

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

MDI ENTERTAINMENT INC
Form 10QSB
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30,
2001.

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

For the transition period from _____ to _____

Commission File Number: 0-24919

MDI Entertainment, Inc.

(Exact name of Registrant as specified in its Charter)

Delaware

73-1515699

(State or other jurisdiction of
incorporation or organization)

(I.R.S Employer Identification No.)

201 Ann Street
Hartford, Connecticut 06103

(Address of principal executive offices)

(860) 527-5359
(Registrant's telephone number)

(Former Name, Former Address and Former Fiscal Year,
if changed since last Report)

Check whether the registrant (1) has filed all reports required to be filed by
Section 13 or 15 (d) of the Exchange Act during the past 12 months (or for 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 X No___

As of August 10, 2001 11,172,306 shares of the issuer's common stock were
outstanding.

Transitional Small Business Disclosure Format (check one): Yes ___ No X ___

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
FORM 10-QSB
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.....

Consolidated Balance Sheets as of June 30, 2001 (unaudited) and December 31, 2000.....

Consolidated Statements of Operations (unaudited) for the six months ended
June 30, 2001 and 2000.....

Consolidated Statements of Operations (unaudited) for the three months ended
June 30, 2001 and 2000.....

Consolidated Statements of Changes in Shareholders' Equity (Deficit) for the six
months ended June 30, 2001 (unaudited).....

Consolidated Statements of Cash Flows (unaudited) for the six months
ended June 30, 2001 and 2000.....

Notes to Unaudited Consolidated Financial Statements.....

Item 2. Management's Discussion and Analysis.....

PART II OTHER INFORMATION

Item 1. Legal Proceedings.....

Item 2. Change in Securities and Use of Proceeds.....

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

Item 6. Exhibits and Reports on Form 8-K.....

Signatures.....

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

	June 30, 2001	December 2000
ASSETS	(unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	\$ 358,606	\$ 528,
Investment securities available-for-sale	-	180,
Accounts receivable	2,761,081	1,140,
Inventory	709,968	285,
Other current assets	480,771	451,
	-----	-----
Total current assets	4,310,426	2,586,
	-----	-----
PROPERTY AND EQUIPMENT, at cost:		
Equipment	261,110	250,
Furniture and fixtures	120,361	120,
	-----	-----
	381,471	370,
Less: Accumulated depreciation	(239,829)	(212,
	-----	-----
Property and equipment, net	141,642	158,
	-----	-----
OTHER ASSETS:		
Licensing costs, net	1,594,313	1,397,
Other (Note 3)	220,071	363,
	-----	-----
Total other assets	1,814,384	1,761,
	-----	-----
Total assets	\$6,266,452	\$4,506,
	=====	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (continued)

	June 30, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)	(unaudited)
CURRENT LIABILITIES:	
Billings in excess of costs and estimated earnings on uncompleted contracts (Note 2)	\$3,465,888
Current portion of long term debt	477,740
Accounts payable	1,128,978
Accrued expenses	856,621
Income taxes payable (Note 5)	21,107

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Total current liabilities	5,950,334
SUBORDINATED CONVERTIBLE DEBENTURE (Note 4)	-

Total liabilities	5,950,334

SHAREHOLDERS' EQUITY (DEFICIT) (Notes 4 and 6):	
Common stock	11,172
Convertible preferred stock-Series B	1
Convertible preferred stock-Series C (Note 10)	-
Additional paid-in capital	5,783,228
Accumulated deficit	(5,478,283)

Total shareholders' equity (deficit)	316,118

Total liabilities and shareholders' equity (deficit)	\$6,266,452
	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	Six months ended June 30,
	2001
	----- (unaudited)
REVENUE	\$ 6,685,465
COST OF REVENUES	3,724,105

Gross profit	2,961,360
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,785,101
TERMINATED MERGER EXPENSES (NOTE 8)	-
COST OF UNSUCCESSFUL FUNDING (NOTE 7)	89,633

Operating profit (loss)	1,086,626
INTEREST EXPENSE, net	119,972
OTHER (INCOME) EXPENSE	(110,166)
GAIN ON SALE-INVESTMENT SECURITIES, net	(12,669)

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Income (loss) before provision for income taxes	1,089,489	
PROVISION FOR INCOME TAXES (Note 5)	12,035	-----
Net income (loss)	\$ 1,077,454	=====
Basic Earnings (Loss) Per Common Share (Note 6)	\$.10	=====
Diluted Earnings (Loss) Per Common Share (Note 6)	\$.09	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended June 30,	
	2001	-----
	(unaudited)	-----
REVENUE	\$ 3,563,467	-----
COST OF REVENUES	2,004,222	-----
Gross profit	1,559,245	-----
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	911,557	-----
TERMINATED MERGER EXPENSES (NOTE 8)	-	-----
COST OF UNSUCCESSFUL FUNDING (NOTE 7)	89,633	-----
Operating profit (loss)	558,055	-----
INTEREST EXPENSE, net	42,212	-----
OTHER EXPENSE	-	-----
LOSS ON SALE-INVESTMENT SECURITIES, net	11,637	-----
Income (loss) before provision for income taxes	504,206	-----
PROVISION FOR INCOME TAXES (Note 5)	4,035	-----
Net income (loss)	\$ 500,171	=====
Basic Earnings (Loss) Per Common Share (Note 6)	\$.04	=====

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Diluted Earnings (Loss) Per Common Share (Note 6)

\$.04

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

For the six months ended June 30, 2001
(Unaudited)

	Shares	Amount
Preferred Stock, par value \$.001 per share authorized 5,000,000 shares:		
Series B, liquidation amount \$2,252.25 per share:		
Balance, December 31, 2000	444	\$ 1
Series C (Note 10)	-	-
Balance, June 30, 2001	444	1
Common Stock, par value \$.001 per share, authorized 25,000,000 shares:		
Balance, December 31, 2000	10,505,872	10,505
Stock options exercised	28,934	29
Issuance of common stock	262,500	263
Conversion of subordinated debenture	375,000	375
Balance, June 30, 2001	11,172,306	11,172
Additional Paid-in Capital:		
Balance, December 31, 2000		5,061,596
Stock options exercised		6,571
Issuance of warrants		28,001
Issuance of common stock		269,025
Conversion of subordinated debenture		418,035
Balance, June 30, 2001		5,783,228
Accumulated Deficit:		
Balance, December 31, 2000		(6,555,737)
Net income		1,077,454
		(5,478,283)

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Balance, June 30, 2001	(5,478,283)

Total Shareholders' Equity as of June 30, 2001	\$ 316,118
	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six 2001 ----- (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income (loss)	\$1,077,
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:	
Depreciation and amortization	416,
Stock based compensation	
Gain on sale of investments, net	(12,
Change in assets and liabilities:	
Increase in accounts receivable	(1,620,
Increase in inventory	(424,
Increase in licensing costs	(563,
Increase in other assets	(13,
Increase in accounts payable	19,
Increase in accrued expenses	652,
Increase (decrease) in income taxes payable	11,
Increase in deferred revenue	
Increase in billings in excess of costs and estimated earnings on uncompleted contracts	576,

