and anticipated sales levels, as well as other qualitative factors. To the extent that this evaluation indicates that the remaining future guaranteed royalty payments are not recoverable, the Company records an impairment charge to cost of revenues and a liability in the period that impairment is indicated.

##### ***Content Acquired***

Amounts paid to third party content providers as part of an agreement to make content available to the Company for a term or in perpetuity, without a revenue share, have been capitalized and are included in the balance sheet as prepaid expenses. These balances will be expensed over the estimated life of the material acquired.

#### **Software Development Costs**

The Company applies the principles of Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* ("SFAS No. 86"). SFAS No. 86 requires that software development costs incurred in conjunction with product development be charged to research and development expense until technological feasibility is established. Thereafter, until the product is released for sale, software development costs must be capitalized and reported at the lower of unamortized cost or net realizable value of the related product.

The Company has adopted the "tested working model" approach to establishing technological feasibility for its products and games. Under this approach, the Company does not consider a product or game in development to have passed the technological feasibility milestone until the Company has completed a model of the product or game that contains essentially all the functionality and features of the final game and has tested the model to ensure that it works as expected. To date, the Company has not incurred significant costs between the establishment of technological feasibility and the release of a product or game for sale; thus, the Company has expensed all software development costs as incurred. The Company considers the following factors in determining whether costs can be capitalized: the emerging nature of the mobile market; the gradual evolution of the wireless carrier platforms and mobile phones for which it develops products and games; the lack of pre-orders or sales history for its products and games; the uncertainty regarding a product's or game's revenue-generating potential; its lack of control over the carrier distribution channel resulting in uncertainty as to when, if ever, a product or game will be available for sale; and its historical practice of canceling products and games at any stage of the development process.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **Product Development Costs**

The Company charges costs related to research, design and development of products to product development expense as incurred. The types of costs included in product development expenses include salaries, contractor fees and allocated facilities costs.

#### **Advertising Expenses**

The Company expenses the production costs of advertising, including direct response advertising, the first time the advertising takes place. Advertising expense was \$2,487 and \$0 in the three months ended December 31, 2008 and 2007, respectively, and \$3,060 and \$0 in the nine months ended December 31, 2008 and 2007, respectively.

#### **Restructuring**

The Company accounts for costs associated with employee terminations and other exit activities in accordance with Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities. The Company records employee termination benefits as an operating expense when it communicates the benefit arrangement to the employee and it requires no significant future services, other than a minimum retention period, from the employee to earn the termination benefits.

#### **Fair Value of Financial Instruments**

For certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, the carrying amounts approximate their fair value due to their relatively short maturity. Based on the borrowing rates available to the Company for loans with similar terms, the carrying value of borrowings outstanding approximates their fair value.

#### **Foreign Currency Translation.**

The Company uses the United States dollar for financial reporting purposes. Assets and liabilities of foreign operations are translated using current rates of exchange prevailing at the balance sheet date. Equity accounts have been translated at their historical exchange rates when the capital transaction occurred. Statement of Operations amounts are translated at average rates in effect for the reporting period. The foreign currency translation adjustment (loss) of \$395 in the three months ended December 31, 2008 and \$279 in the nine months ended December 31, 2008 has been reported as a component of comprehensive loss in the consolidated statement of stockholders equity and comprehensive loss. Translation gains or losses are shown as a separate component of retained earnings. Other comprehensive income / (loss) amounted to \$395 in the three months ended December 31, 2008 and \$279 in the nine months ended December 31, 2008.

#### **Concentrations of Credit Risk.**

Financial instruments which potentially subject us to concentration of credit risk consist principally of cash and cash equivalents, short-term investments, and accounts receivable. We have placed cash and cash equivalents and short-term investments with a single high credit-quality institution. As of December 31, 2008, we did not have any long-term marketable securities. The Company's sales are made either directly to consumers, with the billings performed by and the receivable due from industry aggregators; or directly to the large national Mobile Phone Operators in the countries that we operate. We have a significant level of business and resulting significant accounts receivable balance with one operator and therefore have a high concentration of credit risk with that operator. We perform ongoing credit evaluations of our customers and maintain an allowance for potential credit losses. As of December 31, 2008, approximately 20% of our gross accounts receivable outstanding was with one major customer. This customer accounted for 13% of our gross sales in the three months ended December 31, 2008 and 7% in the nine months ended December 31, 2008.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **Property and Equipment**

Property and equipment is stated at cost. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives of the related assets. Estimated useful lives are eight to ten years for leasehold improvements and 5 years for other assets.

#### **Goodwill**

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS No. 142"), the Company's goodwill is not amortized but is tested for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable.

#### **Impairment of Long-Lived Assets and Intangibles**

Long-lived assets, including purchased intangible assets with finite lives are amortized using the straight-line method over their useful lives ranging from three to ten years and are reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

#### **Income Taxes**

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS No. 109"), which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in its financial statements or tax returns. Under SFAS No. 109, the Company determines deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of assets and liabilities along with net operating losses, if it is more likely than not the tax benefits will be realized using the enacted tax rates in effect for the year in which it expects the differences to reverse. To the extent a deferred tax asset cannot be recognized, a valuation allowance is established if necessary.

We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement 109* ("FIN 48") on January 1, 2008. FIN 48 did not impact the Company's financial position or results of operations at the date of adoption. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. FIN 48 prescribes that a company should use a more-likely-than-not recognition threshold based on the technical merits of the tax position taken. Tax positions that meet the "more-likely-than-not" recognition threshold should be measured as the largest amount of the tax benefits, determined on a cumulative probability basis, which is more likely than not to be realized upon ultimate settlement in the financial statements. We recognize interest and penalties related to income tax matters as a component of the provision for income taxes. We do not currently anticipate that the total amount of unrecognized tax benefits will significantly change within the next 12 months.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **Stock-based compensation.**

We have applied SFAS No. 123(R) Share-Based Payment (“FAS 123R”) and accordingly, we record stock-based compensation expense for all of our stock-based awards.

Under FAS 123R, we estimate the fair value of stock options granted using the Black-Scholes option pricing model. The fair value for awards that are expected to vest is then amortized on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. The amount of expense recognized represents the expense associated with the stock options we expect to ultimately vest based upon an estimated rate of forfeitures; this rate of forfeitures is updated as necessary and any adjustments needed to recognize the fair value of options that actually vest or are forfeited are recorded.

The Black-Scholes option pricing model, used to estimate the fair value of an award, requires the input of subjective assumptions, including the expected volatility of our common stock and an option’s expected life. As a result, the financial statements include amounts that are based upon our best estimates and judgments relating to the expenses recognized for stock-based compensation.

#### **Preferred Stock**

The Company applies the guidance enumerated in SFAS No. 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,” and EITF Topic D-98, “Classification and Measurement of Redeemable Securities,” when determining the classification and measurement of preferred stock. Preferred shares subject to mandatory redemption (if any) are classified as liability instruments and are measured at fair value in accordance with SFAS 150. The Company does not have any preferred shares subject to mandatory redemption. All other issuances of preferred stock are subject to the classification and measurement principles of EITF Topic D-98. Accordingly, the Company classifies conditionally redeemable preferred shares (if any), which includes preferred shares that feature redemption rights that are either within the control of the holder or subject to redemption upon the occurrence of uncertain events not solely within the Company’s control, as temporary equity. At all other times, the Company classifies its preferred shares in stockholders’ equity.

#### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent asset and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. The most significant estimates relate to revenues for periods not yet reported by Carriers, liabilities recorded for future minimum guarantee payments under content licenses, accounts receivable allowances, stock-based compensation expense, the application of purchase accounting, the carrying value and recoverability of long-lived assets, including goodwill, amortizable intangibles, the realizability of deferred tax assets, and the fair value of equity instruments.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

**(all numbers in thousands except per share amounts)**

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#### **Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 160, “Noncontrolling Interests in Consolidated Financial Statements”, which is an amendment of Accounting Research Bulletin (“ARB”) No. 51. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement changes the way the consolidated income statement is presented, thus requiring consolidated net income to be reported at amounts that include the amounts attributable to both parent and the noncontrolling interest. This statement is effective for the fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Based on current conditions, the Company does not expect the adoption of SFAS 160 to have a significant impact on its results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141R (revised 2007), “Business Combinations.” This statement replaces FASB Statement No. 141, “Business Combinations.” This statement retains the fundamental requirements in SFAS 141 that the acquisition method of accounting (which SFAS 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of SFAS 141R to have a significant impact on its results of operations or financial position.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB No. 133,” (“SFAS 161”). SFAS 161 is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity’s derivative instruments and hedging activities and their effects on the entity’s financial position, financial performance, and cash flows. SFAS 161 applies to all derivative instruments within the scope of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”). SFAS 161 also applies to non-derivative hedging instruments and all hedged items designated and qualifying under SFAS 133. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for periods prior to its initial adoption. The Company does not expect the adoption of SFAS 161 to have a significant impact on its results of operations or financial position.

