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SINGING MACHINE CO INC
Form 10-K/A
January 03, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K/A

AMENDMENT TO

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2003

0 - 24968

Commission File Number

THE SINGING MACHINE COMPANY, INC.

(Exact Name Registrant as Specified in its Charter)

Delaware

95-3795478

(State of incorporation)

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

6601 Lyons Road, Building A-7, Coconut Creek, FL 33073

(Address of principal executive offices)

(954) 596-1000

(Issuer's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Name of each Exchange on which Registered

Common Stock American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. |X| Yes | | No

Indicate by check mark if disclosure of delinquent filers pursuant Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K. | |

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the Registrant's voting stock held by non-affiliates, based upon the closing price for the common stock of \$11.00 per share as reported on the American Stock Exchange on September 30, 2002 was approximately \$89,888,458 (based on 8,171,678 shares outstanding).

ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS: Indicate whether the Issuer has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS: State the number of shares outstanding of each of the Issuer's classes of common stock, as of the latest practicable date.

There were 8,171,678 shares of common stock, issued and outstanding at March 31, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

None

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY

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FOR THE FISCAL YEAR ENDED MARCH 31, 2003

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K, including without limitation, statements containing the words "believes," "anticipates," "estimates," "expects," "intends," and words of similar import, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis of Financial Position and Results of Operations - Factors That May Affect Future Results and Market Price of Stock."

Readers are cautioned not to place undue reliance on these forward- looking statements, which reflect management's opinions only as of the date hereof. The Company undertakes no obligation to revise or publicly release the results of any revisions to these forward- looking statements. Readers should carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission.

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PART I

ITEM 1. BUSINESS

OVERVIEW

The Singing Machine Company, Inc. ("the "Company," "we," "us" or "our") is engaged in the development, production, distribution, marketing and sale of consumer karaoke audio equipment, accessories and music. We contract for the manufacture of all electronic equipment products with factories located in Asia. We also produce and market karaoke music, including CD plus graphics ("CD+G's"), and audiocassette tapes containing music and lyrics of popular songs for use with karaoke recording equipment. All of our recordings include two versions of each song; one track offers music and vocals for practice and the other track is instrumental only for performance by the participant. Virtually all of the cassettes sold by us are accompanied by printed lyrics, and our karaoke CD+G's contain lyrics, which appear on the video screen. We contract for the reproduction of music recordings with independent studios.

We were incorporated in California in 1982. We originally sold our products exclusively to professional and semi-professional singers. In 1988, we began marketing karaoke equipment for home use. We believe we were the first company to offer karaoke electronic recording equipment and music for home use in the United States.

In May 1994, we merged into a wholly owned subsidiary incorporated in Delaware with the same name. As a result of that merger, the Delaware Corporation became the successor to the business and operations of the

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California Corporation and retained the name The Singing Machine Company, Inc. In July 1994, we formed a wholly owned subsidiary in Hong Kong, now known as International SMC (HK) Ltd. ("International SMC" or "Hong Kong subsidiary"), to coordinate our production and finance in Asia.

In November 1994, we closed an initial public offering of 2,070,000 shares of our common stock and 2,070,000 warrants. In April 1997, we filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code. On March 17, 1998, our plan of reorganization was approved by the U.S. Bankruptcy Court. On June 10, 1998, our plan of reorganization had been fully implemented. Our common stock currently trades on the American Stock Exchange under the symbol "SMD." We were listed on the AMEX on March 8, 2001. Our principal executive offices are located in Coconut Creek, Florida.

As used herein, the "Company," "we," "us" and similar terms include The Singing Machine Company, Inc. and its subsidiary, International SMC (HK) Ltd., unless the context indicates otherwise.

