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SINGING MACHINE CO INC  
Form 10-Q/A  
March 19, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q/A

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

For the quarterly period ended September 30, 2002

Commission File Number 0-24968

THE SINGING MACHINE COMPANY, INC.  
(Exact Name of Registrant as Specified in its Charter)

Delaware

-----  
(State of Incorporation )

95-3795478

-----  
(IRS Employer I.D. No.)

6601 Lyons Road, Building A-7, Coconut Creek, FL 33073  
(Address of principal executive offices)

(954) 596-1000  
(Registrant's telephone number, including area code)

Indicate 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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate whether the registrant has filed all documents and reports required to be filed by Section 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

APPLICABLE ONLY TO CORPORATE ISSUERS

There were 8,123,303 shares of Common Stock, \$.01 par value, issued and outstanding at September 30, 2002.

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY

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## EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A filed by The Singing Machine Company, Inc. (the "Company") amends the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002.

Subsequent to the filing of such Quarterly Report, Management made the decision to restate our quarterly financial statements for the quarter ended September 30, 2002 to include a provision for income tax expense relating to International SMC (HK) Limited, our Hong Kong subsidiary. In the Form 10-Q that we previously filed for this quarter, we do not include a provision for this income tax, because we believed that International SMC's offshore tax exemption would be approved.

In April 2001, International SMC applied for an offshore tax exemption, based on the locality of profits of the Hong Kong subsidiary. Management believed that the exemption would be approved because the source of all profits of the Hong Kong subsidiary is from exporting to customers outside of Hong Kong. Accordingly, no provision for income taxes was provided in quarterly report for the quarter ended September 30, 2002. Management is continuing its exemption application process. However, due to the extended period of time that the application has been outstanding, as well as management's reassessment of the probability that the application will be approved, management determined to restate the fiscal year 2002 and 2001 consolidated financial statements and certain related quarterly financial statements for fiscal 2002 and 2003 to provide for such taxes.

With regard to United States taxation of foreign income, the Company had originally taken the position that the foreign income of the Hong Kong subsidiary qualified for a deferral under the Internal Revenue Code allowing for such income to be indefinitely deferred and not taxed in the United States until such income is repatriated. Full disclosure of the amount and nature of the indefinite deferral for fiscal year 2002 was reflected in the income tax footnote of the consolidated financial statements for that year. The Internal Revenue Code, regulations and case law regarding international income taxation is quite complex and subject to interpretation. Each case is determined based on the individual facts and circumstances. Due to certain inter-company loans made in 2002 and 2003, the profits previously considered to be indefinitely deferred became partially taxable as "deemed dividends" under section 956 of the Internal Revenue Code. Although certain arguments against the imposition of a "deemed dividend" may be asserted, management has determined to restate the fiscal year 2002 consolidated financial statements based on its reassessment of its original position. The effect of such restatement is to increase income tax expense by \$1,011,628 in fiscal year 2003, which includes the utilization of the foreign tax credits referred to above.

The net effect of the above two adjustments is to decrease net income by \$1,060,257 for the quarter ended September 30, 2002 and \$941,923 for the six months then ended. The net effect on net income per share is to decrease net income per share basic and diluted by \$0.12 and \$0.11, respectively for the six months ended September 30, 2002, and decrease net income per share basic and diluted by \$0.13 and \$0.11, respectively for the quarter ended September 30, 2002.

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THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY  
PART I - FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS

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	September 30, 2002 ----- (restated) (unaudited)	March 31, 2002 ----- (restated)
Assets -----		
Current Assets		
Cash and cash equivalents	\$ 658,436	\$ 5,520,14
Accounts receivable, net	14,383,100	3,536,90
Due from manufacturer	10,767	488,29
Inventories	31,382,386	9,274,35
Prepaid expenses and other current assets	813,130	982,69
Deposits	1,516,666	513,68
	-----	-----
Total Current Assets	48,764,485	20,316,08
	-----	-----
Property and Equipment, Net	1,289,355	574,65
	-----	-----
Other Assets		
Security deposits	150,597	135,62
Reorganization intangible, net	185,416	185,41
Deferred tax asset	191,418	191,41
	-----	-----
Total Other Assets	527,431	512,45
	-----	-----
Total Assets	\$50,581,271	\$21,403,19
	=====	=====
Liabilities and Stockholders' Equity -----		
Current Liabilities		
Accounts payable	\$18,247,003	\$ 1,846,23
Accrued expenses	2,261,136	1,289,59
Loan payable	8,043,272	--
Income tax payable	2,964,958	2,041,92
	-----	-----
Total Current Liabilities	31,516,369	5,177,76
	-----	-----
Stockholders' Equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized, no shares issues and outstanding	--	--
Common stock, Class A, \$0.01 par value, 100,000 shares		

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authorized, no shares issued and outstanding	--	--
Common stock, \$0.01 par value, 18,900,000 shares authorized, 8,123,303 and 8,020,027 shares issued and outstanding	81,233	80,200
Additional paid-in capital	4,753,548	4,602,820
Retained earnings	14,230,121	11,542,400
	-----	-----
Total Stockholders' Equity	19,064,902	16,225,430
	-----	-----
Total Liabilities and Stockholders' Equity	\$50,581,271	\$21,403,190
	=====	=====

See accompanying notes to consolidated financial statements

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THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

(restated)

	Three Months Ended		Six Months
	September 30, 2002	September 30, 2001	September 30, 2002
	-----	-----	-----
Net Sales	\$ 32,976,624	\$ 15,749,241	\$ 37,128,635
Cost of Sales	23,560,826	10,438,974	26,652,358
	-----	-----	-----
Gross Profit	9,415,798	5,310,267	10,476,277
	-----	-----	-----
Operating Expenses			
Compensation	799,406	811,345	1,570,304
Commissions	434,753	341,016	545,421
Advertising	706,845	617,653	872,610
Royalty expense	806,800	281,389	874,630
Selling, general, & administrative expenses	1,764,382	1,018,391	2,985,564
	-----	-----	-----
Total Operating Expenses	4,512,186	3,069,794	6,848,529
	-----	-----	-----
Income from Operations	4,903,612	2,240,473	3,627,748
	-----	-----	-----
Other Income (Expenses)			
Other Income	144,119	125,339	163,564
Interest Expense	(109,344)	(34,465)	(122,509)

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Interest Income	339	28	11,943
	-----	-----	-----
Net Other Expenses	35,114	90,902	52,998
	-----	-----	-----
Income Before Income Tax Provision	4,938,726	2,331,375	3,680,746
Income Tax Provision	1,111,364	505,991	993,030
	-----	-----	-----
Net Income	\$ 3,827,362	\$ 1,825,383	\$ 2,687,716
	=====	=====	=====
Earnings per Share:			
Basic	\$ .47	\$ .27	\$ .33
	=====	=====	=====
Diluted	\$ .44	\$ .23	\$ .30
	=====	=====	=====
Weighted Average Common and Common Equivalent Shares Outstanding:			
Basic	8,119,026	6,775,655	8,090,102
	=====	=====	=====
Diluted	8,881,970	7,984,671	8,899,023
	=====	=====	=====

See accompanying notes to financial statements

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THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

(restated)

Three Months E  
September  
2002

Cash Flow from Operating Activities:

Net Income	\$ 2,687,717
Adjustments to reconcile net income to net cash provided by (used in) operating activities	
Depreciation and amortization	289,134
Stock based expenses	--

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Bad debt	--
Deferred tax benefit	--
Changes in assets and liabilities:	
(Increase) decrease in:	
Accounts receivable	(10,846,197)
Due from manufacturer	477,531
Inventories	(22,108,034)
Prepaid expenses and other assets	154,594
Increase (decrease) in:	
Accounts payable	16,400,765
Accrued expenses	971,539
Income taxes payable	923,029
	-----
Net Cash Provided by (Used in) Operating Activities	(11,049,922)
	-----
Cash Flow from Investing Activities	
Purchase of property and equipment	(1,003,832)
Deposit for credit line	(1,002,982)
Proceeds from investment in factor	--
Proceeds from repayment of officer loans	--
Investment in and advances to unconsolidated subsidiary	--
	-----
Net Cash Provided by (Used in) Investing Activities	(2,006,814)
	-----
Cash Flow from Financing Activities	
Loan proceeds	21,665,040
Loan repayments	(13,621,768)
Proceeds from exercise of stock options and warrants	151,753
	-----
Net Cash Provided by (Used in) Financing Activities	8,195,025
	-----
Increase in Cash and Cash Equivalents	(4,861,711)
Cash and Cash Equivalents - Beginning of Period	5,520,147
	-----
Cash and Cash Equivalents - End of Year	\$ 658,436
	=====
Supplemental Disclosures of Cash Flow Information:	
Cash paid during the period for interest	\$ 57,383
	=====
Cash paid during the year for income taxes	\$ 51,107
	=====

See accompanying notes to consolidated financial statements

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### RESTATEMENT OF FINANCIAL STATEMENTS

-----

Subsequent to the filing of such Quarterly Report, Management made the decision to restate our quarterly financial statements for the quarter ended September 30, 2002 to include a provision for income tax expense relating to International SMC (HK) Limited, our Hong Kong subsidiary. In the Form 10-Q that we previously filed for this quarter, we do not include a provision for this income tax, because we believed that International SMC `s offshore tax exemption would be approved.