Net cash provided by (used for) operating activities	119,

CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(10,
Proceeds of sale of investments	192,

Net cash provided by (used for) investing activities	182,

CASH FLOWS FROM FINANCING ACTIVITIES:	
Repayment of debt	(477,
Proceeds from exercise of common stock options	6,

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Other	-----
Net cash (used for) provided by financing activities	(470,-----)
NET DECREASE IN CASH	(169,-----)
CASH, beginning of the period	528,-----
CASH, end of the period	\$ 358,=====
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid for:	
Interest	\$ 56,
Income taxes	\$
Non-cash investing and financing activities:	
Preferred stock dividend paid in common stock	\$
Imputed interest on subordinated convertible debenture	\$ 5,
Conversion of subordinated debenture into common stock	\$ 418,
Common stock issued for services	\$ 269,
Expenses related to warrants	\$

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

MDI ENTERTAINMENT, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR SIX MONTHS ENDED JUNE 30, 2001

1. PRESENTATION OF UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS.

Information in the accompanying interim consolidated financial statements and notes to the financial statements of MDI Entertainment, Inc. and subsidiary (MDI or the Company) for the six-month periods ended June 30, 2001 and 2000 is unaudited. The accompanying interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and Regulation S-B. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six-month period ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. The consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the audited financial statements of the Company as and for the seven months ended December 31, 2000.

2. REVENUE AND COST RECOGNITION

Revenue is derived from various lottery game contracts (mainly with

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

states) between the Company and the lotteries. The Company provides second chance prize packages consisting of grand prizes and various merchandise prizes. The Company also provides marketing support related to each of the games and obtains the appropriate licenses for the right to use these properties. Many of the lottery contracts require the lotteries to pay upon signing of the contract; therefore, MDI defers this revenue and recognizes the revenue based on the terms of the applicable game.

Revenues from the lottery game contracts that are greater than one year are recognized on the percentage of completion method, determined by the percentage of cost incurred to date to estimated total costs on a specific contract basis. This method is utilized since management considers cost incurred to be the best available measure of progress on these contracts. Contracts costs include all direct costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. As of June 30, 2001, no losses were expected from existing contracts.

The liability "Billings in excess of costs and estimated earnings on uncompleted contracts" represents billings in excess of revenues recognized.

3. OTHER ASSETS

Other assets at June 30, 2001 consisted primarily of prepaid financing costs and security deposits. Other assets at December 31, 2000 also included deferred financing costs related to the subordinated convertible debenture described in Note 4. These costs were charged to additional paid-in capital when the debenture was converted into common stock on March 14, 2001.

4. SUBORDINATED CONVERTIBLE DEBENTURE

On September 21, 1999, the Company issued a subordinated convertible debenture (the "Debenture") to Scientific Games, Inc. for \$750,000. The debenture was converted on March 14, 2001, as discussed below. The Debenture bore interest at 7% per annum and was payable semi-annually, on June 30 and December 31 of each year, until its maturity on September 21, 2009. The Debenture was convertible at the option of Scientific Games at the rate of \$2.00 per share of common stock, subject to adjustment under certain circumstances, into an aggregate of 375,000 shares of common stock and was convertible at the Company's option at any time after the earlier of (a) September 21, 2001 or (b) after the underlying common stock is registered pursuant to the Securities Act of 1933, as amended, and the price of the Company's common stock exceeded \$3.00 per share.

On March 14, 2001, the holder of the subordinated convertible debenture exercised its conversion privilege and was issued 375,000 shares of common stock. The carrying amount of the debenture was \$558,750 and the Company's common stock was trading for \$1.75 on the date of conversion. The Company recorded the transaction utilizing the book value method and accordingly, recognized no gain or loss from the conversion.

5. INCOME TAXES

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109), "Accounting for Income Taxes", which requires that a deferred tax liability or asset be recognized for the estimated future tax effects attributable to temporary differences between

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

the Company's financial statements and tax return. SFAS No. 109 provides for recognition of deferred tax assets for all future deductible temporary differences that, more likely than not, will provide a future benefit. As of June 30, 2001 and December 31, 2000, the Company had a significant deferred tax asset, primarily as a result of net operating loss carry-forwards. A valuation allowance has been established for the full amount of this deferred tax asset. The primary difference between the Company's effective tax rate and the statutory tax rate is the utilization of the net operating loss carryforwards and the related reversal of the valuation allowance.

6. EARNINGS PER SHARE

Basic earnings per common share are based on the average number of common shares outstanding during the fiscal period. Diluted earnings per common share include, in addition to the above, the dilutive effect of common share equivalents during the fiscal period. For the three and six months ended June 30, 2001, common share equivalents represented convertible preferred stock and dilutive stock options and warrants using the treasury method. For the three and six months ended June 30, 2000, preferred stock convertible into 1,015,000 shares of common stock, a subordinated debenture convertible into 375,000 shares of common stock, warrants to purchase 817,895 shares of common stock and options to purchase 974,166 shares of common stock were excluded from the calculation of the diluted earnings per share since their inclusion would be anti-dilutive.

The net income (loss) available to common shareholders and the number of shares used in the earnings (loss) per common share and earnings (loss) per dilutive share computation for 2001 and 2000 were as follows:

	SIX MONTHS ENDED JUNE 30,	
	2001	2000
Net income (loss)	\$1,077,454	\$(1,807,107)
Preferred stock dividends	-	(21,785)
Net income (loss) applicable to common shareholders	\$1,077,454	\$(1,828,892)

	SIX MONTHS ENDED JUNE 30,	
	2001	2000
Basic:		
Average number of common shares outstanding	11,018,145	8,968,793
Dilutive:		
Dilutive effect of options, warrants and convertible securities	1,610,131	not applicable
Average dilutive common shares outstanding	12,628,276	

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

	THREE MONTHS ENDED JUNE 30,	
	2001	2000
Net income (loss)	\$ 500,171	\$ (1,333,939)
Preferred stock dividends	-	(10,143)
Net income (loss) applicable to common shareholders	\$ 500,171	\$ (1,344,082)

	THREE MONTHS ENDED JUNE 30,	
	2001	2000
Basic:		
Average number of common shares outstanding	11,172,306	9,060,106
Dilutive:		
Dilutive effect of options, warrants and convertible securities	1,610,131	not applicable
Average dilutive common shares outstanding	12,782,437	

7. COST OF UNSUCCESSFUL FUNDING

The Company recorded an expense for \$89,633, for costs relating to the placement and issuance of its Series C Preferred Stock to Oxford International, Inc. These costs include legal, accounting and investment banking fees paid or accrued during the six-month period ended June 30, 2001. (See Note 10 "Subsequent Event")