RECENT DEVELOPMENTS

We faced several challenges during fiscal 2003. Although our net revenue increased to \$95,613,766 in fiscal 2003 compared to revenues of \$62,475,753 in fiscal 2002, our net income decreased to \$1,217,812 or \$.15 per share in fiscal 2003 compared with net income of \$6,289,065 in fiscal 2002 or \$.88 per share. Several factors contributed to this decrease in net income, including but not limited to a loss on a guaranteed sales contract of approximately \$2.5 million, an inventory reserve charge of approximately \$3.7 million, higher than expected operating expenses of \$21.6 million in fiscal 2003 and an income tax liability expenses of \$198,772. A more detailed explanation of our financial results is contained under "Management's Discussion and Analysis and Results of Financial Condition" on page 10.

As a result of these factors, our net worth declined to a level which took us out of compliance with a tangible net worth requirement contained in our credit facility with our commercial lender, LaSalle Business Credit, LLC ("LaSalle," "commercial lender" or "lender"). In March 2003, our lender notified us that we were in default of this requirement and that it could accelerate our loan at any time. Due to the liquidity difficulties associated with the excess inventory exposure and our lender's notice of default, our auditors have qualified their opinion on our fiscal 2003 financial statements based on the uncertainty that we will continue as a going concern. While we are endeavoring to sell the excess inventory from last year, to renegotiate our loan with LaSalle and to seek other sources of financing, we cannot assure that we will be successful in any of these efforts.

We also made a decision to restate our financial statements for the fiscal year ended March 31, 2002 and 2001 to increase the accrual for income taxes. The restatement does not change reported revenue, gross margin or pre-tax income for fiscal 2002 or fiscal 2001. See "Management's Discussion and Analysis of Results of Operation and Financial Condition - Restatement" on page 10.

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PRODUCT LINES

We currently have a product line of 34 different models of karaoke machines plus 12 accessories such as microphones, incorporating such features as CD plus graphics player, sound enhancement, echo, tape record/playback features, and multiple inputs and outputs for connection to compact disc players, video cassette recorders, and home theater systems. Our machines sell at retail prices ranging from \$30 for basic units to \$400 for semi-professional units. We

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currently offer our music in two formats - multiplex cassettes and CD+G's with retail prices ranging from \$6.99 to \$19.99. We currently have a song library of over 3,500 recordings, which we license from publishers. Our library of master recordings covers the entire range of musical tastes including popular hits, golden oldies, country, rock and roll, Christian, Latin music and rap. We even have backing tracks for opera and certain foreign language recordings.

MARKETING, SALES AND DISTRIBUTION

MARKETING

We rely on management's ability to determine the existence and extent of available markets for our products. Our management has considerable marketing and sales background and devotes a significant portion of its time to marketing related activities. We achieve both domestic and direct sales by marketing our hardware and music products primarily through our own sales force and various independent sales representatives. Our representatives are located across the United States and are paid a commission based upon sales in their respective territories. The sales representative agreements are generally one (1) year agreements, which automatically renew on an annual basis, unless terminated by either party on 30 days' notice. At March 31, 2003, we worked with 18 independent sales representatives. We work closely with our major customers to determine marketing and advertising plans.

We also market our products at various national and international trade shows each year. We regularly attend the following trade shows and conventions: the Consumer Electronics Show each January in Las Vegas; the American Toy Fair each February in New York and the Hong Kong Electronics Show each October in Hong Kong. We spent approximately \$571,369 on research and development in fiscal 2003, primarily to develop prototypes and working samples.

Our karaoke machines and music are marketed under the Singing Machine(R) trademark throughout the United States, primarily through mass merchandisers, department stores, direct mail catalogs and showrooms, music and record stores, national chains, specialty stores, and warehouse clubs. Our karaoke machines and karaoke music are currently sold in such stores as Best Buy, Circuit City, J.C. Penney, Target and Toys R Us.

Our licensing agreements with MTV Networks and Nickelodeon have further expanded our brand name and our customer base. Through our license with MTV, we have begun to focus on the 12 to 24 year old market and through our agreement with Nickelodeon, we have reached an even younger age group between the ages of 3-6. We also expanded our licensed product lines in fiscal 2003 with the addition of Hard Rock Academy(R) and Motown(R) (Universal Music Entertainment) agreements. The addition of these agreements will help us to reach demographic areas covering all ages.