In April 2001, International SMC applied for an offshore tax exemption, based on the locality of profits of the Hong Kong subsidiary. Management believed that the exemption would be approved because the source of all profits of the Hong Kong subsidiary is from exporting to customers outside of Hong Kong. Accordingly, no provision for income taxes was provided in quarterly report for the quarter ended September 30, 2002. Management is continuing its exemption application process. However, due to the extended period of time that the application has been outstanding, as well as management's reassessment of the probability that the application will be approved, management determined to restate the fiscal year 2002 and 2001 consolidated financial statements and certain related quarterly financial statements for fiscal 2002 and 2003 to provide for such taxes.

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The net effect of the above two adjustments is to decrease net income by \$1,060,257 for the quarter ended September 30, 2002 and \$941,923 for the six months then ended. The net effect on net income per share is to decrease net income per share basic and diluted by \$0.12 and \$0.11, respectively for the six months ended September 30, 2002, and decrease net income per share basic and diluted by \$0.13 and \$0.11, respectively for the quarter ended September 30, 2002.

#### NOTE 1 - BASIS OF PRESENTATION

The accompanying consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and, therefore, omit or condense certain footnotes and other information normally included in financial statements prepared in accordance with generally accepted accounting principles. It is suggested that these consolidated condensed financial statements should be read in conjunction with the Company's consolidated



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financial statements and notes thereto included in the Company's audited financial statements on the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2002.

The accounting policies followed for interim financial reporting are the same as those disclosed in Note 1 of the Notes to Financial Statements included in the Company's audited consolidated financial statements for the fiscal year ended March 31, 2002, which are included in Form 10- KSB.

The Financial Accounting Standards Board has recently issued several new accounting pronouncements which may apply to the Company.

The following statements have been adopted by the Company.

Statement No. 141 "Business Combinations" establishes revised standards for accounting for business combinations. Specifically, the statement eliminates the pooling method, provides new guidance for recognizing intangible assets arising in a business combination, and calls for disclosure of considerably more information about a business combination. This statement is effective for business combinations initiated on or after July 1, 2001. The adoption of this pronouncement on July 1, 2001 did not have a material effect on the Company's financial position, results of operations or liquidity.

Statement No. 142 "Goodwill and Other Intangible Assets" provides new guidance concerning the accounting for the acquisition of intangibles, except those acquired in a business combination, which is subject to SFAS 141, and the manner

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in which intangibles and goodwill should be accounted for subsequent to their initial recognition. Generally, intangible assets with indefinite lives, and goodwill, are no longer amortized; they are carried at lower of cost or market and subject to annual impairment evaluation, or interim impairment evaluation if an interim triggering event occurs, using a new fair market value method. Intangible assets with finite lives are amortized over those lives, with no stipulated maximum, and an impairment test is performed only when a triggering event occurs. This statement is effective for all fiscal years beginning after December 15, 2001. The Company adopted SFAS 142 on April 1, 2002 liquidity.and accordingly has stopped amortizing the reorganization intangible, which had a net balance of \$185,412 at March 31, 2002.

Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" supercedes Statement No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121"). Though it retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss, SFAS 144 provides additional implementation guidance. SFAS 144 excludes goodwill and intangibles not being amortized among other exclusions. SFAS 144 also supercedes the provisions of APB 30, "Reporting the Results of Operations," pertaining to discontinued operations. Separate reporting of a discontinued operation is still required, but SFAS 144 expands the presentation to include a component of an entity, rather than strictly a business segment as defined in SFAS 131, Disclosures about Segments of an Enterprise and Related Information. SFAS 144 also eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. This statement is effective for all fiscal years beginning after December 15, 2001. The implementation of SFAS 144 on April 1, 2002 did not have a material effect on the Company's financial position, results of operations or liquidity.

Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment

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of FASB Statement No. 13, and Technical Corrections," updates, clarifies, and simplifies existing accounting pronouncements. Statement No. 145 rescinds Statement 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses. Statement 64 amended Statement 4, and is no longer necessary because Statement 4 has been rescinded. Statement 44 was issued to establish accounting requirements for the effects of transition to the provisions of the motor Carrier Act of 1980. Because the transaction has been completed, Statement 44 is no longer necessary. Statement 145 amends Statement 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. This amendment is consistent with FASB's goal requiring similar accounting treatment for transactions that have similar economic effects. The adoption of SFAS No. 145 did not have a material impact on the Company's consolidated financial statements.

The following statements will be adopted by the Company as they become effective.

Statement No. 143, "Accounting for Asset Retirement Obligations," requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 is not expected to have a material impact on the Company's financial statements.

Statement No. 146, "Accounting for Exit or Disposal Activities" ("SFAS 146") addresses the recognition, measurement, and reporting of cost that are associated with exit and disposal activities that are currently accounted for pursuant to the guidelines set forth in EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to exit an Activity (including Certain Cost Incurred in a Restructuring)," cost related to terminating a contract that is not a capital lease and one-time benefit arrangements received by employees who are involuntarily terminated - nullifying the guidance under EITF 94-3. Under SFAS 146, the cost associated with an exit or disposal activity is recognized in the periods in which it is incurred rather than at the date the Company committed to the exit plan. This statement is effective for exit or disposal activities initiated after December 31, 2002 with earlier application encouraged. The adoption of SFAS 146 is not expected to have a material impact on the Company's financial position or result of operations.

Certain amounts in the September 30, 2001 interim consolidated financial statements have been reclassified to conform to the September 30, 2002 presentation.

In the opinion of management, all adjustments which are of a normal recurring nature and considered necessary to present fairly the financial positions, results of operations, and cash flows for all periods presented have been made.

The results of operations for the three month period ended September 30, 2002 are not necessarily indicative of the results that may be expected for the entire fiscal year ending March 31, 2003.

The accompanying consolidated condensed financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant inter-company balances and transactions have been eliminated. Assets and

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liabilities of the foreign subsidiary are translated at the rate of exchange in effect at the balance sheet date; income and expenses are translated at the average rates of exchange prevailing during the year. The related translation adjustment is not material.

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### NOTE 2 - DEPOSIT FOR LETTER OF CREDIT FACILITY

The Company, through its Hong Kong subsidiary, maintains letter of credit facilities with two major international banks. The Company's subsidiary is required to maintain separate deposit accounts at these banks in the amount of \$1,516,666. This amount is included in deposits at September 30, 2002.

### NOTE 3 - LOANS AND LETTERS OF CREDIT

In August 2002, the Company amended its Loan and Security Agreement (the "Agreement" or "credit facility") with a commercial lender (the "Lender").

The Lender will advance up to 70% of the Company's eligible accounts receivable, plus up to 40% of the eligible inventory, plus up to 40% of the commercial letters of credit opened for the purchase of eligible inventory, less reserves of up to \$1,000,000 as defined in the Agreement.