8. TERMINATED MERGER EXPENSES

The Company entered into an Agreement and Plan of Merger with The Lottery Channel, Inc. and the Company's wholly-owned subsidiary (established to facilitate the merger), MDI Acquisition, Inc., dated as of January 26, 2000. The obligations of MDI Acquisition, Lottery Channel and the Company to effect the merger were subject to the fulfillment of a number of conditions including, among others, the consummation of certain contemplated investments and receipt of third party consents. Certain of such conditions were not met, and on August 25, 2000, the Company sent a notice of termination to The Lottery Channel terminating the Agreement and Plan of Merger. In accordance with generally accepted accounting principles, \$727,025 of costs related to the proposed merger were written off, as reflected in the accompanying financial statements. Subsequently, by letter dated August 28, 2000, Lottery Channel responded by purporting to terminate the merger agreement due to MDI's breach. The letter claimed that the Company was responsible for all cost and expenses incurred in

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

connection with the transaction. The Company disputes this assertion.

On November 7, 2000, the Company and its subsidiary, MDI Acquisition, Inc., were notified that they had been named as defendants in a complaint filed by the Lottery Channel on November 2, 2000 in the Hamilton County, Common Pleas Civil Division, Cincinnati, Ohio, arising from a decision to terminate its merger agreement with Lottery Channel. Lottery Channel is seeking to recover \$1,763,343.29 in costs and expenses, damages in excess of \$25,000, attorney's fees and costs in prosecuting the action, punitive damages and any other relief to which it is entitled. The Company believes that the lawsuit is without merit and is vigorously defending its position, and is asserting a variety of counterclaims against Lottery Channel, including a demand that Lottery Channel pay certain expenses under the termination provisions of the merger agreement. The lawsuit alleges that the Company (i) breached the merger agreement by failing to fulfill certain conditions necessary to obligate the Company to close the merger and by entering into an agreement with a competitor of Lottery Channel and (ii) breached its fiduciary duty to Lottery Channel by entering into an agreement with a competitor of Lottery Channel. The two conditions specifically cited in the complaint are the requirement of a \$10 million investment by the National Broadcasting Company ("NBC"), the partial owner and strategic partner of Lottery Channel, and the raising of an additional \$5 million in equity as part of a private placement. It is the Company's position that the condition for NBC to invest \$10 million, as well as to amend its stock purchase agreement with Lottery Channel, were conditions that Lottery Channel was obligated to, but did not fulfill. The condition that \$5 million in additional equity be raised was not satisfied by Lottery Channel for a variety of reasons, including the legislative environment relating to activities in Congress with respect to the Internet sale of lottery tickets and because of the change in financial markets relating to Internet companies. There can be no assurance as to the outcome of any such litigation. Steven M. Saferin, the Company's President and Chief Executive Officer, has filed a complaint, in his individual capacity, against Roger W. Ach II, the President and Chief Executive Officer of Lottery Channel, seeking \$108,000 plus interest as payment for a promissory note, due July 30, 2000. Also, on December 19, 2000, the Company filed a complaint in the United States District Court for the Southern District of New York against John Doe, seeking compensatory and punitive damages for defamation occurring on Internet message boards.

9. RECENT ACCOUNTING PRONOUNCEMENTS

On June 30, 2001, the Financial Accounting Standards Board (FASB) finalized Statements of Financial Accounting Standards No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets." Adoption of FASB 142 is required beginning with the first quarter of 2002. The Company has no planned or anticipated business combinations which would be affected by FASB 141. The Company's intangible amortization policies are consistent with FASB 142. Therefore, the implementation of these two standards is not expected to have a material impact on the Company's financial condition or results of operations.

10. SUBSEQUENT EVENT

The Company entered into a Stock Purchase Agreement with Oxford International, Inc. ("Oxford") with an effective date of April 25, 2001. Pursuant to that Agreement, the Company issued to Oxford 2,100 shares of Series C Preferred Stock (the "Series C Stock") representing approximately 15.8% of the outstanding common stock of MDI on an as converted basis. The Company anticipated receipt of \$3,200,000 in cash from this transaction.

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

Oxford failed to pay the consideration of \$3,200,000 required by the April 25, 2001 Stock Purchase Agreement, and because of this failure, the Company did not release its stock to Oxford and did not consider the transaction consummated.

The Company entered into an "Agreement" with Oxford with an effective date of July 9, 2001 whereunder the Company agreed to accept securities of two publicly traded companies valued in excess of \$3.2 million, by reference to the closing prices of such securities, as of the date of its receipt of the securities in lieu of the cash investment Oxford agreed to make under the April 25, 2001 Stock Purchase Agreement. Among other things, Oxford agreed that it would not be entitled to nominate one member to the Company's Board of Directors; that it could not require performance of any matters under the Stock Purchase Agreement and Certificates of Designation up to the date of July 9, 2001 Agreement, including but not limited to payments of dividends; and that the Certificate of Designations was null and void.

Subsequent to the receipt of the securities of the two publicly traded companies from Oxford, the issuers of those securities and the Federal Bureau of Investigation made assertions about Oxford. The FBI notified the Company of its investigations of Oxford, but did not make any assertions concerning the Company or any of its officers or directors. Neither the Company nor its officers and directors are under any investigation by the FBI as part of their investigation of Oxford. The Company was advised that, in the view of the issuers of the publicly traded securities and the FBI, the securities it received from Oxford are or may be subject to a dispute between the issuers and Oxford, which could impair the liquidity and value of the securities. If the liquidity and value of the securities were, in fact, impaired, then the Company believes it may have been defrauded by Oxford.

By letter dated July 27, 2001, the Company notified Oxford that, pursuant to the July 9th Agreement, it was exercising its right to exchange the publicly traded securities it received from Oxford for all of the Company's stock issued to Oxford.

Oxford has refused to honor the Company's exchange right. On August 6, 2001, the Company filed a Motion For Temporary Restraining Order and Preliminary Injunction and a Verified Complaint in the United States District Court of the District of Maryland against Oxford and Gregory C. Dutcher. See "Item 1: Legal Proceedings."

Upon the filing of the Company's Form 8-K on July 16, 2001 reporting these issues, NASDAQ halted trading in its securities. On such date, the Company also received a letter from NASDAQ asking it to respond to various questions, which the Company responded to by the July 20, 2001 deadline. Representatives of the Company met with NASDAQ both on July 30 and August 7, 2001 to discuss the contents of that submission and other issues concerning the Company's financing transaction with Oxford.

The Company agreed with NASDAQ that, since the Company exercised its right of exchange under the Agreement dated July 9, 2001, it no longer meets the net tangible asset maintenance requirements for continued listing on the NASDAQ SmallCap Market. Therefore, the Company is in the process of seeking to move the trading of its securities to the Over-The-Counter Bulletin Board. NASDAQ is cooperating with the Company in this transition. If, in the future, the Company meets the criteria for listing on NASDAQ, it may elect to reapply for such listing.