In November 2001, we signed an international distributorship agreement with Arbiter Group, PLC ("Arbiter"). Arbiter is the exclusive distributor of Singing Machine(R) karaoke machines and music products in the United Kingdom and a non-exclusive distributor in all other European countries. The agreement terminates on December 31, 2003, subject to an automatic renewal provision.

In March 2003, we signed an international distributorship agreement with Top-Toy (Hong Kong) Ltd. Top Toy is the exclusive distributor of Singing Machine(R) karaoke machines and music products in Denmark, Norway, Sweden, Iceland and Faeroe Islands. The agreement is for three years, from January 1, 2003 until December 31, 2005.

SALES

As a percentage of total revenues, our net sales in the aggregate to

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our five largest customers during the fiscal years ended March 31, 2003, 2002 and 2001, respectively, were approximately 67%, 87% and 78% respectively. In fiscal 2003, 2002 and 2001, Best Buy and Toys R Us each accounted for more than 10% of our revenues. In fiscal 2003 Target and in fiscal 2002 Costco also accounted for more than 10% of our revenues. Although we have long-established relationships with all of our customers, we do not have long-term contractual arrangements with any of them. A decrease in business from any of our major customers could have a material adverse effect on our results of operations and financial condition.

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During the last three years, our revenues from international sales have increased. Sales by customer geographic regions were as follows:

| | 2003 | 2002 | 2001 |
|-----------------|--------------|--------------|--------------|
| United States | \$76,777,138 | \$62,333,801 | \$34,391,540 |
| Asia | 21,310 | 49,314 | -- |
| Australia | 814,334 | -- | -- |
| Canada | 919,642 | 47,565 | 11,420 |
| Central America | 96,836 | 5,756 | -- |
| Europe | 15,714,846 | -- | 433,821 |
| Mexico | 1,225,111 | -- | -- |
| South America | 44,549 | 39,317 | 38,570 |
| | ----- | ----- | ----- |
| | \$95,613,766 | \$62,475,753 | \$34,875,351 |
| | ===== | ===== | ===== |

Returns of electronic hardware and music products by our customers are generally not permitted except in approved situations involving quality defects, damaged goods, goods shipped in error or goods that are shipped on a consignment basis. Our policy is to give credit to our customers for the returns in conjunction with the receipt of new replacement purchase orders. Our credit policies are tailored to our customer base. We have not suffered significant credit losses to date.

DISTRIBUTION

We distribute hardware products to retailers and wholesale distributors through two methods: shipments of product from inventory (domestic sales), and shipments of product directly through our Hong Kong subsidiary and manufacturers in Asia (direct sales). Domestic sales, which account for substantially all of our music sales, are made to customers located throughout the United States from inventories maintained at our warehouse facilities in Florida or California.

Domestic Sales. Our strategy of selling products from a domestic warehouse enables us to provide timely delivery and serve as a "domestic supplier of imported goods." We purchase karaoke machines overseas from certain factories in China for our own account, and warehouse the products in leased facilities in Florida and California. We are responsible for costs of shipping, insurance, customs clearance, duties, storage and distribution related to such products and, therefore, warehouse sales command higher sales prices than direct sales. We generally sell from our own inventory in less than container-sized lots. In the fiscal year ended March 31, 2003, approximately 48% of our sales were domestic sales.

Direct Sales. We ship some hardware products sold by us directly to customers from Asia through International SMC, our Subsidiary. Sales made through International SMC are completed by either delivering products to the customers' common carriers at the shipping point or by shipping the products to the customers' distribution centers, warehouses, or stores. Direct sales are

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made in larger quantities (generally container sized lots) to customers world wide, who pay International SMC pursuant to their own international, irrevocable, transferable letters of credit or on an open account. In the fiscal year ended March 31, 2003, approximately 52% of our sales were direct sales.