In April 2008, the FASB issued FASB Staff Position (“FSP”) No. 142-3, “Determination of the Useful Life of Intangible Assets”. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, “Goodwill and Other Intangible Assets”. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect the adoption of SFAS 161 to have a significant impact on its results of operations or financial position.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

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#### 3. Liquidity

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles, which contemplates continuation of the Company as a going concern. One of the Company's operating subsidiaries, Twistbox, has sustained substantial operating losses since commencement of operations. In addition, the Company has incurred negative cash flows from operating activities and the majority of the Company's assets are intangible assets and goodwill.

In view of these matters, realization of a major portion of the assets in the accompanying consolidated balance sheet is dependent upon continued operations of the Company, which is in turn dependent on the Company reaching a positive cash flow position or obtaining additional financing, while maintaining adequate liquidity.

Management believes that actions undertaken to achieve this position provide the opportunity for the Company to continue as a going concern. These actions include the acquisition consummated in the current quarter along with a restructuring as part of the integration, and debt restructuring and equity placements which occurred in the current quarter. In addition, the Company has taken action subsequent to the period end to reduce its ongoing operating cost base. Other actions include continued increases in revenues by introducing new products and revenue streams, continued expansion into new territories, reviewing additional financing options, and accretive acquisitions.

#### 4. Balance Sheet Components

##### *Accounts Receivable*

|                                       | <b>December 31,<br/>2008<br/>(Unaudited)</b> | <b>March 31,<br/>2008</b> |
|---------------------------------------|--|---------------------------|
| Accounts receivable                   | \$ 12,053                                    | \$ 6,330                  |
| Less: allowance for doubtful accounts | (218)  | (168)                     |
|                                       | <u>\$ 11,835</u>                             | <u>\$ 6,162</u>           |

Accounts receivable includes amounts billed and unbilled as of the respective balance sheet dates. Unbilled receivables were \$6,861 at December 31, 2008 and \$983 at March 31, 2008. During the three months ended December 31, 2008 \$95 was provided and \$0 was written off against the allowance. During the nine months ended December 31, 2008, \$106 was provided and \$56 was written off against the allowance.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

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#### *Property and Equipment*

|  | December 31,<br>2008<br><u>(Unaudited)</u> | March 31,<br>2008<br><u>                    </u> |
|--|--|--|
| Equipment                              | \$ 1,067                                   | \$ 654   |
| Equipment subject to capitalized lease | 81   | 71   |
| Furniture & fixtures                   | 312  | 228  |
| Leasehold improvements                 | <u>140</u>                                 | <u>140</u>                                       |
|  | 1,600                                      | 1,093  |
| Accumulated depreciation               | <u>(334)</u>                               | <u>(56)</u>                                      |
|  | <u>\$ 1,266</u>                            | <u>\$ 1,037</u>                                  |

Depreciation expense for the three months ended December 31, 2008 and 2007 was \$113 and \$0, respectively; and for the nine months ended December 31, 2008 and 2007 was \$278 and \$0, respectively.

#### *Capital Lease*

Accumulated depreciation associated with the equipment under capital lease noted above was \$10 and \$0 at December 31, 2008 and December 31, 2007, respectively. The Company has a commitment to pay \$0 under these leases during the year ending December 31, 2009. These payments have a net present value of \$0.

## 5. Description of Stock Plans

On September 27, 2007, the stockholders of the Company adopted the 2007 Employee, Director and Consultant Stock Plan (the "Plan"). Under the Plan, the Company may grant up to 3,000 shares or equivalents of common stock of the Company as incentive stock options (ISO), non-qualified options (NQO), stock grants or stock-based awards to employees, directors or consultants, except that ISO's shall only be issued to employees. Generally, ISO's and NQO's shall be issued at prices not less than fair market value at the date of issuance, as defined, and for terms ranging up to ten years, as defined. All other terms of grants shall be determined by the board of directors of the Company, subject to the Plan.

On February 12, 2008, the Company amended the Plan to increase the number of shares of our common stock that may be issued under the Plan to 7,000 shares and on March 7, 2008, amended the Plan to increase the maximum number of shares of the Company's common stock with respect to which stock rights may be granted in any fiscal year to 1,100 shares. All other terms of the Plan remain in full force and effect.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

The following table summarizes options granted for the periods or as of the dates indicated:

|                                  | Number of<br>Shares | Weighted Average<br>Exercise Price |
|----------------------------------|---------------------|------------------------------------|
| Outstanding at December 31, 2006 | -                   | -                                  |
| Granted                          | 1,600               | \$ 2.64                            |
| Canceled                         | -                   | -                                  |
| Exercised                        | -                   | \$ 2.64                            |
| Outstanding at December 31, 2007 | 1,600               | \$ 2.64                            |
| Granted                          | 2,752               | \$ 4.57                            |
| Transferred in from Twistbox     | 2,462               | \$ 0.64                            |
| Canceled                         | (12)                | \$ 0.81                            |
| Outstanding at March 31, 2008    | 6,802               | \$ 2.70                            |
| Granted                          | 1,861               | \$ 2.67                            |
| Canceled                         | (138)               | \$ 0.48                            |
| Exercised                        | (45)                | \$ 0.48                            |
| Outstanding at December 31, 2008 | <u>8,479</u>        | <u>\$ 2.74</u>                     |
| Exercisable at December 31, 2008 | <u>4,599</u>        | <u>\$ 2.06</u>                     |

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

|                         | Options Granted<br>Nine Months Ended<br>December 31, 2008 | Options Granted | Options transferred<br>from Twistbox |
|-------------------------|---|-----------------|--------------------------------------|
| Expected life (years)   | 4   | 4 to 6          | 3 to 7                               |
| Risk-free interest rate | 3.89  | 2.7% to 3.89%   | 2.03% to 5.03%                       |
| Expected volatility     | 75.20%  | 70% to 75.2%    | 70% to 75%                           |
| Expected dividend yield | 0%  | 0%              | 0%                                   |

The exercise price for options outstanding at December 31, 2008 was as follows:

| Range of<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual Life<br>(Years) | Number<br>Outstanding<br>December 31, 2008 | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|----------------------------|---|--|--|---------------------------------|
| \$0 - \$1.00               | 7.58  | 2,277                                      | \$ 0.64                                  | \$ 2,530,788                    |
| \$2.00 - \$3.00            | 9.16  | 3,450                                      | \$ 2.66                                  | -                               |
| \$3.00 - \$4.00            | -   | -  | \$ -                                     | -                               |
| \$4.00 - \$5.00            | 9.14  | 2,752                                      | \$ 4.57                                  | -                               |
|                            | 8.73  | <u>8,479</u>                               | \$ 2.74                                  | <u>\$ 2,530,788</u>             |

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

The exercise price for options exercisable at December 31, 2008 was as follows:

| Range of Exercise Price | Weighted Average Remaining Contractual Life (Years) | Options Exercisable December 31, 2008 | Weighted Average Exercise Price | Aggregate Intrinsic Value |
|-------------------------|---|---------------------------------------|---------------------------------|---------------------------|
| \$0 - \$1.00            | 7.56  | 2,157                                 | \$ 0.63                         | \$ 2,412,438              |
| \$2.00 - \$3.00         | 9.02  | 1,620                                 | \$ 2.66                         | \$ -                      |
| \$3.00 - \$4.00         | -   | -                                     | \$ -                            | \$ -                      |
| \$4.00 - \$5.00         | 9.14  | 822                                   | \$ 4.61                         | \$ -                      |
|                         | 8.36  | 4,599                                 | \$ 2.06                         | \$ 2,412,438              |

Stock option expense of \$621 and \$711 for the three months ended December 31, 2008 and 2007 respectively; and \$2,587 and \$1,032 for the nine months ended December 31, 2008 and 2007 respectively, is included primarily in general and administrative expense.

## 6. Acquisitions/Purchase Price Accounting

### Twistbox Entertainment, Inc. and related entities

On February 12, 2008, the Company completed an acquisition of Twistbox Entertainment, Inc. ("Twistbox") through an exchange of all outstanding capital stock of Twistbox for 10,180 shares of common stock of the Company and the Company's assumption of all the outstanding options of Twistbox's 2006 Stock Incentive Plan by the issuance of options to purchase 2,463 shares of common stock of the Company, including 2,145 vested and 318 unvested options. After the Merger, Twistbox became a wholly-owned subsidiary of the Company.

Twistbox is a global publisher and distributor of branded entertainment content, including images, video, TV programming and games, for Third Generation (3G) mobile networks. It publishes and distributes its content globally and has developed an intellectual property portfolio unique to its target demographic that includes worldwide mobile rights to global brands and content from leading film, television and lifestyle content publishing companies. Twistbox has built a proprietary mobile publishing platform and has leveraged its brand portfolio and platform to secure "direct" distribution agreements with the largest mobile operators in the world. These factors contributed to a purchase price in excess of the fair value of net tangible and intangible assets acquired, and, as a result, the Company recorded goodwill in connection with this transaction.