THIS QUARTERLY REPORT ON FORM 10-QSB CONTAINS FORWARD LOOKING STATEMENTS THAT INVOLVE CERTAIN RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THE RESULTS DISCUSSED IN THE FORWARD LOOKING STATEMENTS.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

DESCRIPTION OF BUSINESS

The following discussion and analysis should be read in conjunction with our Consolidated Financial Statements and the notes thereto appearing elsewhere in this Form 10-QSB. All statements contained herein that are not historical facts, including but not limited to, statements regarding our current business strategy and our plans for future development and operations, are based upon current expectations. These statements are forward-looking in nature and involve a number of risks and uncertainties. Generally, the words "anticipates," "believes," "estimates," "expects" and similar expressions as they relate to us and our management are intended to identify forward looking statements. Actual results may differ materially. Among the factors that could cause actual results to differ materially are those set forth in our Annual Report on Form 10-KSB under the caption "Description of Business-Risk Factors." We wish to caution readers not to place undue reliance on any such forward-looking statements, which statements speak only as of the date made.

Our principal business has been the scratch ticket segment of the government lottery industry. We are a leader in designing and marketing instant scratch ticket games based on licensed brand names and entertainment properties, and our lottery promotions feature such properties licensed by us. Prizes awarded in such promotions typically include a number of "second chance" prizes related to the licensed property, including collectible logo bearing merchandise such as logo bearing T-shirts and caps, and other related merchandise such as posters, money clips, telephones, playing cards, film cells, stadium blankets, carryall bags, jackets, electronic games, video and music collections, watches, clocks, credit cards with prepaid credit, trips and, in the case of Harley-Davidson(R), Harley-Davidson 1200 Sportster motorcycles.

We developed our strategy of identifying such properties in early 1996. Prior to that time, we had developed a series of promotions that utilized popular videotapes, compact discs and audiocassettes as second chance lottery prizes. Those promotions enabled us to develop an expertise in sourcing and distributing products as second chance lottery prizes and to develop a reputation with lottery personnel as a reliable organization attuned to the special needs of lotteries and their players.

We derive over ninety-five percent (95%) of our revenues from lotteries in two distinct ways. First, we may charge a lottery a license and royalty fee to utilize a particular licensed property as a lottery game. License fees may be fixed assessments while royalties are a percentage of the printing cost of the

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

tickets or a percentage of sales of the ticket. Contracts for licensed properties typically include an up-front license fee and a royalty based on the manufacturing cost of tickets. Manufacturing costs of tickets usually range from \$10.00 per thousand to \$30.00 per thousand. Actual costs depend on the size of the ticket and the quantity printed. Ticket quantities range from about one million to as many as 60 million with an average quantity of about five million.

Our second source of lottery revenue is the sale of logo bearing merchandise to the lottery as second-chance prizes. In merchandise-based lottery games, between 5% to 10% of a lottery's prize fund is typically used for the purchase of merchandise related to the property the lottery is utilizing. Typically, we purchase merchandise from other licensees of the property and resell the merchandise to the lottery at a price that is designed to include overhead costs, profit, shipping and handling and any marketing support we provide the lottery, such as brochures, posters or other advertising assistance for which there are no separate charges.

Our success is dependent on our ability to maintain and secure licensed properties, market these properties to lotteries and the performance of the properties once they are introduced as lottery games to players. We believe that revenues will fluctuate as individual license-based promotions commence or wind down and terminate. In addition, our licenses (which are generally for 1.5 to 3 years) terminate at various times over the next several years. Moreover, the useful life of a license is generally relatively short as the novelty of the game or the popularity of the licensed material wanes over time. The timing of agreements with the lotteries to run promotions, the acquisition of new licenses and the commencement of new promotions is unpredictable. Accordingly, period to period comparisons may not be indicative of future results.

We are in continuous negotiations to obtain additional licensed properties, including those from professional sports leagues, and to extend some existing licenses. We expect to reach several agreements over the next six to 12 months; however we cannot assure you that such agreements will actually be reached. Some of these agreements may require the expenditures of significant up-front advances.

RECENT DEVELOPMENTS

By letter dated July 27, 2001, we exercised our option to exchange securities received from Oxford, International, Inc. for all of our stock, which we had a right of exchange under the Agreement dated July 9, 2001.

Under the April 25, 2001 Stock Purchase Agreement, Oxford was to pay \$3.2 million in cash. Under the July 9, 2001 Agreement, we agreed to accept securities of two publicly traded companies, valued in excess of \$3.2 million by reference to the closing prices of such securities as of the date of its receipt of the securities in lieu of the cash investment Oxford agreed to make under the April 25, 2001 Stock Purchase Agreement.

Subsequent to our receipt of the securities of the two publicly traded companies from Oxford, the issuers of those securities and the Federal Bureau of Investigation made assertions about Oxford. The FBI notified us of its investigations of Oxford, but did not make any assertions concerning MDI or any of its officers or directors. Neither MDI nor its officers and directors are under any investigation by the FBI as part of their investigation of Oxford. We were advised that, in the view of the issuers of the publicly traded securities and the FBI, the securities we received from Oxford are or may be subject to a dispute between the issuers and Oxford, which could impair the liquidity and value of the securities. If the liquidity and value of the securities were, in fact, impaired, then we believe we may have been defrauded by Oxford.

Oxford has refused to honor our exchange right. On August 6,

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

2001, we filed a Motion For Temporary Restraining Order and Preliminary Injunction and a Verified Complaint in the United States District Court of the District of Maryland against Oxford and Gregory C. Dutcher. See "Item 1: Legal Proceedings."

Upon the filing of our Form 8-K on July 16, 2001, reporting these issues, NASDAQ halted trading in our securities. On such date, we also received a letter from NASDAQ asking us to respond to various questions, which we responded to by the July 20, 2001 deadline. We met with NASDAQ both on July 30 and August 7, 2001 to discuss the contents of that submission and other issues concerning our financing transaction with Oxford.

We agreed with NASDAQ that, since the we have exercised our right of exchange under the Agreement, we no longer meet the net tangible asset maintenance requirements for continued listing on the NASDAQ SmallCap Market. Therefore, we are in the process of seeking to move the trading of our securities to the Over-The-Counter Bulletin Board. NASDAQ is cooperating with us in this transition. If, in the future, we meet the criteria for listing on NASDAQ, we may elect to reapply for such listing.