MANUFACTURING AND PRODUCTION

Our karaoke machines are manufactured and assembled by third parties pursuant to design specifications provided by us. Currently, we have ongoing relationships with six factories, located in the Shenzhen Special Economic Zone and Guangdong Province of the People's Republic of China, who assemble our karaoke machines. In manufacturing our karaoke related products, these factories use molds and certain other tooling, most of which are owned by International SMC. Our products contain electronic components manufactured by other companies such as Panasonic, Sanyo, Toshiba, and Sony. Our manufacturers purchase and install these electronic components in our karaoke machines and related products. The finished products are packaged and labeled under our trademark, The Singing Machine (R).

We have obtained copyright licenses from music publishers for all of the songs in our music library. We contract with outside studios on a work-for-hire basis to produce recordings of these songs. After the songs have been recorded, the Company authors the CD+G's in our in house studio. We use outside companies to mass-produce the CD+G's and audiocassettes, once the masters have been completed.

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While our equipment manufacturers purchase our supplies from a small number of large suppliers, all of the electronic components and raw materials used by us are available from several sources of supply, and we do not anticipate that the loss of any single supplier would have a material long-term adverse effect on our business, operations, or financial condition. Similarly, although we primarily use six factories to manufacture our karaoke machines and accessories, and a small number of studios to record our music (including our in house production), we do not anticipate that the loss of any single manufacturer or single studio would have a material long-term adverse effect on our business, operations or financial condition. To ensure that our high standards of product quality and factories meet our shipping schedules, we utilize Hong Kong based employees of International SMC as our representatives. These employees include product inspectors who are knowledgeable about product specifications and work closely with the factories to verify that such specifications are met. Additionally, key personnel frequently visit our factories for quality assurance and to support good working relationships.

All of the electronic equipment sold by us is warranted to the end user against manufacturing defects for a period of ninety (90) days for labor and parts. All music sold is similarly warranted for a period of 30 days. During the fiscal years ended March 31, 2003, 2002 and 2001, warranty claims have not been material to our results of operations.

MERCHANDISE LICENSE AGREEMENTS

In November 2000, we entered into a multi-year merchandise license agreement with MTV Networks, a division of Viacom International, Inc., to create the first line of MTV karaoke machine and compact disks with graphics ("CD+G's") featuring music for MTV's core audience. Under the licensing agreement, we originally produced two MTV-branded machines for the fiscal 2002 year: (1) a large format karaoke machine with a built in, fully functional television that enables users to view song lyrics and (2) a small karaoke system that connects to a television. We also produced exclusive CD+G's featuring music catering to

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MTV's core audience, that were distributed with the MTV branded karaoke machines. . We have amended the agreement three times since November 2000. For fiscal 2004, our line will consist of nine (9) MTV branded machines and a wide assortment of MTV branded music. Our license covers the sale of MTV products in the United States, Canada and Australia. In December 2002, we entered into an amendment, which adjusted some of the financial aspects of the agreement and added an additional minimum guarantee of royalty payments of \$1,500,000. The MTV license expires on December 31, 2003 and management is currently in negotiations to extend this agreement beyond that date. We do not believe that the payment of these guaranteed fees will adversely affect our ongoing operations.

In December 2001, we entered into a multi-year license agreement with the Nickelodeon division of MTV Networks. Under this license, we originally created a line of two Nickelodeon branded machines and music for the fiscal 2003 year. This has expanded to five machines, plus a line of Nickelodeon music. These products are distributed through our established distribution channels. Over the term of this license agreement, we are obligated to make guaranteed minimum royalty payments of \$450,000. We do not believe that the payment of these guaranteed fees will adversely affect our ongoing operations. The Nickelodeon license expires on December 31, 2004.

In December 2002, we entered into a multi-year license agreement with Hard Rock Academy, a division of Hard Rock Cafe. This agreement allows the Company to produce and market a line of its karaoke machines and complementary music through its distribution channels. The first branded machine was introduced in the fourth quarter of fiscal 2003 and a line of music is currently under development. Over the term of this license agreement, we are obligated to make guaranteed minimum royalty payments over a specified period of time in the total amount of \$250,000. We do not believe that the payment of these guaranteed fees will adversely affect our ongoing operations. The Hard Rock Academy license expires on December 31, 2005.