In connection with the Merger, the Company guaranteed up to \$8,250 of principal under an existing note of Twistbox in accordance with the terms, conditions and limitations contained in the note. In connection with the guaranty, the Company issued the lender two warrants, one to purchase 1,093 and the other to purchase 1,093 shares of common stock of the Company, exercisable at \$7.55 per share, and at \$5.00 per share, (increasing to \$7.55 per share, if not exercised in full by February 12, 2009), respectively, through July 30, 2011. The warrants have been included as part of the purchase consideration and have been valued using the Black-Scholes method, using the stock price at the merger date of \$4.75 per share discounted for certain restrictions, a volatility of 70%, and the exercise price and the expected time to vest for each group. These warrants were subsequently amended as described in Note 8.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

The purchase consideration was determined by an independent valuation to be \$67,479, consisting of \$66,025 attributed to the common stock and options exchanged and warrants issued, and \$1,454 in transaction costs. During the last quarter, a further \$59 of transaction costs were recognized, with the result that the purchase consideration was increased to \$67,538, with an equivalent increase in Goodwill. The options and warrants were valued using the Black-Scholes method, using the stock price at the merger date of \$4.75 per share, a volatility of 70%, and in the case of options the exercise price and the expected time to vest for each group. Under the purchase method of accounting, the Company allocated the total purchase price of \$67,538 to the net tangible and intangible assets acquired and liabilities assumed based upon their respective estimated fair values as of the acquisition date as follows:

|   |                  |
|---|------------------|
| Cash  | \$ 6,679         |
| Accounts receivable                                 | 4,966            |
| Prepaid expenses and other current assets           | 1,138            |
| Property and equipment                              | 1,062            |
| Other long-term assets                              | 361              |
| Accounts Payable, accrued license fees and accruals | (6,882)          |
| Other current liabilities                           | (814)            |
| Accrued license fees, long term portion             | (2,796)          |
| Long term debt                                      | (16,483)         |
| Identified Intangibles                              | 19,905           |
| Merger related restructuring reserves               | (1,034)          |
| Goodwill  | 61,436           |
|   | <u>\$ 67,538</u> |

Goodwill recognized in the above transaction amounted to \$61,436. Goodwill in relation to the acquisition of Twistbox is not expected to be deductible for income tax purposes. The preliminary purchase price allocation, including the allocation of goodwill, will continue to be updated as additional information becomes available. Merger related restructuring reserves include reserves for employee severance and for office relocation.

#### AMV Holding Limited group

On October 23, 2008, the Company completed an acquisition of 100% of AMV Holding Limited, a United Kingdom private limited company ("AMV") and 80% of Fierce Media Limited. The acquisition was effective on October 1, 2008.

Subject to adjustment as set forth in the Stock Purchase Agreement, the aggregate purchase price (the "Purchase Price") consisted of: (a) \$5,375 in cash (the "Cash Consideration"); (b) 4,500 fully paid and non-assessable shares of Common Stock (the "Stock Consideration"); (c) a secured promissory note in the aggregate original principal amount of \$5,375 (the "Note"); and (d) additional earn-out amounts, if any, if the Acquired Companies achieve certain targeted earnings for each of the periods from October 1, 2008 to March 31, 2009, April 1, 2009 to March 31, 2010, and April 1, 2010 to September 30, 2010, as determined in accordance with the Stock Purchase Agreement. The Purchase Price is subject to certain adjustments based on the working capital of AMV, to be determined initially within 75 days of the closing, and subsequently within 60 days following June 30, 2009. Any such adjustment of the Purchase Price will be made first by means of an adjustment to the principal sum due under the Note, as set forth in the Stock Purchase Agreement. The initial adjustment has been determined preliminarily as \$443, to be added to the secured promissory note.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

**(all numbers in thousands except per share amounts)**

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Prior to closing, each outstanding option to purchase shares of capital stock of AMV (an "AMV Option") was either exercised in full or terminated. The Note matures on January 30, 2010, and bears interest at an initial rate of 5% per annum, subject to adjustment as provided therein. In the event the Company completes an equity financing that results in gross proceeds of over \$6,000, the Company will prepay a portion of the Note in an amount equal to one-third of the excess of the gross proceeds of such financing over \$6,000. In addition, if within nine months of the issuance date of the Note, the Company completes a financing that results in gross proceeds of over \$15,000, then the Company shall prepay the entire principal amount then outstanding under the Note, plus accrued interest. If within nine months of the issuance date of the Note, the aggregate principal sum then outstanding under the Note plus accrued interest thereon has not been prepaid, then on and after such date, interest shall accrue on the unpaid principal balance of the Note at a rate of 7% per annum. Additionally, in connection with the Note, AMV granted to the Sellers a security interest in its assets. Such security interest is subordinate to the security interest granted to ValueAct Small Cap Master Fund, L.P. ("ValueAct") under the Senior Secured Note, issued by Twistbox Entertainment, Inc., a wholly-owned subsidiary of the Company ("Twistbox"), due January 30, 2010, as amended on February 12, 2008 (the "ValueAct Note"), and as subsequently amended on October 23, 2008. AMV also agreed to guarantee Mandalay's repayment of the Note to the Sellers.

The Purchase Price has been preliminarily estimated by the Company to be \$22,255 consisting of \$9,900 attributed to the Stock Consideration issued, \$5,375 in cash, \$95 in stamp duty, \$5,818 under the Note referenced above, \$313 adjustment in valuation of warrants which were re-priced in connection with the acquisition and \$658 in transaction costs. Any further adjustments required under the "working capital adjustment" provision and any adjustment under the "earn-out" provision of the Agreement have not yet been determined and therefore have not been included in the preliminary calculation of the purchase price. The shares of the Stock Consideration were valued using the closing stock price at the acquisition date of \$2.20 per share. Under the purchase method of accounting, the Company allocated the total Purchase Price of \$22,255 to the net tangible and intangible assets acquired and liabilities assumed based upon their respective estimated fair values as of the acquisition date as follows:

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

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|  |                  |
|--|------------------|
| Cash and cash equivalents                  | \$ 3,020         |
| Accounts receivable, net of allowances     | 9,087            |
| Prepaid expenses and other current assets  | 16               |
| Property and equipment, net                | 406              |
| Accounts payable                           | (10,391)         |
| Bank overdrafts                            | (1,902)          |
| Other current liabilities                  | (1,262)          |
| Other long term liabilities                | (223)            |
| Minority interests                         | 95               |
| Identified intangibles                     | 1,368            |
| Acquisition related restructuring reserves | (647)            |
| Goodwill                                   | 22,688           |
|  | <u>\$ 22,255</u> |

Goodwill recognized in the above transaction is preliminarily estimated at \$22,688. The business acquired is not capital intensive and does not require significant identifiable intangible assets – as a result the greater proportion of consideration has been allocated to goodwill. Goodwill in relation to the acquisition of AMV is not expected to be deductible for income tax purposes. The preliminary purchase price allocation, including the allocation of goodwill, will be updated as additional information becomes available. Acquisition related restructuring reserves include reserves for employee severance and for office relocation.

The acquisitions described above both included the issuance of Company stock as all or part of the consideration. Based on the trading price of the Company's common stock as of the acquisition dates, the total consideration was \$67,538 for the Twistbox acquisition and \$22,255 for the AMV acquisition. Subsequent to the acquisition, the Company's average trading price has decreased significantly. If the decrease in trading price is deemed to "not be temporary in nature", management expects that an impairment of goodwill and other long lived intangible assets could occur by year end. Other factors affecting management's estimate of impairment include the current profitability and expected future cash flows from the acquired business.

#### *Unaudited Pro Forma Summary*

The following pro forma consolidated amounts give effect to the acquisition of Twistbox and AMV by the Company accounted for by the purchase method of accounting as if it had occurred as at the beginning of each of the periods presented. The pro forma consolidated results are not necessarily indicative of the operating results that would have been achieved had the transaction been in effect as of the beginning of the period presented and should not be construed as being representative of future operating results.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

|  | 3 months ended       | 9 months ended       |                      |
|--|----------------------|----------------------|----------------------|
|  | December 31,<br>2007 | December 31,<br>2008 | December 31,<br>2007 |
|  | (unaudited)          | (unaudited)          |                      |
| Revenues   | \$ 8,866             | \$ 41,832            | \$ 35,766            |
| Cost of revenues   | 3,467                | 15,576               | 13,841               |
| Gross profit/(loss)  | 5,399                | 26,256               | 21,925               |
| Operating expenses net of interest<br>income and other expense | 7,563                | 32,309               | 27,647               |
| Income tax expense and minority interests                      | 90                   | 701                  | 1,289                |
| Net loss   | (2,254)              | (6,754)              | (7,011)              |
| Basic and Diluted net loss per common share                    | \$ (0.09)            | \$ (0.18)            | \$ (0.27)            |

#### 7. Other Intangible Assets

|                          | December 31,<br>2008 | March 31,<br>2008 |
|--------------------------|----------------------|-------------------|
|                          | (Unaudited)          |                   |
| Software                 | \$ 1,922             | \$ 1,611          |
| Trade Name / Trademark   | 13,764               | 13,030            |
| Customer list            | 4,378                | 4,378             |
| License agreements       | 886                  | 886               |
| Non-compete agreements   | 323                  | -                 |
|                          | 21,273               | 19,905            |
| Accumulated amortization | (907)                | (125)             |
|                          | <u>\$ 20,366</u>     | <u>\$ 19,780</u>  |

The Company has included amortization of acquired intangible assets directly attributable to revenue-generating activities in cost of revenues. The Company has included amortization of acquired intangible assets not directly attributable to revenue-generating activities in operating expenses. During the three months ended December 31, 2008 and 2007, the Company recorded amortization expense in the amount of \$128 and \$0, respectively, in cost of revenues; and amortization expense in the amount of \$177 and \$0 respectively in operating expenses. During the nine months ended December 31, 2008 and 2007, the Company recorded amortization expense in the amount of \$331 and \$0, respectively, in cost of revenues; and amortization expense in the amount of \$451 and \$0, respectively, in operating expenses.