OPERATIONAL RESULTS

This quarter ended June 30, 2001 continues the trend of profitable operations started in the first quarter of fiscal year 2001. As we indicated after the termination of our merger with The Lottery Channel in August 2000, and through the ensuing months, our focus has been on developing our core business. The results of this second profitable quarter in this fiscal year reflect that focus. Our revenue of over \$3.6 million is a new record for any single quarter. Our revenue for the three months ended June 30, 2001 is more than twice our revenue for the same three-month period ended June 30, 2000, and we have earned \$.04 per common share as opposed to a loss of \$(.15) per share for the same period in 2000. We believe our core business is strong. Our contract backlog continues to be strong and our games continue to perform well in the marketplace. We believe the acceptance of licensed games by lotteries in North America has never been higher. It is our aim to continue to focus on the core business as we strive to increase shareholder value, build a more successful company and become the leader in our market.

INTERNET PLATFORMS

Our value-added initiative to provide customers with Internet components related to our licensed games is being perceived positively by the lottery industry, based on the performance of the first three such initiatives that were introduced in January 2001 in New Jersey (Elvis), Kentucky (Elvis) and Indiana (SPAM). All three lotteries have determined to retain our Internet service for upcoming new promotions, using the model that we implemented for Indiana. This model enables a lottery consumer to register non-winning tickets for second chance merchandise drawings on the Internet, instead of going to the expense of physically mailing the tickets to the lottery, thus providing a tangible convenience and a real cost savings for lottery consumers.

LICENSES AND CONTRACTS

Thirty-five MDI-licensed lottery promotions were underway in North America and Australia at the end of the second quarter ended June 30, 2001, with 17 game introductions during the quarter joining another 18 games on sale prior to the beginning of the quarter. With at least 16 more promotions already launched after the end of the second quarter or scheduled to launch prior to the end of the fiscal year, 2001 will mark the first time that lotteries have launched more than 50 of our proprietary game promotions in a single fiscal year.

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

During the quarter ended June 30, 2001, we had active licensed games on sale in 19 of the 39 government lottery jurisdictions in the United States and three of the five provincial lotteries in Canada. The quarter also saw the launch of our first offshore licensed lottery game contracted by the New South Wales' Lottery Commission.

In addition to the launch of the first MDI-licensed lottery game in New South Wales, the milestone quarter saw our products continue to break into new major lottery markets. Following the launch of Harley-Davidson(R) by the California Lottery (ranked 9th largest lottery in the world in total sales according to LaFleur's 2000 World Lottery Almanac, TLF Publications, 2000) at the end of the first quarter, second quarter promotion launches included the first-ever MDI licensed games to be introduced by the Michigan Lottery Commission (ranked 18th worldwide). Additionally, in the second quarter, the Illinois Lottery (ranked 21st worldwide) made final preparations for their first MDI-licensed game, Harley-Davidson(R), with a mid-July launch.

Some of the licensed games launched during the second quarter ended June 30, 2001 include:

Indiana Lottery	NASCAR Drivers (June 15)
Iowa Lottery	NASCAR Drivers (April 9)
Kentucky Lottery	NASCAR Drivers (April 30)
Maine Lottery	NASCAR Drivers (June 21)
Michigan Lottery	Harley-Davidson (April 30)
New Hampshire Lottery	Elvis Presley (June 15)
New Jersey Lottery	SPAM (April 23)
New Mexico Lottery	Harley-Davidson (May 14)
New South Wales Lotteries	Elvis Presley (May 21)
Oregon Lottery	Harley-Davidson (June 5)
Pennsylvania Lottery	NASCAR Drivers (May 1); Harley-Davidson (June 5)
South Dakota Lottery	SPAM (April 30); NASCAR Drivers (May 1)
Wisconsin Lottery	Louisville Slugger (April 1); CMT (June 18); TABASCO (June 25)

Two of MDI's licensed lottery properties, CMT/Country Music Television and TABASCO, saw their first representation on lottery tickets during the second quarter of fiscal 2001, with the Wisconsin Lottery's introduction of the scratch games CMT Jammin' Country and TABASCO Hot Cash.

We have just reached an agreement, in principle, with the Multi-State Lottery Association ("MUSL"), the consortium of 22 Lotteries that run Powerball, for what amounts to a first of its kind promotion in the industry. A minimum of 16 of the jurisdictions represented by MUSL have indicated agreement to purchase a generic Powerball advertising campaign from us starring the American musical icon Ray Charles. We are currently drafting documents representing our final agreement with MUSL, however, we cannot provide assurance that these will be approved and executed by MUSL. This would be the first time that this many lotteries have attempted to use the same creative entity to promote a lottery product. We are very excited about the potential that this agreement has for the Company and we are working on similar projects elsewhere.

We have also reached an agreement, in principle, with the Federation Internationale De Football ("FIFA"). FIFA sponsors the World Cup soccer competition, which is the biggest sporting event in the world. We have been pursuing the World Cup license for some time now. ISL, the organization formerly representing FIFA, went bankrupt about 90 days ago. The marketing rights, held by ISL, reverted to FIFA. This presented us with an opportunity to obtain the World Cup license. We are currently drafting documents representing our final agreement with FIFA, however, we cannot provide assurance that these

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

will be approved and executed by FIFA. We believe that if this agreement is executed it will provide us with tremendous opportunities for international growth in sales of licensed games.

	Six months ended		
	2001	%	2000
Revenue	\$ 6,685,465	100.0%	\$2,730,900
Cost of revenues	3,724,105	55.7%	1,818,000
Gross profit	2,961,360	44.3%	912,900
Selling, general and administrative expenses	1,785,101	26.7%	1,000,000
Terminated merger expenses	-	0.0%	-
Cost of unsuccessful funding	89,633	1.3%	-
Operating profit (loss)	1,086,626	16.3%	(107,100)
Interest expense	128,745	1.9%	-
Interest income	(8,773)	-0.1%	-
Other (income) expense	(110,166)	-1.6%	-
Gain on sale-investment securities, net	(12,669)	-0.2%	-
Income (loss) before provision for income taxes	1,089,489	16.3%	(107,100)
Provision for income taxes	12,035	0.2%	-
Net income (loss)	\$ 1,077,454	16.1%	\$ (107,100)

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2000

Results for the first half of the year ended December 31, 2001 reflect a 145% increase in revenue as our Harley-Davidson(R) license "leads the pack" of launching increased revenue and profitability half way through the new year. Revenue for the six months ended June 30, 2001 was \$6,685,500 compared to \$2,730,900 for the six months ended June 30, 2000. Harley-Davidson(R), which launched in seven states during the six month period ended June 30, 2001, accounted for 42.3% of our revenue for the 2001 period. This was followed by one of our newest properties, Elvis(R), which accounted for 15.3% of revenue. Not far behind were, SPAM(R) (8.8% of revenue), Betty Boop(R) (8.1% of revenue) and NASCAR(R) Drivers (7.7% of revenue). The remaining 17.8% of revenue was from seven other licensed properties. We have continued to penetrate new markets. Sales in one new state alone, California, amounted to \$997,000 for the six months ended June 30, 2001.