In February 2003, we entered into a multi-year license agreement with Universal Music Entertainment to market a line of Motown karaoke machines and music. This agreement and its subsidiary agreement signed in March 2003, allow The Singing Machine to be the first to use original artist recordings for our CD+G formatted karaoke music. The original introduction will be one machine and six CD+G discs. Over the term of this license agreement, we are obligated to make guaranteed minimum royalty payments over a specified period of time in the amount of \$300,000. We do not believe that the payment of these guaranteed fees will adversely affect our ongoing operations. The Universal Music Entertainment license expires on March 31, 2006.

We distribute all of our licensed products through our established distribution channels, including Best Buy, Costco, JC Penny, Sam's Club, Target and Toys R Us. Our distribution network also includes the online versions of these retail customers.

COMPETITION

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Our business is highly competitive. Our major competitors for karaoke machines and related products are Craig, Curtis, Grand Prix and Memorex. 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, UAV, Sybersound and Sound Choice. We believe that competition for karaoke music is based primarily on popularity of song titles, price, reputation, and delivery times.

We try to stay ahead of our competition by introducing new products

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each year and upgrading our existing products. We believe that we were one of the first companies to introduce CD+G technology to karaoke machines. In fiscal 2004, we will be introducing more than 20 new models of karaoke machines.

In addition, we compete with all 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 videocassettes. Our financial position depends, among other things, on our ability to keep pace with changes and developments in the entertainment industry and to respond to the requirements of our customers. Many of our competitors have significantly greater financial, marketing, and operating resources and broader product lines than we do.

TRADEMARKS

We have registered various trademarks with the United States Patent & Trademark Office for our Singing Machine(R) products and also have common law rights in these trademarks. We have also registered our trademark in Germany, the Benelux countries, Switzerland and the United Kingdom. In fiscal 2003, we filed an application to obtain a European Community Trademark for the 15 European Community countries and filed registrations in certain Asian countries.

Our trademarks are a significant asset because they provide product recognition. We believe that our intellectual property is significantly protected, but there are no assurances that these rights can be successfully asserted in the future or will not be invalidated, circumvented or challenged.

COPYRIGHTS AND LICENSES

We hold federal and international copyrights to substantially all of the music productions comprising our song library. However, since each of those productions is a re-recording of an original work by others, we are subject to contractual and/or statutory licensing agreements with the publishers who own or control the copyrights of the underlying musical compositions. We are obligated to pay royalties to the holders of such copyrights for the original music and lyrics of all of the songs in our library that have not passed into the public domain. We are currently a party to more than 3,500 different written copyright license agreements.

The majority of the songs in our song library are subject to written copyright license agreements, oftentimes referred to as synchronization licenses. Our written licensing agreements for music provide for royalties to be paid on each song. The actual rate of royalty is negotiable, but typically ranges from \$0.09 to \$0.18 per song on each CD that is sold. Our written licenses typically provide for quarterly royalty payments, although some publishers require reporting on a semi-annual basis.

We currently have compulsory statutory licenses for certain songs in our song library which are reproduced on audiocassettes. The Federal Copyright Act creates a compulsory statutory license for all non-dramatic musical works, which have been distributed to the public in the United States. Royalties due under compulsory licenses are payable quarterly and are based on the statutory rate. The statutory rate is the greater of \$0.08 per song for five minutes of playing time or \$0.0155 per minute of playing time or fraction thereof with respect to each item of music produced and distributed by us. We also have written license agreements for substantially all of the printed lyrics, which are distributed with our audiocassettes, which licenses also typically provide for quarterly payments of royalties at the statutory rate.

GOVERNMENT REGULATION

Our karaoke machines must meet the safety standards imposed in various

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national, state, local and provincial jurisdictions. Our karaoke machines sold in the United States are designed, manufactured and tested to meet the safety standards of Underwriters Laboratories, Inc. or Electronic Testing Laboratories. Our production and sale of music products is subject to federal copyright laws.