The outstanding loan limit varies between zero and \$25,000,000 depending on the time of year, as stipulated in the Agreement. The credit facility also provides the Company with the ability to obtain commercial letters of credit of up to \$2,500,000, which reduces the loan limits set forth above. The loans bear interest at the commercial lender's prime rate plus 0.5% and an annual fee equal to 1% of the maximum loan amount, which is \$250,000. The term of the credit facility expires on April 26, 2004 and is automatically renewable for one-year terms. All amounts under the credit facility are due within 90 days of demand. The loans are secured by a first lien on all present and future assets of the Company except for certain tooling located at a vendor in China.

The Agreement contains a financial covenant stipulating a minimum tangible net worth of \$14,250,000 from September 30, 2002 to October 30, 2002 with escalations after this point as defined in the Agreement.

The outstanding balance under the credit facility at September 30, 2002, was \$8,043,272.

### NOTE 4 - EQUITY

Stock options and warrants were exercised during the second quarter of fiscal year 2003. 34,350 shares of common stock were issued with proceeds to the Company of \$70,074. The total of stock options and warrants exercised for the six month period ended September 30, 2002 were 103,350 shares with a total proceeds to the Company of \$151,859.

On August 15, 2002, 50,000 stock options were granted at the then current stock price of \$8.61 to our executive vice president of sales and marketing as per his employment contract. On September 11, 2002, the outside directors of the Company were each issued 30,000 common stock options (90,000 options total) at the then current stock price of \$11.09. Pursuant to APB no. 25, no compensation expense will be recognized.

### NOTE 5 - COMMITMENTS

On April 15, 2002, the Company entered into a three-year employment agreement with a new Executive Vice President of Sales and Marketing. The agreement

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provides for a salary and bonuses and a 50% of annual pay severance clause. The agreement grants 50,000 options to the employee. After his first year of employment, the employee may elect to return the first year options to the Company or one of its representatives for \$100,000.

In June 2002, the Board of Directors approved the terms of a consulting agreement effective on February 28, 2003 with the current CEO when he retires on that day. The CEO will receive \$250,000 per year and will also receive an appreciation bonus of \$200,000 on February 28, 2003.

In May and June 2002, the Company's subsidiary entered into new office leases in Hong Kong, each for 36 months at an aggregate \$13,364 per month.

Effective May 1, 2002, the Company signed a 5-year warehouse lease in California for \$33,970 per month. The Company also subleased out its space in the other California warehouse for rent income of \$12,393 per month through January 31, 2004.

Effective June 1, 2002, the Company signed an additional 27-month lease to expand its corporate headquarters. The additional rent is \$1,987 per month.

The Company entered into an agreement with a retail customer whereby they guaranteed the customer a minimum gross margin of \$3,573,000 from the sale of the Company's products during the period from September 1, 2002 through January 15, 2003. Under the agreement, the Company will reimburse the customer for the difference between the customer's gross margin on sales and the minimum guarantee. The inventory is being held by the customer on a consignment basis. The Company would have a total exposure of \$3,537,000, in the event that there were no sales of the Company's products made by the retail customer during this period.

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Effective September 1, 2002, the Company signed an additional 24 month lease to expand its corporate headquarters. The additional rent is \$1,980 per month.

### NOTE 6 - CONCENTRATIONS

The Company derives the majority of its revenues from retailers of products in the United States. Financial instruments, which potentially subject the Company to concentrations of credit risk, consist of accounts receivable. The Company's allowance for doubtful accounts is based upon management's estimates and historical experience and reflects the fact that accounts receivable are concentrated with several large customers whose credit worthiness have been evaluated by management. At September 30, 2002, 51.8% of accounts receivable were due from three U.S. customers and two foreign customers. Accounts receivable from three customers that individually owed over 10% of accounts receivable at September 30, 2002 was 12.9%, 11.0% and 10.3%. The Company performs ongoing credit evaluations of its customers and generally does not require collateral.

Revenues derived from five customers for the six months ended September 30, 2002 and 2001 were 69.4% and 94%. Revenues derived from two customers for the six months ended September 30, 2002 and 2001, respectively, which individually purchased greater than 10% of the Company's total revenues, were 32% and 11% for the six months ended September 30, 2002 and 79% and 32% for the six months ended September 30, 2001.

In the fourth quarter of fiscal 2002, a major customer that provided 37% of the Company's revenue in 2002 converted its purchase method to a consignee basis. The Company recorded approximately \$2,875,000 of sales returns and reversal of

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related cost of sales of \$2,112,000 in the fourth quarter of fiscal 2002 and the customer retained the inventory on a consignment basis. As of September 30, 2002 this customer was still on a consignment basis with all but two products.

The Company is dependent upon foreign companies for manufacture of all of its electronic products. The Company's arrangements with manufacturers are subject to the risk of doing business abroad, such as import duties, trade restrictions, work stoppages, foreign currency fluctuations, political instability, and other factors, which could have an adverse impact on its business. The Company believes that the loss of any one or more of their suppliers would not have a long-term material adverse effect because other manufacturers with whom the Company does business would be able to increase production to fulfill their requirements. However, the loss of certain suppliers in the short-term could adversely affect business until alternative supply arrangements are secured.

During fiscal 2002 and 2001, manufacturers in the People's Republic of China (China) accounted for in excess of 95% and 94%, respectively of the Company's total product purchases, including virtually all of the Company's hardware purchases. The Company expects purchasing for 2003 to fall within the above range as well.

Purchases of products derived from three factories based in China during fiscal 2002 were 51%, 39%, and 5% and from two manufacturers based in China during fiscal 2001 were 80% and 14%, respectively. For the six months ended September 30, 2002, purchases of product were derived from seven factories based in China.

The Company finances its sales primarily through a credit facility with one lender. Although management believes there are other sources available, a loss of the current credit facility could be in the short term, adversely affect operations until an alternate lending arrangement is secured.

Net sales derived from the Company's Hong Kong based subsidiary aggregated approximately \$29,322,407 for the six months ended September 30, 2002 and \$17,654,747 for the same period in 2001. The carrying value of net assets held by the Company's Hong Kong based subsidiary was approximately \$12,454,151 at September 30, 2002.

### NOTE 7 - EARNINGS PER SHARE

Basic net income (loss) per common share (Basic EPS) excludes dilution and is computed by dividing net income (loss) available to common stockholder by the weighted-average number of common shares outstanding for the period. Diluted net income per share (Diluted EPS) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. At September 30, 2002 there were 1,101,125 common stock equivalents outstanding which may dilute future earnings per share.

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### NOTE 8 - SEGMENTS

The Company operates in one segment and maintains its records accordingly. Sales by customer geographic region were as follows:

	September 30,	
	2002	2001
-----		-----

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United States	\$29,450,108	\$21,241,045
Asia	--	24,657
Australia	242,652	--
Canada	19,921	2,250
Central America	68,673	4,789
Europe	6,800,801	--
Mexico	546,480	--
South America	--	110
	-----	-----
	\$37,128,635	\$21,272,851
	=====	=====

### NOTE 9 - SUBSEQUENT EVENTS

On November 4, 2002, a customer that provided 5% of the Company's revenue for the six months ended September 30, 2002 converted its purchase method to a consignee basis. The Company recorded approximately \$858,839 of sales returns and reversal of related cost of sales of \$641,285 in September and the customer retained the inventory on a consignment basis. This agreement is effective as of October 30, 2002. No future shipments to this customer will be included in this consignment agreement.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A filed by The Singing Machine Company, Inc. (the "Company") amends the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002.

Subsequent to the filing of such Quarterly Report, Management made the decision to restate our quarterly financial statements for the quarter ended September 30, 2002 to include a provision for income tax expense relating to International SMC (HK) Limited, our Hong Kong subsidiary. In the Form 10-Q that we previously filed for this quarter, we do not include a provision for this income tax, because we believed that International SMC's offshore tax exemption would be approved.

In April 2001, International SMC applied for an offshore tax exemption, based on the locality of profits of the Hong Kong subsidiary. Management believed that the exemption would be approved because the source of all profits of the Hong Kong subsidiary is from exporting to customers outside of Hong Kong. Accordingly, no provision for income taxes was provided in quarterly report for the quarter ended September 30, 2002. Management is continuing its exemption application process. However, due to the extended period of time that the application has been outstanding, as well as management's reassessment of the probability that the application will be approved, management determined to restate the fiscal year 2002 and 2001 consolidated financial statements and certain related quarterly financial statements for fiscal 2002 and 2003 to provide for such taxes.