As of September 30, 2008, the total expected future amortization related to intangible assets was as follows:

|                        | 12 Months ended December 31, |                 |                 |               |               |                 |
|------------------------|------------------------------|-----------------|-----------------|---------------|---------------|-----------------|
|                        | 2009                         | 2010            | 2011            | 2012          | 2013          | Thereafter      |
| Software               | \$ 334                       | \$ 334          | \$ 308          | \$ 230        | \$ 230        | \$ 257          |
| Customer List          | 547                          | 547             | 547             | 547           | 547           | 1,162           |
| License Agreements     | 177                          | 177             | 177             | 177           | 21            | -               |
| Non-compete agreements | 162                          | 121             | -               | -             | -             | -               |
|                        | <u>\$ 1,220</u>              | <u>\$ 1,179</u> | <u>\$ 1,032</u> | <u>\$ 954</u> | <u>\$ 798</u> | <u>\$ 1,419</u> |

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

#### 8. Debt

|   | December 31,<br>2008<br>(Unaudited) | March 31,<br>2008 |
|---|-------------------------------------|-------------------|
| <b>Short Term Debt</b>                                  |                                     |                   |
| Capitalized lease liabilities, current portion          | \$ 3                                | \$ 20             |
| Senior secured note, accrued interest                   | -                                   | 228               |
|   | <u>\$ 3</u>                         | <u>\$ 248</u>     |
|   | December 31,<br>2008<br>(Unaudited) | March 31,<br>2008 |
| <b>Long Term Debt</b>                                   |                                     |                   |
| Senior Secured Note, long term portion, net of discount | \$ 17,102                           | \$ 16,483         |
| Secured Note, long term portion                         | 5,818                               | -                 |
| Deferred purchase consideration, long term portion      | 169                                 | -                 |
|   | <u>\$ 23,089</u>                    | <u>\$ 16,483</u>  |

In July 2007, Twistbox entered into a debt financing agreement in the form of a senior secured note amounting to \$16,500, payable at 30 months with ValueAct Small Cap Master Fund L.P. (the "ValueAct Note"). The holder of the ValueAct Note was granted first lien over all of the Company's assets. The ValueAct Note carried interest of 9% annually for the first year and 10% subsequently, with semi-annual interest only payments. The agreement included certain restrictive covenants. In conjunction with the merger described in Note 6, the Company guaranteed up to \$8,250 of the principal; and the restrictive covenants were modified, including a requirement for both the Company and Twistbox to maintain certain minimum cash balances. In connection with the guaranty, the Company issued the lender warrants to purchase 1,093 and 1,093 shares of common stock of the Company, exercisable at \$7.55 per share, and at \$5.00 per share, (increasing to \$7.55 per share, if not exercised in full by February 12, 2009), respectively, through July 30, 2011. These warrants replaced warrants originally issued by Twistbox in conjunction with the ValueAct Note.

On October 23, 2008, the Company, Twistbox and ValueAct entered into a Second Amendment (the "Second Amendment") to the ValueAct Note. Among other things, the Second Amendment provides for a payment in kind election, whereby, in lieu of making any cash payments to ValueAct on the following two interest payment dates, Twistbox may elect that the amount of any interest due on such date be added to the principal amount due under the ValueAct Note. That election was made in connection with the first interest payment following the amendment. In addition, ValueAct agreed to amend the ValueAct Note to modify the covenant requiring that the Company and Twistbox maintain certain minimum combined cash balances, during specified periods of time. Lastly, the Second Amendment provides that an event of default may be triggered in the event the Company fails to observe certain covenants as agreed to in the Second Amendment, including a covenant that, until all principal and interest and any other amounts due under the ValueAct Note are paid in full in cash, the Company: (i) will not create, incur, assume or permit to exist certain indebtedness, except for indebtedness in connection with a receivables facility as described in the Second Amendment, which indebtedness would rank pari passu in right of payment on the ValueAct Note, provided, that any receivables used to procure and maintain such receivables facility shall not be subject to any lien of ValueAct during the term of such receivables facility; and (ii) will not, and will not permit any subsidiary to, without the prior consent of ValueAct, prepay any indebtedness incurred in connection with the AMV Note, other than prepayments with proceeds raised in an equity financing as permitted by the AMV Note. Additionally, on October 23, 2008, in connection with the ValueAct Note, as amended, AMV agreed to grant to ValueAct a security interest in its assets, which ranks senior to the security interest granted to the Sellers. AMV also agreed to guarantee Twistbox's repayment of the ValueAct Note.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

**(all numbers in thousands except per share amounts)**

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As described above, the Company had previously issued to ValueAct two warrants to purchase shares of the Company's common stock, \$0.0001 par value per share (the "Common Stock"). One warrant entitled ValueAct to purchase up to a total of 1,093 shares of Common Stock at an exercise price of \$7.55 per share ("\$7.55 Warrant"). The other warrant entitled ValueAct to purchase up to a total of 1,093 shares of Common Stock at an initial exercise price of \$5.00 per share ("\$5.00 Warrant," and together with the \$7.55 Warrant, the "ValueAct Warrants"). On October 23, 2008, the Company and ValueAct entered into an allonge to each of the ValueAct Warrants. Among other things, the exercise price of each of the ValueAct Warrants was amended to be \$4.00 per share.

Minimum future obligations, including interest, under the Senior Secured Note are \$19,101 during the year ended December 31, 2010 including repayment of the principal. Capitalized lease assets are set out in Note 4. Future obligations under capitalized leases are included as part of Other Obligations in Note 15.

#### **9. Related Party Transactions**

The Company engages in various business relationships with shareholders and officers and their related entities. The significant relationships are disclosed below.

##### ***Mandalay Media, Inc.***

On September 14, 2006, the Company entered into a management agreement (the "Management Agreement") with Trinad Management for five years. Pursuant to the terms of the Management Agreement, Trinad Management will provide certain management services, including, without limitation, the sourcing, structuring and negotiation of a potential business combination transaction involving the Company in exchange for a fee of \$90 per quarter, plus reimbursements of all expenses reasonably incurred in connection with the provision of Agreement. The Management Agreement expires on September 14, 2011. Either party may terminate with prior written notice. However, if the Company terminates, it shall pay a termination fee of \$1,000. For the three months ended December 31, 2008 and 2007, the Company paid management fees under the agreement of \$90 and \$90, respectively. For the nine months ended December 31, 2008 and 2007, the Company paid management fees under the agreement of \$270 and \$270, respectively.

In March 2007, the Company entered into a month to month lease for office space with Trinad Management for rent of \$9 per month. Rent expense in connection with this lease was \$26 and \$26 respectively for the three months ended December 31, 2008 and 2007; and \$81 and \$81 respectively for the nine months ended December 31, 2008 and 2007.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

**(all numbers in thousands except per share amounts)**

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#### *Twistbox Entertainment, Inc.*

##### Lease of Premises

Twistbox leases its primary offices in Los Angeles from Berkshire Holdings, LLC, a company with common ownership by officers of Twistbox. Amount paid in connection with this lease was \$95 and \$95 for the three months ended December 31, 2008 and 2007, respectively, and \$284 and \$284 for the nine months ended December 31, 2008 and 2007, respectively.

Twistbox is party to an oral agreement with a person affiliated with Twistbox with respect to a lease of an apartment in London. Amount paid in connection with this lease was \$12 and \$18 for the three months ended December 31, 2008 and 2007, respectively, and \$48 and \$54 for the nine months ended December 31, 2008 and 2007, respectively.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **10. Capital Stock Transactions**

##### *Preferred Stock*

On October 3, 2006, the Company designated a Series A Preferred Stock, par value \$.0001 per share (Series A). The Series A holders shall be entitled to: (1) vote on an equal per share basis as holders of common stock; (2) dividends on an if-converted basis; and (3) a liquidation preference equal to the greater of \$10, per share of Series A (subject to adjustment) or such amount that would have been paid on an if-converted basis. Each Series A holder may treat as a dissolution or winding up of the Company any of the following transactions: a consolidation, merger, sale of substantially all the assets of the company, issuance/sale of common stock of the Company constituting a majority of all shares outstanding and a merger/business combination, each as defined.

In addition, the Series A holders may convert, at their discretion, all or any of their Series A shares into the number of common shares equal to the number calculated by dividing the original purchase price of such Series A Preferred, plus the amount of any accumulated, but unpaid dividends, as of the conversion date, by the original purchase price (subject to certain adjustments) in effect at the close of business on the conversion date.

On August 3, 2006, the Company sold 100 shares of the Series A to Trinad Management, LLC (Trinad Management), an affiliate of Trinad Capital LP (Trinad Capital), one of the Company's principal shareholders, for an aggregate sale price of \$100, \$1.00 per share. The Company recognized a one time, non-cash deemed preferred dividend of \$43 because the fair value of our common stock at the time of the sale of \$1.425 per share, greater than the conversion price of \$1.00 per share.