Our manufacturing operations in China are subject to foreign regulation. China has permanent "normal trade relations" ("NTR") status under US tariff laws, which provides a favorable category of US import duties. China's NTR status became permanent on January 1, 2002, following enactment of a bill authorizing such status upon China's admission to the World Trade Organization ("WTO") effective as of December 1, 2001. This substantially reduces the possibility of China losing its NTR status, which would result in increasing costs for the Company.

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SEASONALITY AND SEASONAL FINANCING

Our business is highly seasonal, with consumers making a large percentage of karaoke purchases around the traditional holiday season in our third quarter. A significant portion of our customers place orders in our second and third quarter in anticipation of such holiday buying. These seasonal purchasing patterns and requisite production lead times cause risk to our business associated with the underproduction or overproduction of products that do not match consumer demand. Retailers also attempt to manage their inventories more tightly, requiring the Company to ship products closer to the time that retailers expect to sell the products to consumers. These factors increase the risk that the Company may not be able to meet demand for certain products at peak demand times, or that the Company's own inventory levels may be adversely impacted by the need to pre-build products before orders are placed. In fiscal 2003, we overestimated the demand for our products and had \$25 million of inventory as of March 31, 2003.

In fiscal 2003 and 2002, our financing of seasonal working capital grew in the first quarter and peaked in the second and third quarter, consistent with the industry taken as a whole. In fiscal 2004, we do not expect that our working capital requirements will be as extensive as they were in fiscal 2003. Because we have a significant amount of inventory on hand as of March 31, 2003, we do not plan on significantly increasing our inventory levels. During fiscal 2004, we intend to liquidate the excess \$25 million in inventory that we own as of March 31, 2003. We believe that this inventory is highly saleable and marketable. We intend on spending approximately \$10 to \$15 million on new inventory in fiscal 2004. However, we may change this amount, depending on business conditions. We are currently in the process of seeking to amend our existing line of credit to provide this working capital financing. If these efforts are unsuccessful, we will need to seek alternative facilities. To finance seasonal working capital requirements of our Hong Kong subsidiary, we expect to use short-term foreign credit lines with a number of banks. Our foreign credit lines total approximately \$5.5 million.

BACKLOG

We ship our products in accordance with delivery schedules specified by our customers, which usually request delivery within three months. In the consumer electronics industry, orders are subject to cancellation or change at any time prior to shipment. In recent years, a trend toward just-in-time inventory practices in the toy industry has resulted in fewer advance orders and therefore less backlog of orders for the Company. We believe that backlog orders at any given time may not accurately indicate future sales.

EMPLOYEES

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As of April 15, 2003, we employed 60 persons, all of whom are full-time employees, including four executive officers. Fourteen of our employees are located at International SMC's corporate offices in Hong Kong. The remaining thirty-four employees are based in the United States, including the four executive positions; sixteen are engaged in warehousing and technical support, and fourteen in accounting, marketing, sales and administrative functions.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Coconut Creek, Florida in an 18,000 square foot office and warehouse facility. Our four leases for this office space expire on August 31, 2004. We sublease showroom space at the International Toy Center in New York City. We have leased 9,393 square feet of office and showroom space in Hong Kong from which we oversee our China based manufacturing operations. Our two leases for this space in the Ocean Center building expire on April 30, 2005 and May 31, 2005, respectively.

We have two warehouse facilities in southern California. The Compton facility has 69,000 square feet and the lease expires on February 23, 2008. The Rancho Dominguez location has 94,650 square feet, predominately warehouse. This lease expires June 30, 2005. We have also subleased warehouse space in Carson, California, that we previously leased for warehouse space to an unrelated third party until the expiration of the lease, January 2004. We intend to consolidate our operations by October of 2003 and sublease one of the remaining facilities for the term of its lease.

We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the term of the existing leases.

ITEM 3. LEGAL PROCEEDINGS

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We filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Florida, case number 97-22199-BKC-RBR, on April 11, 1997. On March 17, 1998, the U.S. Bankruptcy Court confirmed our First Amended Plan of Reorganization. As of June 10, 1998, our plan has been fully implemented.