With regard to United States taxation of foreign income, the Company had originally taken the position that the foreign income of the Hong Kong subsidiary qualified for a deferral under the Internal Revenue Code allowing for

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such income to be indefinitely deferred and not taxed in the United States until such income is repatriated. Full disclosure of the amount and nature of the indefinite deferral for fiscal year 2002 was reflected in the income tax footnote of the consolidated financial statements for that year. The Internal Revenue Code, regulations and case law regarding international income taxation is quite complex and subject to interpretation. Each case is determined based on the individual facts and circumstances. Due to certain inter-company loans made in 2002 and 2003, the profits previously considered to be indefinitely deferred became partially taxable as "deemed dividends" under section 956 of the Internal Revenue Code. Although certain arguments against the imposition of a "deemed dividend" may be asserted, management has determined to restate the fiscal year 2002 consolidated financial statements based on its reassessment of its original position. The effect of such restatement is to increase income tax expense by \$1,011,628 in fiscal year 2003, which includes the utilization of the foreign tax credits referred to above.

The net effect of the above two adjustments is to decrease net income by \$1,060,257 for the quarter ended September 30, 2002 and \$941,923 for the six months then ended. The net effect on net income per share is to decrease net income per share basic and diluted by \$0.12 and \$0.11, respectively for the six months ended September 30, 2002, and decrease net income per share basic and diluted by \$0.13 and \$0.11, respectively for the quarter ended September 30, 2002.

### FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q, including without limitation, statements containing the words believes, anticipates, estimates, expects, and words of similar import, constitute forward-looking statements. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the Securities and Exchange Commission.

Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements.

### GENERAL

The Singing Machine Company, Inc. and its wholly owned subsidiary, International (SMC) HK, Ltd. (the "Company", "we" or "us") engages in the production, distribution, marketing and sale of consumer karaoke audio equipment, accessories and music. Our electronic karaoke machines and audio software products are marketed under The Singing Machine(R) trademark.

Our products are sold throughout the United States, primarily through department stores, lifestyle merchants, mass merchandisers, direct mail catalogs and showrooms, music and record stores, national chains, specialty stores and warehouse clubs.

Our karaoke machines and karaoke software are currently sold in such retail outlets as Best Buy, Toys R Us, Target, J.C. Penney and Circuit City.

We had net income of \$3,629,639 for the six month period ended September 30, 2002. Our working capital as of September 30, 2002, was \$20,173,425.

RESULTS OF OPERATIONS

REVENUES

Revenues for the three months ended September 30, 2002 were \$32,976,624, compared to revenues of \$15,749,241 for the three months ended September 30, 2001. Revenues for the six months ended September 30, 2002 and 2001 were \$37,128,635 and \$21,272,851, respectively. Our revenue increase is due not only to increased sales to our historical customer base, but also to the addition of new customers. Our new customers include Circuit City and K-Mart.

GROSS PROFIT

Gross profit for the three-month period ended September 30, 2002 was \$9,415,798 or 28.6% of sales compared with \$5,310,267 or 33.7% of sales for the second quarter of the prior year. Gross profit for the six months ended September 30, 2002 was \$10,476,277 or 28.2% of sales compared with \$7,171,322 or 33.7% of sales for the six months ended September 30, 2001. The decrease in gross profit is primarily due to increased sales from our subsidiary and sales to international customers. Sales to international customers historically maintain a lower gross profit, but there are no other variable expenses from these sales. Other variable expenses that are normally included with sales are advertising allowances, returns and commissions.

OPERATING EXPENSES

Operating expenses were \$4,512,186 or 13.7% of total revenues, in the second quarter, up from \$3,069,794 or 19.5% of total revenues, in the second quarter of the prior year. For the six months ended September 30, 2002 and 2001, operating expenses were \$6,848,529 or 18.4% and \$4,877,849 or 22.9%, respectively. Although operating expenses increased in dollar value, as compared to revenues, they decreased materially as a percentage of sales.

The primary factors that contributed to the increase in operating expenses for the six months ended September 30, 2002 are:

- (i) the increase in depreciation in the amount of \$186,170 due to the addition of molds for new product additions for fiscal year 2003,
- (ii) compensation expense in the amount of \$299,347 due to the addition of key personnel both here and at our Hong Kong subsidiary,
- (iii) expansion of the California warehouse and its associated expenses in the amount of \$241,648,
- (iv) expansion of the Hong Kong subsidiary and its related expenses in the amount of \$367,218.

Other increases in operating expenses were to selling expenses, which are considered variable. These expenses are based directly on the level of sales and include: commissions, direct advertising, and royalty expenses. These areas alone contributed \$643,355 to the increase in operating expenses.

DEPRECIATION AND AMORTIZATION EXPENSES

The Company's depreciation and amortization expenses were \$300,863 or .8 % of total revenues for the six months ended September 30, 2002, up from \$114,693 or .5% for the six months ended September 30, 2001. The increase in depreciation and amortization expenses can be attributed to the Company's acquisition of new molds and tooling for our expanded product line.



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### OTHER INCOME AND EXPENSES

Other income net of other expenses was \$35,114, for the second quarter of fiscal 2003 and \$52,998 for the six months ended September 30, 2002. We generated income of approximately \$111,841 from royalty payments received in Hong Kong for the use of Company owned mold by third parties during the first six months of fiscal 2003 compared with income of approximately \$93,904 during the same period of fiscal 2002. Our interest expense decreased for the six months ended September 30, 2002 as compared to the same period of the prior year primarily due to the decreased level of borrowing required under our credit facility with LaSalle during this period at a significantly lower prime rate. Prior to August 2002, the Company had cash reserves to fund operations and did not need to borrow on the line. Our interest income increased from \$2,475 during the six months ended September 30, 2001, to \$11,943 during the first six months of fiscal 2003 because we earned income on our cash balances held by our lender by investing in 24 hour commercial paper investments.

### INCOME BEFORE INCOME TAX EXPENSE

The Company's net income before income taxes was \$3,680,746 for the six months ended September 30, 2002 compared with \$2,304,968 for the same period of the prior year.

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### INCOME TAX EXPENSE

The Company files separate tax returns for the parent and for the Hong Kong Subsidiary.

During the second quarter of fiscal 2003, the Company showed a loss in the U.S. parent company, and a profit in International SMC (HK) Ltd., its wholly-owned Hong Kong subsidiary. As a result of this, the accrual for income tax included the estimate for "deemed dividend" tax in the U.S.A., \$285,403, and a provision for income tax for the subsidiary income, \$774,854.

In April 2001, International SMC applied for an offshore tax exemption, based on the locality of profits of the Hong Kong subsidiary. Management believed that the exemption would be approved because the source of all profits of the Hong Kong subsidiary is from exporting to customers outside of Hong Kong. Accordingly, no provision for income taxes was provided in quarterly report for the quarter ended September 30, 2002. Management is continuing its exemption application process. However, due to the extended period of time that the application has been outstanding, as well as management's reassessment of the probability that the application will be approved, management determined to restate the fiscal year 2002 and 2001 consolidated financial statements and certain related quarterly financial statements for fiscal 2002 and 2003 to provide for such taxes.

With regard to United States taxation of foreign income, the Company had originally taken the position that the foreign income of the Hong Kong subsidiary qualified for a deferral under the Internal Revenue Code allowing for such income to be indefinitely deferred and not taxed in the United States until such income is repatriated. Full disclosure of the amount and nature of the indefinite deferral for fiscal year 2002 was reflected in the income tax footnote of the consolidated financial statements for that year. The Internal Revenue Code, regulations and case law regarding international income taxation is quite complex and subject to interpretation. Each case is determined based on the individual facts and circumstances. Due to certain inter-company loans made in 2002 and 2003, the profits previously considered to be indefinitely deferred

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became partially taxable as "deemed dividends" under section 956 of the Internal Revenue Code. Although certain arguments against the imposition of a "deemed dividend" may be asserted, management has determined to restate the fiscal year 2002 consolidated financial statements based on its reassessment of its original position. The effect of such restatement is to increase income tax expense by \$1,006,979 for the six months ended September 30, 2002, which includes the utilization of the foreign tax credits referred to above.

### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2002, the Company had cash on hand of \$658,436 compared to \$5,520,147 at March 31, 2002. The decreased cash is a direct result of purchasing inventory. At September 30, 2002, the Company had current assets of \$48,764,485 and total assets of \$50,842,526 compared to current assets of \$20,316,081 and total assets of \$21,664,451 at March 31, 2002. The increase in current assets is the result of increased accounts receivable and inventory to support sales for the second and third quarter of fiscal 2003. The increase in total assets is due to the increase in accounts receivable, inventory and fixed assets.

Current liabilities increased to \$28,591,060 as of September 30, 2002, compared to \$3,194,377 at March 31, 2002. This increase in current liabilities is primarily due to increased accounts payable for inventory purchases. At September 30, 2002, the balance of the credit facility with LaSalle Business Credit was \$8,043,272.

The Company's stockholders' equity increased to \$22,251,466 as of September 30, 2002 from \$18,470,074 as of March 31, 2002, due primarily to the net income for the quarter.

Cash flows used in operating activities were \$11,049,922 during the six months ended September 30, 2002. Cash flows were used in operating activities primarily due to the increase in inventory in the amount of \$22,108,034, accounts receivable in the amount of \$10,846,197 and an income tax payable accrual of \$18,893. Cash flows were provided by operating activities due to the increase in accrued expenses in the amount of \$971,539, an increase in accounts payable in the amount of \$16,400,765, a decrease in amounts due from a manufacturer in the amount of \$477,531 and a decrease in prepaid expenses and other assets in the amount of 154,594. The increased inventory was partially offset by the increase in accounts payable which funded this inventory.

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Cash used in investing activities during the six months ended September 30, 2002 was \$2,006,814. Cash used in investing activities resulted primarily from the payment of fixed deposits for letter of credit facilities in the amount of \$1,002,982 and the purchase of fixed assets of \$1,003,832. The purchase of fixed assets consists primarily of the tooling and molds required for production of new machines for this fiscal year. Tooling and molds are depreciated over a three year period.

Cash flows provided by financing activities were \$8,195,025 during the six months ended September 30, 2002. This consisted of proceeds from the exercise of warrants and options in the amount of \$151,753. The remainder of cash provided from financing activities was provided by net borrowings on the credit line at LaSalle National Bank in the amount of \$8,043,272.

The Company expects that its capital needs will increase during fiscal 2003. Our capital needs stem primarily from our need to purchase sufficient levels of

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inventory for the Christmas season. Our principal sources of capital in the next twelve months include our operating cash flows, borrowings under our credit facility with LaSalle and advances made under three letters of credit issued to our factories. Our credit facility with LaSalle has been amended to provide us with up to \$25 million in financing depending upon the time of the year. We believe this will help us to meet our capital needs for fiscal 2003.

We entered into a credit facility with LaSalle in April 2001. This facility was amended in August of 2002. Under this credit facility, LaSalle will advance up to 70% of the Company's eligible accounts receivable, plus up to 40% of eligible inventory, plus up to 40% of commercial letters of credit issued by LaSalle minus reserves as set forth in the loan documents. The credit facility is subject to loan limits from zero to \$25,000,000 depending on the time of the year, as stipulated in the loan documents. Advances made under the credit facility bear interest at LaSalle's prime rate plus .5%. There is also an annual fee of 1% of the loan maximum, or \$250,000. The credit facility expires on April 26, 2004 and is automatically renewable for one-year terms thereafter. Under the terms of the credit facility, the Company is required to maintain certain financial ratios and conditions. The loan contains a clean up period every 12 months where the loan amount must go to zero for a period of time. The loan is secured by a first lien on all present and future assets of the Company, except certain tooling located in China.

Our Hong Kong subsidiary, International SMC, maintains a letter of credit facility with the Hong Kong Shanghai Banking Corporation ("HSBC"). The facility requires International SMC to maintain a separate deposit account in the amount of \$516,666. The facility also required a \$1,000,000 deposit to be restricted in our regular operating account. This amount is included in deposits at September 30, 2002. During April and May 2002, HSBC agreed to issue International SMC two documentary letters of credit to finance its purchases of karaoke machines from our factories. One letter of credit provides for advances of up to \$200,000 per draw, provided that the total drawings do not exceed \$2 million. The other letter of credit is for \$1 million. These letters of credit expire on December 21, 2002 and November 30, 2002, respectively and our factories are the beneficiaries. In June 2002, International SMC obtained a \$1 million documentary letter of credit from Fortis Bank, formerly known as Belgian Bank, Hong Kong, a subsidiary of Generale Bank, Belgium. This letter of credit expires on December 6, 2002 and one of our factories is the beneficiary.

International SMC also has use of a \$500,000 credit facility from Fortis Bank. This facility is a revolving line based upon drawing down a maximum of 15% of the value of export letters of credit held by Fortis Bank. There is no maturity date except that Fortis Bank reserves the right to revise the terms and conditions at the Bank's discretion. The cost of this credit facility is the U.S. Dollar prime rate plus 1.25%. Repayment of principal plus interest shall be made upon negotiation of the export letters of credit, but not later than ninety (90) days after the advance. This credit facility is not currently in use.

In the fourth quarter of fiscal 2002, a major customer that provided 37% of the Company's revenue in 2002 converted its purchase method to a consignee basis. The Company recorded approximately \$2,875,000 of sales returns and reversal of related cost of sales of \$2,112,000 in the fourth quarter of fiscal 2002 and the customer retained the inventory on a consignment basis. As of September 30, 2002 this customer was still on a consignment basis with all but two products. As of February 28, 2003, we expect that this consignment agreement will only apply to the Company's music products and will exclude all of the Company's karaoke machines.

The Company entered into an agreement with a retail customer in April 2002, which was amended in July 2002, whereby it guaranteed the customer a minimum gross margin of \$3,573,000 from the sale of the Company's products during the period from September 1, 2002 through January 1, 2003. Under this agreement, the

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Company will reimburse the customer for the difference between the customer's gross margin on sales and the minimum guarantee. Accordingly, the maximum amount the Company may be committed to pay is \$3,537,000. The Company would have a total exposure of \$3,537,000, in the event that there were no sales of the Company's products made by the retail customer during this period. The inventory held by the customer is on a consignment basis. In September 2002, the customer provided the Company with initial sell through statistics on its products. Based on this information received, the Company intends to renegotiate this agreement and believes that based on the renegotiation, there will be no material impact to the Company. However, if the Company is not able to renegotiate this agreement, the Company's total exposure under this agreement would be a maximum of \$3,537,000.

On November 4, 2002, a customer that provided 5% of the Company's revenue for the six months ended September 30, 2002 converted its purchase method to a

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consignee basis. The Company recorded approximately \$858,839 of sales returns and reversal of related cost of sales of \$641,285 in September and the customer retained the inventory on a consignment basis. No future shipments to this customer will be included in this consignment agreement. This agreement expires on February 1, 2003. The Company does not believe that this agreement will have a material effect on the Company.

As of September 30, 2002, we do not have any material commitments for capital expenditures, other than (i) our obligation to make certain guaranteed minimum royalty payments in the amount of \$450,000 under our licensing agreement with Nickelodeon, (ii) our lease for our warehouse space in California and (iii) our purchases of inventory from certain factories in China. We also have contractual obligations under our real estates leases in Florida, Hong Kong and California. Except for the foregoing, we do not have any present commitment that is likely to result in our liquidity increasing or decreasing in any material way. In addition, except for the Company's need for additional capital to finance inventory purchases, the Company knows of no trend, additional demand, event or uncertainty that will result in, or that is reasonably likely to result in, the Company's liquidity increasing or decreasing in any material way.

### SEASONAL AND QUARTERLY RESULTS

Historically, the Company's operations have been seasonal, with the highest net sales occurring in the second and third quarters (reflecting increased orders for equipment and music merchandise during the Christmas selling months) and to a lesser extent the first and fourth quarters of the fiscal year.

The Company's results of operations may also fluctuate from quarter to quarter as a result of the amount and timing of orders placed and shipped to customers, as well as other factors. The fulfillment of orders can therefore significantly affect results of operations on a quarter-to-quarter basis.

### INFLATION

Inflation has not had a significant impact on the Company's operations. The Company has historically passed any price increases on to its customers since prices charged by the Company are generally not fixed by long-term contracts.