##### *Common Stock*

On July 24, 2007, the Company sold 5,000 shares of the Company's common stock, at \$0.50 per share, for aggregate proceeds of \$2,473, net of offering costs of \$27.

In September, October and December 2007, warrants to purchase 625 shares of common stock were exercised in a cashless exchange for 239 shares of the Company's common stock based on the average closing price of the Company's common stock for the five days prior to the exercise date.

On November 7, 2007, the Company granted non-qualified stock options to purchase 500 shares of common stock of the Company to a director under the Plan. The options have a ten year term and are exercisable at \$2.65 per share, with one-third of the options vesting immediately upon grant, one-third vesting on the first anniversary of the date of grant and the remaining one-third on the second anniversary of the date of grant. The options were valued at \$772 using a Black-Scholes model assuming a risk free interest rate of 3.89%, expected life of four years, and expected volatility of 75.2%.

On November 14, 2007, the Company granted non-qualified stock options to purchase 100 shares of common stock of the Company to a director under the Plan. The options have a ten year term and are exercisable at a price of \$2.50 per share, with one-third of the options granted vesting immediately upon grant, one-third vesting on the first anniversary of the date of grant and the remaining one-third vesting on the second anniversary of the date of grant. The options were valued at \$160 using a Black-Scholes model assuming a risk free interest rate of 3.89%, expected life of four years, and expected volatility of 75.2%.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

**(all numbers in thousands except per share amounts)**

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On February 12, 2008, the Company issued 10,180 shares of common stock in connection with the merger with Twistbox. The Company also assumed all the outstanding options of Twistbox's 2006 Stock Incentive Plan by the issuance of options to purchase 2,463 shares of common stock of the Company, including 2,144 vested and 319 unvested options; and the Company issued two warrants to a lender to Twistbox, one to purchase 1,093 shares of common stock and the other to purchase 1,093 shares of common stock of the Company, exercisable at \$7.55 per share, and at \$5.00 per share, (increasing to \$7.55 per share, if not exercised in full by February 12, 2009), respectively, through July 30, 2011.

On April 9, 2008 a former director of the company exercised warrants to purchase 50 shares of common stock in a cashless exchange for 25 shares of the Company's common stock.

In April and June 2008, warrants to purchase 350 shares of common stock were exercised in a cashless exchange for 217 shares of the Company's common stock based on the average closing price of the Company's common stock for the five days prior to the exercise date.

On June 18, 2008, the Company granted non-qualified stock options to purchase 1,500 shares of common stock of the Company to four directors under the Plan. The options have a ten year term and are exercisable at a price of \$2.75 per share, with one-third of the options granted vesting immediately upon grant, one-third vesting on the first anniversary of the date of grant and the remaining one-third vesting on the second anniversary of the date of grant. The options were valued at \$2,403 using a Black-Scholes model assuming a risk free interest rate of 3.89%, expected life of four years, and expected volatility of 75.2%.

On September 29, 2008, the Company granted non-qualified stock options to purchase 350 shares of common stock of the Company to two directors under the Plan. The options have a ten year term and are exercisable at a price of \$2.40 per share, with one-third of the options granted vesting immediately upon grant, one-third vesting on the first anniversary of the date of grant and the remaining one-third vesting on the second anniversary of the date of grant. The options were valued at \$489 using a Black-Scholes model assuming a risk free interest rate of 3.89%, expected life of four years, and expected volatility of 75.2%.

On October 23, 2008, the Company entered into a Securities Purchase Agreement with certain investors, pursuant to which the Company agreed to sell in a private offering an aggregate of 1,685 shares of Common Stock and warrants to purchase 843 shares of Common Stock (the "Warrants"), for gross proceeds to the Company of \$4,500. The Warrants have a five year term and an exercise price of \$2.67 per share.

In October 2008, warrants to purchase 2,300 shares of common stock were exercised in a cashless exchange for 286 shares of the Company's common stock based on the average closing price of the Company's common stock for the five days prior to the exercise date.

#### **11. Employee Benefit Plans**

The Company has an employee 401(k) savings plan covering full-time eligible employees. These employees may contribute eligible compensation up to the annual IRS limit. The Company does not make matching contributions.

## **Mandalay Media, Inc. and Subsidiaries**

### **Notes to Unaudited Consolidated Financial Statements**

(all numbers in thousands except per share amounts)

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#### **12. Income Taxes**

As of December 31, 2008, the Company had net operating loss (NOL) carry-forwards to reduce future Federal income taxes of approximately \$41,400, expiring in various years ranging through 2027. The Company may have had ownership changes, as defined by the Internal Revenue Service, which may subject the NOL's to annual limitations which could reduce or defer the use of the NOL carry-forwards.

In connection with the acquisitions described in Note 6 above, the Company has recorded Goodwill, amounting to \$83,758, which will not be amortized for book purposes and is not deductible for tax purposes. The Company also recorded intangibles which will have differing amortization for book and tax purposes. Trademarks, amounting to \$13,761, will not be amortized for book purposes, but will be subject to amortization for tax purposes, giving rise to a permanent difference. Other intangible assets, amounting to \$7,506, will be amortized over a shorter period for book purposes than tax purposes, giving rise to timing differences. These differences will impact the Company's NOL carry-forwards in the future.

As of December 31, 2008, realization of the Company's net deferred tax asset of approximately \$18,120 was not considered more likely than not and, accordingly, a valuation allowance of \$18,120 has been provided. During the three months ended December 31, 2008, the valuation allowance decreased by \$80.

Management has evaluated and concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements as of December 31, 2008.

The Company adopted the provisions of FIN 48 on January 1, 2008 and there was no difference between the amounts of unrecognized tax benefits recognized in the balance sheet prior to the adoption of FIN 48 and those after the adoption of FIN 48. There were no unrecognized tax benefits not subject to valuation allowance as at December 31, 2008 and December 31, 2007. The Company recognized no interest and penalties on income taxes in its statement of operations for the three months or the nine months ended December 31, 2008 and 2007. Management believes that with few exceptions, the Company is no longer subject to income tax examinations by tax authorities for years before March 31, 2004.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

#### 13. Segment and Geographic information

The Company operates in one reportable segment in which it is a developer and publisher of branded entertainment content for mobile phones. Revenues are attributed to geographic areas based on the country in which the carrier's principal operations are located. The Company attributes its long-lived assets, which primarily consist of property and equipment, to a country primarily based on the physical location of the assets. Goodwill and intangibles are not included in this allocation. The following information sets forth geographic information on our sales and net property and equipment for the period ended December 31, 2008:

|  | North<br>America | Europe    | South<br>America | Other<br>Regions | Consolidated |
|--|------------------|-----------|------------------|------------------|--------------|
| Three Months ended December 31, 2008             |                  |           |                  |                  |              |
| Net sales to unaffiliated customers              | \$ 1,160         | \$ 7,356  | \$ 172           | \$ 2,317         | \$ 11,005    |
| Nine Months ended December 31, 2008              |                  |           |                  |                  |              |
| Net sales to unaffiliated customers              | \$ 2,831         | \$ 15,168 | \$ 524           | \$ 2,831         | \$ 21,354    |
| Property and equipment, net at December 31, 2008 | \$ 754           | \$ 501    | \$ -             | \$ 11            | \$ 1,266     |

Our three largest customers accounted for 14%, 13% and 12% of our revenue in the three months ended December 31, 2008; and 26%, 7% and 7% of our revenue in the nine months ended December 31, 2008.

#### 14. Commitments and Contingencies

##### Operating Lease Obligations

The Company leases office facilities under noncancelable operating leases expiring in various years through 2011.

Following is a summary of future minimum payments under initial terms of leases at December 31, 2008:

##### Year Ending December 31

|                              |               |
|------------------------------|---------------|
| 2009                         | \$ 412        |
| 2010                         | \$ 193        |
| 2011                         | \$ -          |
| Total minimum lease payments | <u>\$ 605</u> |

These amounts do not reflect future escalations for real estate taxes and building operating expenses. Rental expense amounted to \$254 for the three months ended December 31, 2008; and \$621 for the nine months ended December 31, 2008.

##### Minimum Guaranteed Royalties

The Company has entered into license agreements with various owners of brands and other intellectual property so that it could develop and publish branded products for mobile handsets.

## Mandalay Media, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

(all numbers in thousands except per share amounts)

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Pursuant to some of these agreements, the Company is required to pay minimum royalties over the term of the agreements regardless of actual sales. Future minimum royalty payments for those agreements as of December 31, 2008 were as follows:

| <u>Year Ending December 31</u> | <u>Minimum<br/>Guaranteed<br/>Royalties</u> |
|--------------------------------|---|
| 2009                           | 224   |
| 2010                           | 120   |
| 2011                           | 60  |
| 2012                           | -   |
| Total minimum payments         | <u>\$ 404</u>                               |

#### Other Obligations

As of December 31, 2008, the Company was obligated for payments under various distribution agreements, equipment lease agreements, employment contracts and the management agreement described in Note 9 with initial terms greater than one year at December 31, 2008. Annual payments relating to these commitments at December 31, 2008 are as follows:

| <u>Year Ending December 31</u> | <u>Commitments</u> |
|--------------------------------|--------------------|
| 2009                           | 2,907              |
| 2010                           | 2,449              |
| 2011                           | 379                |
| 2012                           | -                  |
| Total minimum payments         | <u>\$ 5,735</u>    |

#### Litigation

As of the date of filing this Quarterly Report on Form 10-Q, we are not a party to any litigation that we believe would have a material adverse effect on us.