From July 2, 2003 through July 8, 2003, six securities class action lawsuits were filed against the Singing Machine and certain of its officers and directors in the United States District Court for the Southern District of Florida on behalf of all persons who purchased the Singing Machine's securities during the various class action periods specified in the complaints. We expect that all of these actions will be consolidated in the United States District Court for the Southern District of Florida.

The complaints that have been filed allege violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Rule 10(b)-5. The complaints seek compensatory damages, attorney's fees and injunctive relief. While the specific factual allegations vary slightly in each case, the complaints generally allege that defendants falsely represented the Singing Machine's financial results during the relevant class periods.

We believe the allegations in these cases are without merit and we intend to vigorously defend these actions.

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

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No matters were submitted to a vote of security holders through a solicitation of proxies or otherwise, during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock currently trades on the American Stock Exchange under the symbol "SMD." We began trading on the AMEX on March 8, 2001. From January 26, 1996 through March 7, 2001, we traded on the National Association of Securities Dealers, Inc.'s OTC Bulletin Board under the symbol "SING". Set forth below is the range of high and low information for our common stock as traded on the American Stock Exchange from March 8, 2001 through March 31, 2003, as reported by Commodity Systems, Inc.. This information regarding trading on AMEX represents prices between dealers and does not reflect retail mark-up or markdown or commissions, and may not necessarily represent actual market transactions. This information contained in this table has been restated to give effect to our 3-for-2 stock split to stockholders of record on March 4, 2002.

| Fiscal Period | HIGH | LOW |
|---|---------|---------|
| 2003: | | |
| First quarter (April 1 - June 30, 2002) | \$16.89 | \$12.06 |
| Second quarter (July 1 - September 30, 2002) | 12.74 | 8.05 |
| Third quarter (October 1 - December 31, 2002) | 13.49 | 8.50 |
| Fourth quarter (January 1 - March 31, 2003) | 9.19 | 5.30 |
| 2002: | | |
| First Quarter (April 1 - June 30, 2001) | \$ 4.45 | \$ 2.90 |
| Second Quarter (July 1 - September 30, 2001) | 5.02 | 3.70 |
| Third Quarter (October 1 - December 31, 2001) | 16.19 | 4.30 |
| Fourth Quarter (January 1 - March 31, 2002) | 17.80 | 12.53 |

As of July 1, 2003, there were approximately 311 record holders of our outstanding common stock.

COMMON STOCK

The Company has never declared or paid cash dividends on its common stock and the Company's Board of Directors intends to continue its policy for the foreseeable future. Furthermore, the Company's credit facility with LaSalle Business Credit, Inc. restricts the Company from paying any dividends to its shareholders, unless it obtains prior written consent from LaSalle. Future dividend policy will depend upon the Company's earnings, financial condition, contractual restrictions and other factors considered relevant by the Company's Board of Directors and will be subject to limitations imposed under Delaware law.

On March 14, 2002, the Company affected a 3 for 2 stock split for all shareholders on record as of March 4, 2002.

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SALE OF UNREGISTERED SECURITIES

During the three-month period ended March 31, 2003, two employees exercised stock options issued under our 2001 Management Stock Option Plan. The employees exercised options to acquire an aggregate of 38,500 shares of our common stock. The names of the option holders, the dates of exercise of the number of shares purchased, the exercise price and the proceeds received by us are listed below.

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| Name | Date of Exercise | No. of Shares | Exercise Price | Proceeds |
|-------------|------------------|---------------|----------------|----------|
| Edwin Young | 01/21/2003 | 37,500 | 2.04 | 76,500 |
| April Green | 02/24/2003 | 1,000 | 2.04 | 2,040 |

Each of these individuals paid for the shares with cash. 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.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth, for the periods indicated, certain items included in the Company's financial statements located here and in other filings with the Securities and Exchange Commission and should be read in conjunction with the financial data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related footnotes (included in Item 8).