Cost of revenue as a percentage of revenue decreased to 55.7% from 68.3% for the six months ended June 30, 2001 compared to the six months ended

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

June 30, 2000. This decrease in the cost ratio reflects our ability to achieve a higher gross profit due to product mix and creative game design.

The gross profit increased in the six months ended June 30, 2001 to \$2,961,400 (44.3% of revenue) compared to \$865,500 (31.7 % of revenue) for the six months ended June 30, 2000. This represents a gross profit percentage increase of 39.7% over the six months ended June 30, 2000.

Selling, general and administrative expenses were \$1,785,100 (26.7% of revenue) for the six months ended June 30, 2001 compared to \$1,844,500 for the six months ended June 30, 2000. Salaries and employee benefits increased approximately \$135,000 during the first six months of 2001 compared to the same period in 2000 due to the increased sales staffing to develop our regional sales reorganization which helped to maintain our sales backlog of \$15.5 million as of June 30, 2001. Total selling general and administrative expenses for the six months ended June 30, 2001 are lower primarily due to the reduction of lobbying expenses of \$80,000 and \$103,000 of employee stock option expense as compared to the six months ended June 30, 2000.

Costs of unsuccessful funding of \$ 89,600 for the six months ended June 30, 2001 includes legal, accounting and investment banking fees associated with our unsuccessful placement of our Series C Preferred Stock with Oxford International, Inc. which is discussed in greater detail in "Item 1 Legal Proceedings."

Terminated merger expenses for the six months ended June 30, 2000 of \$727,000 relate to our unsuccessful merger with The Lottery Channel, Inc.

Operating income was \$1,086,600 (16.3% of revenue) for the six months ended June 30, 2001 compared to an operating loss of \$(1,706,061) (62.5% of revenue) for the six months ended June 30, 2000. This substantial positive net change of \$2,792,700 is due to the factors described above.

Interest expense was \$128,700 for the six months ended June 30, 2001 compared to \$50,500 for the six months ended June 30, 2000. This increase in interest expense is attributable to both interest and amortization of warrant costs associated with \$720,000 of additional short-term debt outstanding during the six months ended June 30, 2001. All but \$260,000 of this debt was paid off during the second quarter ended June 30, 2001.

Other income was \$110,200 for the six months ended June 30, 2001 compared to a \$57,200 expense for the six months ended June 30, 2000. This \$110,200 was attributable to the exchange of stock for legal services that was negotiated during the first quarter of 2001. The \$57,200 expense for the six months ended June 30, 2000 represented legal fees in excess of an inventory loss judgement favorable to us.

The gain on sale of securities of \$12,669 for the six months ended June 30, 2001 was attributable to the sale of eLot stock held for investment.

For the reasons set forth above, we had income before taxes of \$1,089,500 for the six months ended June 30, 2001 compared to a loss before taxes of \$(1,804,800) for the six months ended June 30, 2000.

The foregoing resulted in a \$.10 basic earnings per share and a \$.09 diluted earnings per share on net income for the six months ended June 30, 2001. Had we not incurred the \$89,700 of costs attributable to the unsuccessful placement of our Series C Preferred Stock our basic earnings per share would have been \$.11 and diluted earnings per share would have remained at \$.09. For the six months ended June 30, 2000, we had a basic and diluted loss per share of \$(.20).

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

	Three months ended		
	2001	%	2000
Revenue	\$ 3,563,467	100.0%	\$1,715,900
Cost of revenues	2,004,222	56.2%	1,198,800
Gross profit	1,559,245	43.8%	517,100
Selling, general and administrative expenses	911,557	25.7%	1,060,000
Terminated merger expenses	-	0.0%	72,000
Cost of unsuccessful funding	89,633	2.5%	-
Operating profit (loss)	558,055	15.7%	(1,270,000)
Interest expense	48,531	1.4%	200,000
Interest income	(6,319)	-0.2%	(100,000)
Other expense	-	0.0%	300,000
Loss on sale-investment securities, net	11,637	0.3%	-
Income (loss) before provision for income taxes	504,206	14.1%	(1,330,000)
Provision for income taxes	4,035	0.1%	-
Net income (loss)	\$ 500,171	14.0%	\$ (1,330,000)

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2000.

Results for the second quarter of our new fiscal year ending December 31, 2001 reflect a 108% increase in revenue as our Harley-Davidson(R) license "leads the pack" of launching increased revenue and profitability into this year. Revenue for the three months ended June 30, 2001 was \$3,563,500 compared to \$1,715,900 for the three months ended June 30, 2000. Harley-Davidson(R), which launched in four states the second quarter of 2001, accounted for 50.6% of our revenue. One of our newest properties, Elvis(R), accounted for 14.3% of revenue. Not far behind were NASCAR(R) Drivers (14.1% of revenue) and SPAM(R) (11.5% of revenue).The remaining 9.5% represented revenue from seven other licensed properties.

Cost of revenues as a percentage of revenue decreased to 56.2% from 69.8% for the three months ended June 30, 2001 compared to the three months ended June 30, 2000. This decrease in the cost ratio reflects our ability to achieve a higher gross profit due to product mix and creative game design.

The gross profit increased in the three months ended June 30, 2001 to

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

\$1,559,200 (43.8% of revenue) compared to \$518,400 (30.2% of revenue) for the three months ended June 30, 2000. This result represents a gross profit percentage increase of 45% over the three months ended June 30, 2000.

Selling, general and administrative expenses were \$911,600 (25.7% of revenue) for the three months ended June 30, 2001 compared to \$1,065,800 for the three months ended June 30, 2000. Salaries and employee benefits increased approximately \$76,200 for the three months ended June 30, 2001 due to increased sales staffing to develop our regional sales reorganization, which has helped to maintain our sales backlog of \$15.5 million as of June 30, 2001. However, total selling, general and administrative expenses for the three months ended June 30, 2001 are still lower than for the same period ended June 30, 2000 due to a reduction of lobbying expense of \$80,000 and employee stock option expenses of \$103,000 as compared to in the three months ended June 30, 2000.

Costs of unsuccessful funding for the three months ended June 30, 2001 represented legal, accounting and investment banking fees related to our unsuccessful placement of our Series C Preferred Stock with Oxford International, Inc. which is discussed in greater detail in "Item 1 Legal Proceedings"

Terminated merger expenses for the three months ended June 30, 2000 of \$727,000 relate to our unsuccessful merger with The Lottery Channel.

Operating income was \$558,100 (15.7% of revenue) for the three months ended June 30, 2001 compared to an operating loss of \$(1,274,400) (74.3% of revenue) for the three months ended June 30, 2000. This substantial positive net change of \$1,832,500 is due to the factors described above.

Interest expense was \$48,500 for the three months ended June 30, 2001 compared to \$25,400 for the three months ended June 30, 2000. This increase in interest expense is attributable to both interest and amortization of warrant costs associated with \$720,000 of additional short-term debt outstanding during the six months ended June 30, 2001. All but \$260,000 of this debt was paid off during the quarter ended June 30, 2001.