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

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Financial Statements and the Notes thereto included in this report. This discussion contains certain forward-looking statements that involve substantial risks and uncertainties. When used in this Quarterly Report on Form 10-Q, the words "anticipate," "believe," "estimate," "expect" and similar expressions, as they relate to our management or us, are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements as a result of a variety of factors including those set forth under "Risk Factors" in our Transitional Report on Form 10-KT for the Transition Period ended March 31, 2008. Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Unless the context otherwise indicates, the use of the terms "we," "our" "us" or the "Company" refer to the business and operations of Mandalay Media, Inc. ("Mandalay") through its operating and wholly-owned subsidiaries, Twistbox Entertainment, Inc. ("Twistbox") and AMV Holding Limited, a United Kingdom private limited company ("AMV").

### ***Historical Operations of Mandalay Media, Inc.***

The Company was originally incorporated in the State of Delaware on November 6, 1998 under the name eB2B Commerce, Inc. On April 27, 2000, the Company merged into DynamicWeb Enterprises Inc., a New Jersey corporation, and changed its name to eB2B Commerce, Inc. On April 13, 2005, the Company changed its name to Mediavest, Inc. On November 7, 2007, through a merger, the Company reincorporated in the State of Delaware under the name Mandalay Media, Inc. On October 27, 2004, and as amended on December 17, 2004, the Company filed a plan for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the "Plan of Reorganization"). Under the Plan of Reorganization, as completed on January 26, 2005: (1) the Company's net operating assets and liabilities were transferred to the holders of the secured notes in satisfaction of the principal and accrued interest thereon; (2) \$400,000 were transferred to a liquidation trust and used to pay administrative costs and certain preferred creditors; (3) \$100,000 were retained by the Company to fund the expenses of remaining public; (4) 3.5% of the new common stock of the Company (140,000 shares) was issued to the holders of record of the Company's preferred stock in settlement of their liquidation preferences; (5) 3.5% of the new common stock of the Company (140,000 shares) was issued to common stockholders of record as of January 26, 2005 in exchange for all of the outstanding shares of the common stock of the Company; and (6) 93% of the new common stock of the Company (3,720,000 shares) was issued to the sponsor of the Plan of Reorganization in exchange for \$500,000 in cash. Through January 26, 2005, the Company and its subsidiaries were engaged in providing business-to-business transaction management services designed to simplify trading between buyers and suppliers.

Prior to February 12, 2008, the Company was a public shell company with no operations, and controlled by its significant stockholder, Trinad Capital Master Fund, L.P.

### **Twistbox Entertainment, Inc.**

On February 12, 2008, Mandalay completed its acquisition of Twistbox Entertainment, Inc. pursuant to an Agreement and Plan of Merger entered into on December 31, 2007, as subsequently amended by the Amendment to Agreement and Plan of Merger dated February 12, 2008, with Twistbox Acquisition, Inc., a Delaware corporation and a wholly-owned subsidiary of Mandalay ("Merger Sub"), Twistbox Entertainment, Inc. ("Twistbox"), and Adi McAbian and Spark Capital, L.P., as representatives of the stockholders of Twistbox, as part of which Merger Sub merged with and into Twistbox, with Twistbox as the surviving corporation (the "Merger"). Following the Merger, Twistbox became the sole operating subsidiary of Mandalay until the acquisition of AMV on October 23, 2008 as described below.

Twistbox is a global publisher and distributor of branded entertainment content, including images, video, TV programming and games, for Third Generation (3G) mobile networks. Twistbox publishes and distributes its content in over 40 countries representing more than one billion subscribers. Operating since 2003, Twistbox has developed an intellectual property portfolio unique to its target demographic (18 to 35 year old) that includes worldwide exclusive (or territory exclusive) mobile rights to global brands and content from leading film, television and lifestyle content publishing companies. Twistbox has built a proprietary mobile publishing platform that includes: tools that automate handset portability for the distribution of images and video; a mobile games development suite that automates the porting of mobile games and applications to over 1,500 handsets; and a content standards and ratings system globally adopted by major wireless carriers to assist with the responsible deployment of age-verified content. Twistbox has leveraged its brand portfolio and platform to secure "direct" distribution agreements with the largest mobile operators in the world, including, among others, AT&T, Hutchinson 3G, O2, MTS, Orange, T-Mobile, Telefonica, Verizon and Vodafone. Twistbox has experienced annual revenue growth in excess of 50% over the past two years and expects to become one of the leading players in the rapidly-growing, multibillion-dollar mobile entertainment market.

Twistbox maintains a worldwide distribution agreement with Vodafone. Through this relationship, Twistbox serves as Vodafone's exclusive supplier of late night content, a portion of which is age-verified. Additionally, Twistbox is one of the select few content aggregators for Vodafone. Twistbox aggregates content from leading entertainment companies and manages distribution of this content to Vodafone. Additionally, Twistbox maintains distribution agreements with other leading mobile network operators throughout the North American, European, and Asia-Pacific regions that include Verizon, Virgin Mobile, T-Mobile, Telefonica, Hutchinson 3G, O2 and Orange.

Twistbox's intellectual property encompasses over 75 worldwide exclusive or territory exclusive content licensing agreements that cover all of its key content genres including lifestyle, glamour, and celebrity news and gossip for U.S. Hispanic and Latin American markets, poker news and information, late night entertainment and casual games.

Twistbox currently has content live on more than 100 network operators in 40 countries. Through these relationships, Twistbox can currently reach over one billion mobile subscribers worldwide. Its existing content portfolio includes 300 WAP sites, 250 games and 66 mobile TV channels.

In addition to its content publishing business, Twistbox operates a rapidly growing suite of Premium Short Message Service (Premium SMS) services that include text and video chat and web2mobile marketing services of video, images and games that are promoted through on-line, magazine and TV affiliates. The Premium SMS infrastructure essentially allows end consumers of Twistbox content to pay for their content purchases directly from their mobile phone bills.

Twistbox's end-users are the highly-mobile, digitally-aware 18 to 35 year old demographic. This group is a major consumer of digital entertainment services and commands significant amounts of disposable income. In addition, this group is very focused on consumer lifestyle brands and is much sought after by advertisers.

### **AMV Holding Limited**

As previously disclosed in our Current Report on Form 8-K filed with the Securities and Exchange Commission (the "SEC") on October 28, 2008, Mandalay consummated the acquisition of 100% of the issued and outstanding share capital of AMV Holding Limited, a United Kingdom private limited company ("AMV") and 80% of the issued and outstanding share capital of Fierce Media Limited, United Kingdom private limited company (collectively the "Shares") on October 23, 2008 (the "AMV Acquisition"). The aggregate purchase price (subject to adjustments as provided in the stock purchase agreement) for the Shares consisted of (i) \$5,375,000 in cash; (ii) 4,500,000 shares of common stock, par value \$0.0001 per share (the "Common Stock"); (iii) a secured promissory note in the aggregate principal amount of \$5,375,000 (the "Note"); and (iv) additional earn-out amounts, if any, based on certain targeted earnings as set forth in the stock purchase agreement.

The Note matures on January 30, 2010, and bears interest at an initial rate of 5% per annum, subject to adjustment as provided therein. In the event Mandalay completes an equity financing that results in gross proceeds of over \$6,000,000, Mandalay will prepay a portion of the Note in an amount equal to one-third of the excess of the gross proceeds of such financing over \$6,000,000. In addition, if within nine months of the issuance date of the Note, Mandalay completes a financing that results in gross proceeds of over \$15,000,000, then Mandalay shall prepay the entire principal amount then outstanding under the Note, plus accrued interest. If within nine months of the issuance date of the Note, the aggregate principal sum then outstanding under the Note plus accrued interest thereon has not been prepaid, then on and after such date, interest shall accrue on the unpaid principal balance of the Note at a rate of 7% per annum.

In addition, also on October 23, 2008, in connection with the AMV Acquisition, Mandalay, Twistbox and ValueAct SmallCap Master Fund L.P. ("ValueAct") entered into a Second Amendment to the a certain senior secured promissory note purchased by ValueAct from Twistbox in the amount of \$16,500,000 (the "ValueAct Note"), which among other things, provides for a payment in kind election at the option of Twistbox, modifies the financial covenants set forth in the ValueAct Note to require that Mandalay and Twistbox maintain certain minimum combined cash balances and provides for certain covenants with respect to the indebtedness of Mandalay and its subsidiaries. Also on October 23, 2008, AMV granted to ValueAct a security interest in its assets to secure the obligations under the ValueAct Note. In addition, Mandalay and ValueAct entered into an allonge to each of the those certain warrants issued to ValueAct in connection with the Merger, which, among other things, amended the exercise price of each of the warrants to \$4.00 per share.