### CRITICAL ACCOUNTING POLICIES

The U.S. Securities and Exchange Commission defines critical accounting policies as "those that are both most important to the portrayal of a company's financial

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condition and results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain". Preparation of our financial statements involves the application of several such policies. These policies include: estimates of accruals for product returns, the realizability of the deferred tax asset, calculation of our allowance for doubtful accounts and the Hong Kong income tax exemption.

Accrual for product returns. We regularly receive requests from our customers for product returns. Our accrual amount is based on historical experience and is recorded as a reduction of sales and costs of sales and as a liability equal to the resulting gross profit on the estimated returns. At September 30, 2002, the accrual was approximately \$802,213.

Realizability of Deferred Tax Asset. We eliminated our valuation allowance on the deferred tax asset since we determined that it is more likely than not that the deferred tax asset will be realized.

Estimate for Doubtful Accounts. We estimate an allowance for doubtful accounts using the specific identification method since a majority of accounts receivable are concentrated with several customers whose credit worthiness is evaluated periodically by us. The allowance was \$0 at September 30, 2002.

Hong Kong Income Tax Exemption. We estimated that the Hong Kong income tax to be zero based on our assessment of the probability that the application for the Hong Kong income tax exemption would be approved.

In addition to the above policies, several other policies, including policies governing the timing of revenue recognition, are important to the preparation of our financial statements, but do not meet the definition of critical accounting policies because they do not involve subjective or complex judgments.

### RISK FACTORS

Set forth below and elsewhere in this Quarterly Report on Form 10-Q and in the other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward looking statements contained in this Annual Report.

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### FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF STOCK

#### WE RELY ON SALES TO A LIMITED NUMBER OF KEY CUSTOMERS WHICH ACCOUNT FOR A LARGE PORTION OF OUR NET SALES

As a percentage of total revenues, our net sales to our five largest customers during the fiscal period ended September 30, 2002 and 2001 were approximately 69.4% and 94% respectively. In the second quarter of fiscal 2003, two major customers accounted for 42.1% and 16.9% of our net sales. Although we have long-established relationships with many of our customers, we do not have long-term contractual arrangements with any of them. A substantial reduction in or termination of orders from any of our largest customers could adversely affect our business, financial condition and results of operations. In addition, pressure by large customers seeking price reductions, financial incentives, changes in other terms of sale or requesting that we bear the risks and the cost of carrying inventory, such as consignment agreements, could adversely affect our business, financial condition and results of operations. The Company has significantly broadened its base of customers, decreasing the amount of reliance on their largest customers. If one or more of our major customers were to cease doing business with us, significantly reduced the amount of their purchases from

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us or returned substantial amounts of our products, it could have a material adverse effect on our business, financial condition and results of operations.

### OUR LICENSING AGREEMENT WITH MTV IS IMPORTANT TO OUR BUSINESS

We generated \$23,354,270, or 37.8% of our net sales, in fiscal 2002 from our sales of MTV licensed merchandise. Management values this license with MTV and desires to continue this licensing relationship. If the MTV license were to be terminated or failed to be renewed, our business, financial condition and results of operations could be adversely affected. However, management believes that our company has developed a strong brand name in the karaoke industry and that it will be able to continue to develop and grow its business, even if the MTV licensing relationship did not exist. The Company and MTV are currently negotiating an extension of this agreement.

### INVENTORY MANAGEMENT AND CONSIGNMENT AGREEMENTS

Because of our reliance on manufacturers in the Far East, our production lead times are relatively long. Therefore, we must commit to production in advance of customers orders. If we fail to forecast customers or consumer demand accurately we may encounter difficulties in filling customer orders or liquidating excess inventories, or may find that customers are canceling orders or returning products. Distribution difficulties may have an adverse effect on our business by increasing the amount of inventory and the cost of storing inventory. As of September 30, 2002, we have entered into consignment agreements with three of our customers. Additionally, changes in retailer inventory management strategies could make inventory management more difficult. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

### OUR INABILITY TO COMPETE AND MAINTAIN OUR NICHE IN THE ENTERTAINMENT INDUSTRY COULD HURT OUR BUSINESS

The business in which we are engaged is highly competitive. Our major competitors for karaoke machines and related products are Grand Prix, JVC, Memorex and Pioneer Corp. We believe that competition for karaoke machines is based primarily on price, product features, reputation, delivery times, and customer support. Our primary competitors for producing karaoke music are Pocket Songs and Sound Choice. We believe that competition for karaoke music is based primarily on popularity of song titles, price, reputation, and delivery times.

We believe that our new product introductions and enhancements of existing products are material factors for our continued growth and profitability. In fiscal 2002, we produced 6 new karaoke machines. However, many of our competitors are substantially larger and have significantly greater financial, marketing and operating resources than we have. No assurance can be given that we will continue to be successful in introducing new products or further enhancing our existing products.

In addition, we must compete with all the other existing forms of entertainment including, but not limited to: motion pictures, video arcade games, home video games, theme parks, nightclubs, television and prerecorded tapes, CD's and video cassettes.

### WE ARE SUBJECT TO SEASONALITY, WHICH IS AFFECTED BY VARIOUS ECONOMIC CONDITIONS AND CHANGES RESULTING IN FLUCTUATIONS IN QUARTERLY RESULTS

Sales of consumer electronics and toy products in the retail channel are highly seasonal, causing the substantial majority of our sales to occur during the second quarter ended September 30 and the third quarter ended December 31. Sales in our second and third quarter, combined, accounted for approximately 81% of net sales in fiscal 2002 and 75% of net sales in fiscal 2001.

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The seasonal pattern of sales in the retail channel requires significant use of our working capital to manufacture and carry inventory in anticipation of the holiday season, as well as early and accurate forecasting of holiday sales. Failure to predict accurately and respond appropriately to consumer demand on a timely basis to meet seasonal fluctuations, or any disruption of consumer buying habits during their key period, would harm our business and operating results.

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Additional factors that can cause our sales and operating results to vary significantly from period to period include, among others, the mix of products, fluctuating market demand, price competition, new product introductions by competitors, fluctuations in foreign currency exchange rates, disruptions in delivery of components, political instability, general economic conditions, and the other considerations described in this section entitled Risk Factors.

WE HAVE SIGNIFICANT FUTURE CAPITAL NEEDS WHICH ARE SUBJECT TO THE UNCERTAINTY OF ADDITIONAL FINANCING

In August 2002, we increased our credit facility with LaSalle Business Credit to \$25 million. In addition, the Company has attained additional financing in Hong Kong. If this amount is not adequate, we may be unable to sustain our rapid growth, which would have a material adverse effect on our business, results of operations, and financial condition.

A DISRUPTION IN THE OPERATION OF OUR WAREHOUSE CENTERS IN CALIFORNIA AND FLORIDA WOULD IMPACT OUR ABILITY TO DELIVERY MERCHANDISE TO OUR STORES, WHICH COULD ADVERSELY IMPACT OUR REVENUES AND HARM OUR BUSINESS AND FINANCIAL RESULTS

A significant amount of our merchandise is shipped to our customers from one of our two warehouses, which are located in Compton, California and Coconut Creek, Florida. Events such as fire or other catastrophic events, any malfunction or disruption of our centralized information systems or shipping problems may result in delays or disruptions in the timely distribution of merchandise to our customers, which could adversely impact our revenues and our business and financial results.

OUR BUSINESS OPERATIONS COULD BE DISRUPTED IF THERE ARE LABOR PROBLEMS ON THE WEST COAST

During fiscal 2002, approximately 55% of our sales were domestic sales, which were made from our warehouses in California and Florida. We anticipated the potential labor problems on the West Coast in the second quarter of fiscal 2002 and increased the amount of inventory that we held in our California warehouses. As such, the work-slow-by the West Coast longshoremen in October 2002 did not significantly impact our operations. However, if another strike or work slow-down were to occur and we have not received a sufficient level of inventory, a strike or work slow-down would result in increased costs to our company and may reduce our profitability in fiscal 2003.