There was no "other expense" for the three months ended June 30, 2001 compared to a \$36,400 expense for the three months ended June 30, 2000 which represented legal fees in excess of an inventory loss judgement favorable to us.

The loss on sale of investment securities of \$11,600 for the three months ended June 30, 2001 was attributable to the sale of the remaining shares of eLot stock held for investment. However, we had a total gain of \$12,700 on the liquidation of this investment which took place during the six months ended June 30, 2001.

For the reasons set forth above, we had income before taxes of \$504,200 for the three months ended June 30, 2001 compared to a loss before taxes of \$(1,333,900) for the three months ended June 30, 2000.

The foregoing resulted in a \$.04 basic and diluted earnings per share on net income for the three months ended June 30, 2001. Had we not incurred the \$89,700 of costs attributable to the unsuccessful placement of our Series C Preferred Stock, our basic and diluted earnings per share would have been \$.05. For the three months ended June 30, 2000 we had a basic and diluted loss per share of \$(.15).

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2001, we had cash and cash equivalents of \$358,600 compared to \$528,200 as of December 31, 2000. This decreased cash position was

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

in part due to the payment of short-term notes of \$460,000 late in the second quarter ended June 30, 2001. However, accounts receivable were \$2,761,100 as of June 30, 2001 compared to \$1,140,900 as of December 31, 2000 reflecting our increased game launch activity.

As of June 30, 2001, we had a net working capital deficit of \$1,639,900. However, within current liabilities is \$3,465,900 of "Billings in excess of cost and estimated earnings on uncompleted contracts" representing unrecognized revenue (i.e., revenue which we had already been paid or billed for but which cannot be recognized until we purchase the contracted merchandise before a game drawing occurs). Accordingly, such liability will not adversely impact cash flow, except to the extent that we need to purchase merchandise and incur subsequent fulfillment costs relative to this revenue, which typically approximates 50% of the related revenue. Without such liability, working capital would have been \$93,050.

As part of our continuing effort to improve working capital, in January 2001, we negotiated a stock for fees exchange with two of our law firms and our investment banking firm. The cash flow savings from this exchange totaled \$269,025.

Our indebtedness as of June 30, 2001, was \$477,700, consisting of an installment note payable and a short-term note of \$260,000 both payable to our President and Chief Executive Officer. As stated earlier, we repaid \$460,000 of short-term loans to unrelated parties late in the second quarter ended June 30, 2001.

The convertible subordinated debenture, with an outstanding balance of \$558,750, was converted into common stock on March 14, 2001. Under the terms of the conversion we will continue to pay the interest payments which would have been due through September 21, 2001.

As more fully disclosed elsewhere in April 2001, we entered into an agreement to sell Series C Convertible Preferred Stock for \$3.2 million. The funds were never received and attempts were made to restructure the financing transaction. We agreed to accept securities in lieu of cash. Ultimately, we determined to exercise our right to exchange these securities for our stock under the July 9, 2001 Agreement.

We do not have any material capital commitments and do not currently anticipate making any substantial expenditure other than in the normal course of business. We have undertaken an aggressive program of acquiring new licenses, some of which may require substantial up front payments.

SEASONALITY AND REVENUE FLUCTUATIONS

Our business is not seasonal. However, our revenues are expected to fluctuate as individual license-based promotions commence or wind down and terminate. The useful life of a promotion is generally relatively short as the novelty of the game or the popularity of the licensed material wanes over time. In addition, our licenses (which are generally for 1.5 to 3 years) terminate at various times over the next several years. The life span of a promotion, the timing of agreements with the lotteries to run promotions, the acquisition of new licenses and the commencement of new promotions are unpredictable. Also, since most lotteries are government agencies with lottery executives appointed by the state's governor or other high ranking official, opportunities or projects in progress can be slowed after an election if the incumbent governor is not reelected. Accordingly, period to period comparisons may not be indicative of future results.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On August 6, 2001, we filed a Motion For Temporary Restraining Order and Preliminary Injunction and a Verified Complaint in the United States District Court of the District of Maryland against Oxford International, Inc. and its principal, Gregory C. Dutcher.

We asked the court to enter an Order and Decree to the effect that Oxford and Mr. Dutcher (and their officers, agents, servants, employees, attorneys and any persons in active concert or participation with them) shall not transfer, alienate, sell, gift, pledge without giving notice of our right to exchange, hypothecate, give, grant an option as to, or otherwise dispose in any way any of our shares of stock that we transferred to Oxford. In addition, we requested the court to set a date for a Preliminary Injunction maintaining such an Order and Decree, or alternatively, entering a mandatory injunction causing the parties to exchange our stock for the securities we received from Oxford.

The court held a telephone conference on August 6, 2001. During the telephone conference, according to the order, Mr. Dutcher stated that he had no intention of transferring of our stock within the next 20 days. At 4:00 p.m. on August 6, 2001, the court ordered, among other things, that Oxford and Mr. Dutcher, and their officers, agents, servants, employees, attorneys, and any person in active concert or participation with them, shall not transfer or otherwise dispose in any way of any shares of our stock that were transferred to Oxford by us. The Temporary Restraining Order issued by the court will expire at 5 p.m. on August 16, 2001, unless within such time the order is extended for good cause, or unless Oxford and Mr. Dutcher consent to an extension. A copy of the Temporary Restraining Order has been forwarded to Prudential Securities Inc., whom we believe has physical possession of the Series C Preferred shares involved in this order.

In our Verified Complaint, we alleged claims of federal and state securities fraud and common law fraud, claims of misrepresentation and breach of contract, and other claims. We asked for remedies including specific performance that Oxford and Mr. Dutcher transfer our stock to us, rescission, monetary damages and injunctive relief, as referenced above.

Subsequently, by agreement of the parties, the material terms of the August 6, 2001 Temporary Restraining Order have been extended to September 7, 2001, with the parties to confer with the Judge during the week of September 4, 2001, to schedule a Preliminary Injunction hearing. Oxford and Mr. Dutcher, their officers, agents, servants employees, attorneys, and any person in active concert or participation with them, still cannot transfer or otherwise dispose of our stock during that time period. Information concerning the contents of this most recent Order are being forwarded to Prudential Securities, Inc., and a copy of that Order will be transmitted to Prudential Securities, Inc. as well, upon receipt of a written Order.

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

We entered into a Stock Purchase Agreement with Oxford International, Inc. with an effective date of April 25, 2001. Pursuant to that Agreement, we issued to Oxford 2,100 shares of Series C Preferred Stock, representing approximately 15.8% of the outstanding common stock of MDI on an as converted basis. We anticipated receipt of \$3,200,000 in cash from this transaction.

Oxford failed to pay the consideration of \$3,200,000 required by the April 25, 2001 Stock Purchase Agreement, and because of this failure, we did not release its stock to Oxford and did not consider the transaction consummated.