AMV is a mobile media and marketing company delivering games and lifestyle content directly to consumers in the United Kingdom, Australia, South Africa and various other European countries. AMV markets its well established branded services including *Bling*, *Phonebar* and *GameZone* through a unique Customer Relationship Management (CRM) platform that drives revenue through mobile internet, print and TV advertising.

On October 23, 2008, Mandalay entered into a Securities Purchase Agreement with certain investors identified therein (the "Investors"), pursuant to which Mandalay agreed to sell to the Investors in a private offering an aggregate of 1,685,394 shares of Common Stock and warrants to purchase 842,697 shares of Common Stock for gross proceeds to Mandalay of \$4,500,000. The warrants have a five year term and an exercise price of \$2.67 per share. The funds were held in an escrow account pursuant to an Escrow Agreement, dated October 23, 2008 and were released to Mandalay on or about November 8, 2008.

The Merger and the AMV Acquisition both included the issuance of Common Stock as all or part of the consideration. Based on the trading price of the Common Stock as of the acquisition dates, the total consideration was approximately \$67.5 million for the Merger and approximately \$22.2 million for the AMV Acquisition. Subsequent to the Merger and the AMV Acquisition, the average trading price of the Common Stock has decreased significantly. If the decrease in trading price is deemed to "not be temporary in nature", management expects that an impairment of goodwill and other long lived intangible assets could occur by year end. Other factors affecting management's estimate of impairment include the current profitability and expected future cash flows from the acquired business.

*Comparison of the Three Months Ended December 31, 2008 and 2007*

**Revenues**

|                       | <b>Three Months Ended December 31,</b> |             |
|-----------------------|--|-------------|
|                       | <b>2008</b>                            | <b>2007</b> |
| <b>(In thousands)</b> |  |             |
| Revenues by type:     |  |             |
| Games                 | \$ 1,245                               | \$ -        |
| Other content         | 9,760                                  | -           |
| Total                 | <u>\$ 11,005</u>                       | <u>-</u>    |

The Company had no operations in 2007 and consequently no revenues. Revenues in the three months ended December 31, 2008 relate to the revenues of Twistbox and AMV. Games revenue includes both licensed and internally developed games for use on mobile phones. Other content includes a broad range of products delivered in the form of WAP, Video, Wallpaper and Mobile TV.

**Cost of Revenues**

|                               | <b>Three Months Ended December 31,</b> |             |
|-------------------------------|--|-------------|
|                               | <b>2008</b>                            | <b>2007</b> |
| <b>(In thousands)</b>         |  |             |
| Cost of Revenues:             |  |             |
| License Fees                  | \$ 1,670                               | \$ -        |
| Other direct cost of revenues | 2,264                                  | -           |
| Total Cost of Revenues        | <u>\$ 3,934</u>                        | <u>\$ -</u> |
| Revenues                      | <u>11,005</u>                          | <u>\$ -</u> |
| Gross Margin                  | <u>64.3%</u>                           | <u>N/A</u>  |

The Company had no operations in 2007 and consequently no cost of revenues. Cost of revenues in the three months ended December 31, 2008 relate to the cost of revenues of Twistbox and AMV. License fees represent costs payable to content providers for use of their intellectual property in products sold. Other direct cost of revenues includes costs to deliver products, and amortization of the intangibles identified as part of the purchase price accounting and attributed to cost of revenues.

### *Operating Expenses*

|                                     | <b>Three Months Ended December 31,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2008</b>                            | <b>2007</b> |
| <b>(In thousands)</b>               |  |             |
| Product Development Expenses        | \$ 1,563                               | \$ -        |
| Sales and Marketing Expenses        | 4,243                                  | -           |
| General and Administrative Expenses | 2,173                                  | 1,278       |
| Amortization of Intangible Assets   | 177                                    | -           |

Prior to the Merger, the Company was a public shell company with no operations; and as a result the only activity in the three months ended December 31, 2007 represents expenses incurred in developing the Company. In both years, General and Administrative expenses consists primarily of consulting and professional fees, accounting and legal expenses and employee related expenses including stock based compensation. The increase in 2008 over 2007 is primarily the result of stock based compensation to directors, employing executive management for the company, a significant increase in legal and other professional fees, and the addition of Twistbox expenses. Product Development and Sales and Marketing Expenses represent the operating expenses of Twistbox and AMV. Amortization of intangibles represents amortization of the intangibles identified as part of the purchase price accounting related to both acquisitions and attributed to operating expenses.

### *Other Expenses*

|                                     | <b>Three Months Ended December 31,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2008</b>                            | <b>2007</b> |
| <b>(In thousands)</b>               |  |             |
| Interest and other income/(expense) | \$ (1,138)                             | \$ 91       |

Interest and other income/(expense) includes interest income on invested funds, interest expense related the ValueAct Note, foreign exchange transaction gains and losses, and depreciation expense.

### *Comparison of the Nine Months Ended December 31, 2008 and 2007*

#### *Revenues*

|                          | <b>Nine Months Ended December 31,</b> |             |
|--------------------------|---------------------------------------|-------------|
|                          | <b>2008</b>                           | <b>2007</b> |
| <b>(In thousands)</b>    |                                       |             |
| <b>Revenues by type:</b> |                                       |             |
| Games                    | \$ 3,738                              | \$ -        |
| Other content            | 17,616                                | -           |
| Total                    | \$ 21,354                             | -           |

The Company had no operations in 2007 and consequently no revenues. Revenues in the nine months ended December 31, 2008 relate to the revenues of Twistbox, and AMV for the current quarter. Games revenue includes both licensed and internally developed games for use on mobile phones. Other content includes a broad range of products delivered in the form of WAP, Video, Wallpaper and Mobile TV.

### *Cost of Revenues*

|                               | <b>Nine Months Ended December 31,</b> |             |
|-------------------------------|---------------------------------------|-------------|
|                               | <b>2008</b>                           | <b>2007</b> |
| <b>(In thousands)</b>         |                                       |             |
| <b>Cost of Revenues:</b>      |                                       |             |
| License Fees                  | \$ 5,604                              | \$ -        |
| Other direct cost of revenues | 2,468                                 | -           |
| Total Cost of Revenues        | <u>\$ 8,072</u>                       | <u>\$ -</u> |
| Revenues                      | <u>21,354</u>                         | <u>\$ -</u> |
| Gross Margin                  | <u>62.2%</u>                          | <u>N/A</u>  |

The Company had no operations in 2007 and consequently no cost of revenues. Cost of revenues in the nine months ended December 31, 2008 relate to the cost of revenues of Twistbox, and AMV for the current quarter. License fees represent costs payable to content providers for use of their intellectual property in products sold. Other direct cost of revenues includes costs to deliver products, and amortization of the intangibles identified as part of the purchase price accounting and attributed to cost of revenues.

### *Operating Expenses*

|                                     | <b>Nine Months Ended December 31,</b> |             |
|-------------------------------------|---------------------------------------|-------------|
|                                     | <b>2008</b>                           | <b>2007</b> |
| <b>(In thousands)</b>               |                                       |             |
| Product Development Expenses        | \$ 5,130                              | \$ -        |
| Sales and Marketing Expenses        | 6,527                                 | -           |
| General and Administrative Expenses | 7,545                                 | 2,189       |
| Amortization of Intangible Assets   | 451                                   | -           |

Prior to the Merger, the Company was a public shell company with no operations; and as a result the only activity in the nine months ended December 31, 2007 represents expenses incurred in developing the Company. In both years, General and Administrative expenses consists primarily of consulting and professional fees, accounting and legal expenses and employee related expenses including stock based compensation. The increase in 2008 over 2007 is primarily the result of stock based compensation to directors, employing executive management for the company, a significant increase in legal and other professional fees, and the addition of Twistbox expenses. Product Development and Sales and Marketing Expenses represent the operating expenses of Twistbox and AMV. Amortization of intangibles represents amortization of the intangibles identified as part of the purchase price accounting related to both acquisitions and attributed to operating expenses.

## Other Expenses

| <b>Nine Months Ended December 31,</b> |             |
|---------------------------------------|-------------|
| <b>2008</b>                           | <b>2007</b> |
| <b>(In thousands)</b>                 |             |

|                                     |    |         |    |     |
|-------------------------------------|----|---------|----|-----|
| Interest and other income/(expense) | \$ | (2,084) | \$ | 256 |
|-------------------------------------|----|---------|----|-----|

Interest and other income/(expense) includes interest income on invested funds, interest expense related the ValueAct Note, foreign exchange transaction gains and losses, and depreciation expense.

## Financial Condition

### Assets

Our current assets totaled \$19,044 and \$17,629 at December 31, 2008 and March 31, 2008, respectively. Total assets were \$125,078 and \$100,124 at December 31, 2008 and March 31, 2008, respectively. The increase in current assets is primarily due to the addition of AMV accounts receivables following the AMV Acquisition. The increase in total assets is primarily due to the additional intangibles flowing from the AMV Acquisition.