OUR PRODUCTS ARE SHIPPED FROM CHINA AND ANY DISRUPTION OF SHIPPING COULD HARM OUR BUSINESS

We rely principally on four contract ocean carriers to ship virtually all of the products that we import to our warehouse facility in Compton, California. Retailers that take delivery of our products in China rely on a variety of carriers to import those products. Any disruptions in shipping, whether in California or China, caused by labor strikes, other labor disputes, terrorism, and international incidents or otherwise could significantly harm our business and reputation.

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### WE MAY NOT BE ABLE TO SUSTAIN OR MANAGE OUR RAPID GROWTH

We experienced rapid growth in net sales and net income in the last year. Our net sales for the fiscal year ended March 31, 2002 increased 80.2% to \$61.8 million compared to \$34.3 million for the fiscal year ended March 31, 2001. Similarly, our net income increased to \$8.06 million for fiscal 2002 compared to \$4.6 million for fiscal 2001. As a result, comparing our period-to-period operating results may not be meaningful, and results of operations from prior periods may not be indicative of future results. We cannot assure you that we will continue to experience growth in, or maintain our present level of, net sales or net income.

Our growth strategy calls for us to continuously develop and diversify our karaoke products by (i) developing new karaoke machines and music products, (ii) entering into additional license agreements (iii) expanding into international markets, (iv) developing new retail customers in the United States and (v) obtaining additional financing. Our growth strategy will place additional demands on our management, operational capacity and financial resources and systems. To effectively manage future growth, we must continue to expand our operational, financial and management information systems and train, motivate and manage our work force.

In addition, implementation of our growth strategy is subject to risks beyond our control, including competition, market acceptance of new products, changes in economic conditions, our ability to maintain our licensing agreements with MTV and Nickelodeon and our ability to finance increased levels of accounts receivable and inventory necessary to support our sales growth, if any. Accordingly, we cannot assure you that our growth strategy will be implemented successfully.

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### THE MARKET PRICE OF OUR COMMON STOCK MAY BE VOLATILE

Market prices of the securities of companies in the toy and entertainment industry are often volatile. The market prices of our common stock may be affected by many factors, including:

- unpredictable consumer preferences and spending trends;
- operating results that vary from the expectations of investors and securities analysts;
- the actions of our customers and competitors (including new product line announcements and introduction;
- changes in our pricing policies, the pricing policies of our competitors and general pricing trends in the consumer and electronics and toy markets;
- regulations affecting our manufacturing operations in China;
- other factors affecting the entertainment and consumer electronics industries in general; and
- sales of our common stock into the public market.

In addition, the stock market periodically has experienced significant price and volume fluctuations which may have been unrelated to the operating performance



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of particular companies.

OUR MANUFACTURING OPERATIONS ARE LOCATED IN THE PEOPLE'S REPUBLIC OF CHINA, SUBJECTING US TO RISKS COMMON IN INTERNATIONAL OPERATIONS

We are dependent upon six factories in the People's Republic of China to manufacture all of our electronic products. Our arrangements with these factories are subject to the risks of doing business abroad, such as import duties, trade restrictions, work stoppages, foreign currency fluctuations, limitations on the repatriation of earnings, political instability, and other factors which could have an adverse impact on our business. Furthermore, we have limited control over the manufacturing processes themselves. As a result, any difficulties encountered by the third-party manufacturers that result in product defects, production delays, cost overruns or the inability to fulfill orders on a timely basis could adversely affect our business, financial condition and results of operations. We believe that the loss of any one or more of our manufacturers would not have a long-term material adverse effect on us because other manufacturers with whom we do business would be able to increase production to fulfill our requirements. However, the loss of certain of our manufacturers, could, in the short-term, adversely affect our business until alternative supply arrangements were secured.

WE MAY HAVE SIGNIFICANT RETURNS, MARKDOWNS AND PURCHASE ORDER CANCELLATIONS

As is customary in the consumer electronics industry, the Company has, on occasion, (i) permitted certain customers to return slow-moving items for credit, (ii) provided price protection to certain customers by making price reductions effective as to certain products then held by customers in inventory and (iii) accepted customer cancellations of purchase orders issued to the Company. The Company expects that it will continue to be required to make such accommodations in the future. Any significant increase in the amount of returns, markdowns or purchaser order cancellations could have a material adverse effect on the Company's results of operations.

WE DEPEND ON THIRD PARTY SUPPLIERS FOR PARTS FOR OUR KARAOKE MACHINES AND RELATED PRODUCTS, AND IF WE CANNOT OBTAIN SUPPLIES AS NEEDED, OUR OPERATIONS WILL BE SEVERELY DAMAGED

Our growth and ability to meet customer demand depends in part on our capability to obtain timely deliveries of karaoke machines and our electronic products. We rely on third party suppliers to produce the parts and materials we use to manufacture and produce these products. If our suppliers are unable to provide our factories with the parts and supplies, we will be unable to produce our products. We cannot guarantee that we will be able to purchase the parts we need at reasonable prices or in a timely fashion. In the last several years, there have been shortages of certain chips that we use in our karaoke machines. We, however, have anticipated this shortage and have made commitments to our factories to purchase chips in advance. If we are unable to anticipate any shortages of parts and materials in the future, we may experience severe production problems, which would impact our sales.

CONSUMER DISCRETIONARY SPENDING MAY AFFECT KARAOKE PURCHASES AND IS AFFECTED BY VARIOUS ECONOMIC CONDITIONS AND CHANGES

Our business and financial performance may be damaged more than most companies by adverse financial conditions affecting our business or by a general weakening of the economy. Purchases of karaoke machines and music are considered discretionary for consumers. Our success will therefore be influenced by a number of economic factors affecting discretionary and consumer spending, such as employment levels, business, interest rates, and taxation rates, all of which are not under our control. Adverse economic changes affecting these factors may

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restrict consumer spending and thereby adversely affect our growth and profitability.

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### WE MAY BE INFRINGING UPON THE COPYRIGHTS OF THIRD PARTIES

Each song in our catalog is licensed to us for specific uses. Because of the numerous variations in each of our licenses for copyrighted music, there can be no assurance that we have complied with scope of each of our licenses and that our suppliers have complied with these licenses. Additionally, third parties over whom we exercise no control may use our sound recordings in such a way that is contrary to our license agreement and by violating our license agreement we may be liable for contributory copyright infringement. Any infringement claims may have a negative effect on our ability to sell products.

### WE HAVE SIGNIFICANT RELIANCE ON LARGE RETAILERS WHICH ARE SUBJECT TO CHANGES IN THE ECONOMY

We sell products to retailers, including department stores, lifestyle merchants, direct mail retailers which are catalogs and showrooms, national chains, specialty stores, and warehouse clubs. Certain of such retailers have engaged in leveraged buyouts or transactions in which they incurred a significant amount of debt, and some are currently operating under the protection of bankruptcy laws. Despite the difficulties experienced by retailers in recent years, we have not suffered significant credit losses to date. Deterioration in the financial condition of our customers could have a material adverse effect on our future profitability.

### OUR NET INCOME MAY BE REDUCED IF OUR HONG KONG SUBSIDIARY DOES NOT RECEIVE AN EXEMPTION FOR OFFSHORE INCOME TAX

Our Hong Kong subsidiary has applied for a Hong Kong "offshore claim" income tax exemption based on the locality of the profits of the Hong Kong subsidiary. Management believes that since the source of all profits of the Hong Kong subsidiary are from exporting to customers outside of Hong Kong, it is likely that the exemption will be approved. Accordingly, no provision for foreign income taxes has been provided in the Company's financial statements. In the event the exemption is not approved, the Hong Kong subsidiary's profits will be taxed at a flat rate of 16% resulting in an income tax expense of approximately \$725,000 and \$460,000 for fiscal 2002 and 2001.

### OUR BUSINESS OPERATIONS COULD BE SIGNIFICANTLY DISRUPTED IF WE LOSE MEMBERS OF OUR MANAGEMENT TEAM

Our success depends to a significant degree upon the continued contributions of our executive officers, both individually and as a group. Although we have entered into employment contracts with Edward Steele, our Chief Executive Officer; John Klecha, our President, Chief Operating Officer; and Jack Dromgold, our Executive Vice President of Sales and Marketing, the loss of the services of any of these individuals could prevent us from executing our business strategy. We cannot assure you that we will be able to find appropriate replacements for Edward Steele, John Klecha or Jack Dromgold, if the need should arise, and any loss or interruption of Mr. Steele, Mr. Klecha or Mr. Dromgold's services could adversely affect our business, financial condition and results of operations. Mr. Steele will be retiring in February 2003; however, we expect to retain him as a consultant on product development for a period of at least one-year after his retirement.