We entered into an "Agreement" with Oxford with an effective date of July 9, 2001 whereunder we agreed to accept securities of two publicly traded companies valued in excess of \$3.2 million, by reference to the closing prices of such securities, as of the date of its receipt of the securities in lieu of the cash investment Oxford agreed to make under the April 25, 2001 Stock Purchase Agreement. Among other things, Oxford agreed that it would not be entitled to nominate one member to our Board of Directors; that it could not require performance of any matters under the Stock Purchase Agreement and Certificate of Designations up to the date of July 9, 2001 Agreement, including but not limited to payments of dividends; and that the Certificates of Designation was null and void.

The Series C Preferred Stock originally had a liquidation preference of \$1,523.81 per share, paid a cumulative preferred dividend at the rate of 8% per annum, payable in cash or common stock at our discretion, and was convertible into an aggregate of 2,100,000 shares of common stock, subject to adjustment only for events such as stock splits, stock dividends and similar events and was not adjustable or resettable based on the market price of the common stock. If not previously converted by Oxford, five hundred twenty five (525) shares of the Series C Preferred Stock would have been automatically converted into common stock no later than 120 days from the issue date, and after a registration statement covering the full amount of the shares of common stock underlying the Series C Preferred Stock had been filed by us with the Securities and Exchange Commission, an aggregate of five hundred twenty five (525) shares of Series C Preferred Stock would have been automatically converted into common stock every ninety (90) days. We were not permitted to create or increase the authorized number of shares of any class or series of stock ranking prior to or on parity with the Series C Preferred Stock either as to dividends or liquidation without approval of the holders of at least a majority of the then outstanding shares of Series C Preferred Stock.

Oxford had the option of nominating one member of our Board of Directors reasonably acceptable to us so long as the sum of (i) the aggregate number of shares of common stock issuable upon conversion of the Series C Preferred Stock and (ii) aggregate number of shares of common stock owned by Oxford and its subsidiaries was equal to or greater than 2,100,000 and Oxford and its subsidiaries beneficially owned greater than ten percent (10%) of the number of shares of our common stock outstanding.

In connection with the transaction, we issued an aggregate of 42,000 shares of common stock as an origination fee to persons affiliated with Oxford. We also contemplated paying Venture Partners Capital, LLC, a registered broker-dealer with whom our former Executive Vice President of Finance is affiliated, a \$256,000 cash fee. Such fee was not paid due to the circumstances surrounding the transaction. See "Item 1. Legal Proceedings." In addition, warrants previously issued to Venture Partners Capital, LLC became exercisable.

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The Company held its Annual Meeting of Stockholders on June 8, 2001.

The following matters were voted upon at the Annual Meeting of Stockholders:

1. Proposal to amend the Company's Certificate of Incorporation to authorize staggered terms for election of directors, under which the Board of Directors will be divided into three classes, Class I, Class II and Class III as nearly equal in number as possible, to serve initial terms of one, two and three years, respectively, with each director being assigned to one of the three classes as provided by the Board.

NUMBER OF SHARES VOTED		
FOR	AGAINST	ABSTAIN
7,672,705	14,255	504

2. Election of a Board of Directors.

NAME	CLASS	NUMBER OF SHARES VOTED		
		FOR	AGAINST	ABSTAIN
Steven M. Saferin	III	9,985,869	0	108
Robert J. Wussler	I	9,987,871	0	406
Kenneth M. Przysiecki	III	9,935,871	0	50,006
Todd P. Leavitt	II	9,987,869	0	308
S. David Fineman	I	9,987,871	0	306
William G. Malloy	II	9,987,871	0	306

3. Proposal to increase by 800,000 shares the aggregate number of shares for which stock options may be granted under the Company's 1998 Stock Option and Award Plan.

NUMBER OF SHARES VOTED		
FOR	AGAINST	ABSTAIN
7,547,071	138,682	1,712

4. Ratification of the appointment of Arthur Andersen LLP as the independent auditors and accountants for the Company for the year ending December 31, 2001.

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

NUMBER OF SHARES		
FOR	AGAINST	ABSTAIN
9,974,486	13,860	781

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

- Exhibit 4.1 Certificate of Designations for Series C Preferred Stock of MDI Entertainment (Incorporated by reference to Form 8-K filed May 2, 2001).
- Exhibit 10.1 Stock Purchase Agreement, dated as of April 25, 2001, between MDI Entertainment, Inc. and Oxford International, Inc. (Incorporated by reference to Form 8-K filed May 2, 2001).
- Exhibit 10.2 Agreement, dated July 9, 2001, between MDI Entertainment, Inc and Oxford International, Inc. (Incorporated by reference to Form 8-K filed July 16, 2001).

(b) Reports on Form 8-K

- Filed on May 1, 2001 (Item 5: Other Events-Sale of Series C Preferred Stock to Oxford International, Inc. Oxford International, Inc.).
- Filed on May 2, 2001 (Item 5: Other Events-Stock Purchase Agreement with Oxford International, Inc.).
- Filed on July 16, 2001 (Item 5: Other Events- Amendment of Financing Agreement regarding Oxford International, Inc.).
- Filed on July 24, 2001 (Item 5: Other Events-NASDAQ halts trading of MDI Entertainment, Inc. securities - Press release dated July 19, 2001).
- Filed on July 31, 2001 (Item 5: Other Events- MDI exercises its option to exchange stock it received from Oxford International, Inc. for MDI Stock issued to Oxford; Correction to previously reported date of securities trade halt by

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

NASDAQ).

Filed on August 8, 2001 (Item 5: Other Events- Officer Changes and Filing of Temporary Restraining Order, Preliminary Injunction and Verified Complaint against Oxford International, Inc. and Gregory C. Dutcher).

SIGNATURE PAGE

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 14, 2001

MDI ENTERTAINMENT, INC.

(Registrant)

By: /s/ Steven M. Saferin
Steven M. Saferin
President and Chief Executive
Officer and Director
(Principal Executive Officer)

By: /s/ Kenneth M. Przysiecki
Kenneth M. Przysiecki
Vice President of Accounting and Administration, Secretary and Director
(Principal Financial Officer)

EXHIBIT INDEX

No.	Description
4.1	Certificate of Designations for Series C Preferred Stock of MDI Entertainment (Incorporated by reference to Form 8-K filed May 2, 2001).
10.1	Stock Purchase Agreement, dated April 25, 2001, between MDI Entertainment, Inc. and Oxford International, Inc. (Incorporated by reference to Form 8-K filed May 2, 2001).

Edgar Filing: MDI ENTERTAINMENT INC - Form 10QSB

10.2

Agreement, dated July 9, 2001,
between MDI Entertainment, Inc and
Oxford International, Inc.
(Incorporated by reference to Form
8-K filed July 16, 2001).