### Liabilities and Working Capital

At December 31, 2008, our total liabilities were \$43,349. Our current liabilities totaled \$19,673 and \$9,255 at December 31, 2008 and March 31, 2008, respectively. This resulted in negative working capital of (\$629) at December 31, 2008 as accounts payable and other current liabilities increased, largely as a result of the AMV Acquisition, with additional AMV payables, amounts payable related to the AMV Acquisition and restructuring reserves in connection with the AMV Acquisition.

## Liquidity and Capital Resources

| <b>Nine Months<br/>Ended<br/>December 31,<br/>2008</b> | <b>Nine Months<br/>Ended<br/>December 31,<br/>2007</b> |
|--|--|
| <b>(In thousands)</b>                                  | <b>(In thousands)</b>                                  |

### Consolidated Statement of Cash Flows Data:

|  |         |       |
|--|---------|-------|
| Capital expenditures                                   | (101)   | -     |
| Cash flows used in operating activities                | (5,591) | (496) |
| Cash flows (used in)/ provided by investing activities | (3,363) | (141) |
| Cash flows from financing activities                   | 4,300   | 2,473 |

Prior to the Merger, the Company was a public shell company with no operations. Twistbox has incurred losses and negative annual cash flows since inception. The primary sources of liquidity have historically been issuance of common and preferred stock, in the case of Twistbox, borrowings under the ValueAct Note with aggregate proceeds of \$16.5 million. In the future, we anticipate that our primary sources of liquidity will be cash generated by our operating activities and potentially equity raises and/or additional borrowing.

### Operating Activities

In the nine months ended December 31, 2008, operating expense consisted solely of employee compensation and other general and administrative expenses. In the nine months ended December 31, 2008, we used \$5.6 million of net cash in operating expenses. This primarily related to the net loss of \$8.9 million, decreases in accounts payable, accrued license fees and other liabilities of \$3.8 million, partially offset by a decrease in accounts receivable of \$3.4 million and non cash stock based compensation and depreciation and amortization included in the net loss of \$2.6 million and \$1.1 million respectively.

*Investing Activities*

In the nine months ended December 31, 2008, \$3.4 million was used in investing activities, primarily the cash consideration in the acquisition of AMV, amounting to \$6.3 million, and the purchase of plant and equipment of \$0.1 million; offset by cash acquired on acquisition of the subsidiary of \$3.0 million.

*Financing Activities*

In the nine months ended December 31, 2008, \$4.4 million was provided from the sale of Common Stock, while \$0.1 million was used in payments related to a prior acquisition.

As of December 31, 2008, the Company had approximately \$6.4 million of cash, and management believes it has sufficient cash to satisfy the Company's monetary needs for the next twelve months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these sources are insufficient to satisfy our cash requirements, we may seek to sell additional debt securities or additional equity securities or to obtain a credit facility. The sale of convertible debt securities or additional equity securities could result in additional dilution to our stockholders. The incurrence of increased indebtedness would result in additional debt service obligations and could result in additional operating and financial covenants that would restrict our operations. In addition, there can be no assurance that any additional financing will be available on acceptable terms, if at all. In addition, there are specific minimum cash covenants under the ValueAct Note, and there is no certainty that these covenants will be achieved.

### **Off-Balance Sheet Arrangements**

We do not have any relationships with unconsolidated entities or financial partners, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt, and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

#### ***Interest Rate and Credit Risk***

Our current operations have exposure to interest rate risk that relates primarily to our investment portfolio. All of our current investments are classified as cash equivalents or short-term investments and carried at cost, which approximates market value. We do not currently use or plan to use derivative financial instruments in our investment portfolio. The risk associated with fluctuating interest rates is limited to our investment portfolio, and we do not believe that a 10% change in interest rates would have a significant impact on our interest income, operating results or liquidity.

Currently, our cash and cash equivalents are maintained by financial institutions in the United States, Germany, the United Kingdom, Poland, Russia, Argentina and Colombia, and our current deposits are likely in excess of insured limits. We believe that the financial institutions that hold our investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments. Our accounts receivable primarily relate to revenues earned from domestic and international Mobile phone carriers. We perform ongoing credit evaluations of our carriers' financial condition but generally require no collateral from them. At December 31, 2008, our largest customer represented 20% of our gross accounts receivable.

#### ***Foreign Currency Risk***

The functional currencies of our United States and German operations are the United States Dollar, or USD, and the Euro, respectively. A significant portion of our business is conducted in currencies other than the USD or the Euro. Our revenues are usually denominated in the functional currency of the carrier. Operating expenses are usually in the local currency of the operating unit, which mitigates a portion of the exposure related to currency fluctuations. Intercompany transactions between our domestic and foreign operations are denominated in either the USD or the Euro. At month-end, foreign currency-denominated accounts receivable and intercompany balances are marked to market and unrealized gains and losses are included in other income (expense), net. Our foreign currency exchange gains and losses have been generated primarily from fluctuations in the Euro and pound sterling versus the USD and in the Euro versus the pound sterling. In the future, we may experience foreign currency exchange losses on our accounts receivable and intercompany receivables and payables. Foreign currency exchange losses could have a material adverse effect on our business, operating results and financial condition.

#### ***Inflation***

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we might not be able to offset these higher costs fully through price increases. Our inability or failure to do so could harm our business, operating results and financial condition.

## **Item 4T. Controls and Procedures.**

### ***Evaluation of Disclosure Controls and Procedures***

Members of our management, including our Principal Executive Officer, James Lefkowitz, and Principal Financial Officer, Jay A. Wolf, have evaluated the effectiveness of our disclosure controls and procedures, as defined by the Securities Exchange Act of 1934 (the "Exchange Act") Rules 13a-15(e) or 15d-15(e), as of December 31, 2008, the end of the period covered by this report. Based upon that evaluation, Messrs. Lefkowitz and Wolf concluded that our disclosure controls and procedures are adequate and effective to ensure that material information relating to use was made known to them by others within those entities, particularly during the period for which this Quarterly Report on Form 10-Q was prepared.

### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal controls over financial reporting as of December 31, 2008. Based on our assessment, we have concluded that our internal controls over financial reporting were effective as of December 31, 2008.

There were no changes in our internal control over financial reporting or in other factors identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13(a)-15 or 15(d)-15 that occurred during the third quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

As of the date of filing this Quarterly Report on Form 10-Q, we are not a party to any litigation that we believe would have a material adverse effect on us.

### **Item 1A. Risk Factors.**

*The effects of the recession in the United States and general downturn in the global economy, including financial market disruptions, could have an adverse impact on our business, operating results or financial condition.*

Our operating results also may be affected by uncertain or changing economic conditions such as the challenges that are currently affecting economic conditions in the United States. If global economic and market conditions, or economic conditions in the United States or other key markets, remain uncertain or persist, spread, or deteriorate further, we may experience material impacts on our business, operating results, and financial condition in a number of ways including negatively affecting our profitability and causing our stock price to decline.

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

On December 17, 2008, the Board granted 25,000 and 20,000 shares of Common Stock to each of Merriman, Curhan and Ford & Co. and CEOcast Inc., respectively, in connection with consulting services provided to the Company. The issuances of the shares were made in reliance on the exemption from registration provided under Rule 506 promulgated under the Securities Act of 1933, as amended.

### **Item 3. Defaults Upon Senior Securities.**

None.

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

None.

### **Item 5. Other Information.**

None.

**Item 6. Exhibits.**

- 31.1 Certification of James Lefkowitz, Principal Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*
- 31.2 Certification of Jay A. Wolf, Principal Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*
- 32.1 Certification of James Lefkowitz, Principal Executive Officer, pursuant to 18 U.S.C. Section 1350. \*
- 32.1 Certification of Jay A. Wolf, Principal Financial Officer, pursuant to 18 U.S.C. Section 1350. \*

\* Filed herewith

## 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

Mandalay Media, Inc.

Date: February 20, 2009

By: /s/ James Lefkowitz

James Lefkowitz

President

(Authorized Officer and Principal Executive Officer)

Date: February 20, 2009

By: /s/ Jay A. Wolf

Jay A. Wolf

Chief Financial Officer and Secretary

(Authorized Officer and Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James Lefkowitz, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Mandalay Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 20, 2009

/s/ James Lefkowitz  
James Lefkowitz  
President  
(Principal Executive Officer)



**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jay A. Wolf, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Mandalay Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 20, 2009

/s/ Jay A. Wolf

Jay A. Wolf  
Chief Financial Officer and Secretary  
(Principal Financial Officer)



**Certification of Principal Executive Officer  
Pursuant to 18 U.S.C. Section 1350  
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of Mandalay Media, Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Quarterly Report on Form 10-Q for the period ended December 31, 2008 of the Company (the "Form 10-Q") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 20, 2009

/s/ James Lefkowitz  
James Lefkowitz  
President  
(Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and shall be furnished to the Securities and Exchange Commission or its staff upon request.



**Certification of Principal Financial Officer**  
**Pursuant to 18 U.S.C. Section 1350**  
**As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of Mandalay Media, Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Quarterly Report on Form 10-Q for the period ended December 31, 2008 of the Company (the "Form 10-Q") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 20, 2009

/s/ Jay A. Wolf

Jay A. Wolf

Chief Financial Officer and Secretary

(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and shall be furnished to the Securities and Exchange Commission or its staff upon request.