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OUR OBLIGATION TO MAKE SEVERANCE PAYMENTS COULD PREVENT OR DELAY TAKEOVERS.

Our employment agreements with Eddie Steele, John Klecha, April Green and Jack Dromgold require us, under certain conditions, to make substantial severance payments to them if they resign after a change of control. These provisions could delay or impede a merger, tender, offer or other transaction resulting in a change in control of the Company, even if such a transaction would have significant benefits to our shareholder. As a result, these provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

WE MAY BE SUBJECT TO CLAIMS FROM THIRD PARTIES FOR UNAUTHORIZED USE OF THEIR PROPRIETARY TECHNOLOGY, COPYRIGHTS OR TRADE SECRETS

We believe that we independently developed the technology used in our electronic and audio software products and that it does not infringe on the proprietary rights, copyrights or trade secrets of others. However, we cannot assure you that we have not infringed on the proprietary rights of third parties or those third parties will not make infringement violation claims against us. Any infringement claims may have a negative effect on our ability to manufacture our products.

YOUR INVESTMENT MAY BE DILUTED

If additional funds are raised through the issuance of equity securities, your percentage ownership in our equity will be reduced. Also, you may experience additional dilution in net book value per share, and these equity securities may have rights, preferences, or privileges senior to those of yours.

RISKS ASSOCIATED WITH OUR CAPITAL STRUCTURE

FUTURE SALES OF OUR COMMON STOCK HELD BY CURRENT STOCKHOLDERS MAY DEPRESS OUR STOCK PRICE

As of September 30, 2002, there were 8,123,303 shares of our common stock outstanding. We have filed three registration statements registering an aggregate 6,742,234 of shares of our common stock (a registration statement on Form S-3 registering the resale of 2,947,984 shares of our common stock, a registration statement on Form S-8 to registering the sale of 1,844,250 shares underlying options granted under our 1994 Stock Option Plan and a registration statement on Form S-8 to register 1,950,000 shares of our common stock underlying options granted under our Year 2001 Stock Option Plan). The market price of our common stock could drop due to the sale of large number of shares

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of our common stock, such as the shares sold pursuant to the registration statements or under Rule 144, or the perception that these sales could occur.

ADVERSE EFFECT ON STOCK PRICE FROM FUTURE ISSUANCES OF ADDITIONAL SHARES

Our Certificate of Incorporation authorizes the issuance of 18,900,000 million shares of common stock. As of September 30, 2002, we had 8,123,303 shares of common stock issued and outstanding and an aggregate of 1,101,125 outstanding options and warrants. As such, our Board of Directors has the power, without stockholder approval, to issue up to 9,675,572 shares of common stock.

Any issuance of additional shares of common stock, whether by us to new stockholders or the exercise of outstanding warrants or options, may result in a reduction of the book value or market price of our outstanding common stock.

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Issuance of additional shares will reduce the proportionate ownership and voting power of our then existing stockholders.

PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW MAY MAKE IT DIFFICULT FOR A THIRD PARTY TO ACQUIRE OUR COMPANY AND COULD DEPRESS THE PRICE OF OUR COMMON STOCK.

Delaware law and our certificate of incorporation and bylaws contain provisions that could delay, defer or prevent a change in control of our company or a change in our management. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. These provisions of our restated certificate of incorporation include: authorizing our board of directors to issue additional preferred stock, limiting the persons who may call special meetings of stockholders, and establishing advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are also subject to certain provisions of Delaware law that could delay, deter or prevent us from entering into an acquisition, including the Delaware General Corporation Law, which prohibits a Delaware corporation from engaging in a business combination with an interested stockholder unless specific conditions are met. The existence of these provisions could limit the price that investors are willing to pay in the future for shares of our common stock and may deprive you of an opportunity to sell your shares at a premium over prevailing prices.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company does not hold any investments in market risk sensitive instruments. Accordingly, the Company believes that it is not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk instruments

### ITEM 4. CONTROLS AND PROCEDURES

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

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## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any material legal proceeding, nor to the knowledge of management are any legal proceedings threatened against the

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Company. From time to time, the Company may be involved in litigation relating to claims arising out of operations in the normal course of business.

### ITEM 2. CHANGES IN SECURITIES

(a) Not Applicable.

(b) Not Applicable.

(c) During the three month period ended September 30, 2002, one employee and one director exercised stock options granted under one of the Company's stock option plans. The employees exercised options to acquire an aggregate of 34,350 shares of our common stock. The names of the option holder, the dates of exercise, the number of shares purchased, the exercise price and the proceeds received by the Company are listed below.

Name	Date of Exercise	No. of Shares	Exercise Price	Proceeds
Howard Moore	07/12/02	33,750	\$2.04	\$68,850
Terri Phillips	07/31/02	600	\$2.04	\$ 1,224

Mr. Moore and Ms. Phillips paid for their shares with cash. Both Mr. Moore and Ms. Phillips exercised their options in reliance upon Section 4(2) of the Securities Act of 1933, because they are knowledgeable, sophisticated and had access to comprehensive information about the Company. The shares issued to our employees were registered under the Securities Act on a registration statement on Form S-8. As such, no restrictive legends were placed on the shares of Ms. Phillips. A control legend was placed on Mr. Moore's shares as he is a member of the Company's Board of Directors.

(d) Not applicable.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

The Annual Meeting of Stockholders of the Company was held on September 12, 2002. Proxies for the meeting were solicited pursuant to Regulation 14A of the Securities Exchange Act of 1934 and there was no solicitation in opposition to that of management. All of management's nominees for directors as listed in the proxy statement were elected with the number of votes cast for each nominee as follows:

	Shares Voted "FOR"	Votes Withheld
Edward Steele	7,579,999	36,283
John Klecha	7,580,019	36,263
Josef Bauer	7,586,714	29,568
Howard Moore	7,098,069	518,213
Robert Weinberg	7,586,719	29,563

The proposal to appoint Salberg & Company, P.A., as independent accountants for the Company for the year ended March 31, 2003, was ratified by the following vote:

Shares Voted	Shares Voted	Shares	Broker
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"FOR"	"AGAINST"	"ABSTAINING"	"NON-VOTE"
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7,605,366	8,122	2,794	---

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ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

EXHIBIT NO. DESCRIPTION

- 
- 10.1 Fifth Amendment dated August 13, 2002 to Loan and Security Agreement dated April 26, 2001 by and between LaSalle Business Credit, Inc. and the Company (incorporated by reference to Exhibit 10.1 in the Company's Quarterly Report on Form 10-Q filed with the SEC on November 14, 2002).
  - 10.2 First Amendment and Allonge to that Certain Demand Note dated April 26, 2001 executed by the Company in favor of LaSalle Business Credit, Inc. in the original principal amount of \$10,000.00 (incorporated by reference to Exhibit 10.2 in the Company's Quarterly Report on Form 10-Q filed with the SEC on November 14, 2002).
  - 31.1 Certification of Yi Ping Chan, Chief Executive Officer and Chief Operating Officer of The Singing Machine Company, Inc., Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*
  - 31.2 Certification of April Green, Chief Financial Officer of The Singing Machine Company, Inc., Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*
  - 32.1 Certification of Yi Ping Chan, Chief Executive Officer and Chief Operating Officer of The Singing Machine Company, Inc., Pursuant to 18 U.S.C. Section 1350.\*
  - 32.2 Certification of April Green, Chief Financial Officer of The Singing Machine Company, Inc., Pursuant to 18 U.S.C. Section 1350.\*

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\*Filed herewith

(b) Reports on Form 8-K

The Company did not file any Report on Form 8-K during the three months ended September 30, 2002.

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SIGNATURES

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

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THE SINGING MACHINE COMPANY, INC.

By: /s/ April J. Green

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April J. Green  
Chief Financial Officer  
(On behalf of Registrant and  
Chief Accounting Officer)

Dated: March 19, 2004

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EXHIBIT INDEX

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