| | 2003 | 2002 (as restated) (1) | 2001* (as restated) (1) | 2000 (1) | |
|--|--------------|------------------------------|-------------------------------|--------------|-------|
| Statement of Operations: | | | | | |
| Net Sales | \$95,613,766 | \$62,475,753 | \$34,875,351 | \$19,032,320 | \$ 9, |
| Earnings(loss) before income taxes | \$ 1,416,584 | \$ 8,184,559 | \$ 4,188,021 | \$ 577,686 | \$ |
| Income tax expense (benefit) | \$ 198,772 | \$ 1,895,494 | \$ 494,744 | \$ 160,299 | \$ |
| Net earnings (loss) | \$ 1,217,812 | \$ 6,289,065 | \$ 3,696,277 | \$ 737,985 | \$ |
| Balance Sheet: | | | | | |
| Working capital | \$13,389,509 | \$14,577,935 | \$ 6,956,879 | \$ 2,985,120 | \$ |
| Current ratio | 1.63 | 3.82 | 4.37 | 7.77 | |
| Property, plant and equipment, net | \$ 1,096,423 | \$ 574,657 | \$ 263,791 | \$ 99,814 | \$ |
| Total assets | \$38,935,294 | \$21,403,196 | \$10,509,682 | \$ 4,346,901 | \$ 2, |
| Shareholders' equity | \$17,685,364 | \$16,225,433 | \$ 8,450,237 | \$ 3,906,286 | \$ |
| Per Share Data: | | | | | |
| Earnings (loss) per common share - basic | \$ 0.15 | \$ 0.88 | \$ 0.59 | \$ 0.23 | \$ |
| Earnings (loss) per common share - diluted | \$ 0.14 | \$ 0.79 | \$ 0.50 | \$ 0.19 | \$ |
| Cash dividends paid | 0.00 | 0.00 | 0.00 | 0.00 | |

(1) Certain numbers in these financial statements have been reclassified to conform with current year presentation.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

OVERVIEW

RESTATEMENT OF FINANCIAL STATEMENTS

In July 2003, we were advised by Grant Thornton, our independent accountants, that we needed to restate our financial statements for the fiscal years ended March 31, 2002 and March 31, 2001 to increase the reported income tax liability. As restated, our income taxes increased from \$119,277 in fiscal 2002 to \$1,895,494 and from \$23,320 in fiscal 2001 to \$491,744.

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There are two reasons why the reported income tax liability in our restated financial statements is higher than previously reported. First, we are including an accrual for taxes on certain intercompany loans between our U.S. parent and our Hong Kong subsidiary pursuant to Section 956 of the Internal Revenue Code ("IRC"). This accrual was not included in our audited financial statements for fiscal 2002 and 2001.

Second, we are accruing income taxes for profits generated by our Hong Kong subsidiary. Our Hong Kong subsidiary applied for a Hong Kong offshore income exemption in 2001. Management believed that the exemption would be approved because all profits of the Hong Kong subsidiary were derived from exporting to customers outside of Hong Kong. Accordingly, no provision for foreign income taxes on the profits of the Hong Kong subsidiary was provided for in our reported earnings for fiscal 2002 and 2001. However, we did include a footnote in the audited financial statements which discussed the effect on our financial statements, if we were denied this income tax exemption. As of July 1, 2003, we had not received official approval of the Hong Kong tax exemption. We decided to include a provision for these taxes in fiscal 2003 and to restate income for the prior two years to include a provision for these taxes, in the event that the exemption is denied. As previously disclosed in the footnotes to our financial statements, the provisions accrued for fiscal 2002 and 2001 were \$748,672 and \$468,264, respectively.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain income and expense items expressed as a percentage of the Company's total revenues:

| | 2003 | 2002 | 2001 |
|--------------------------------------|--------|--------|--------|
| Total Revenues | 100.0% | 100.0% | 100.0% |
| Cost of Sales | 75.6% | 65.4% | 63.5% |
| Operating expenses | 22.7% | 21.4% | 22.1% |
| Operating income | 1.7% | 13.2% | 14.4% |
| Other expenses, net | 0.2% | 0.1% | 2.4% |
| Income before taxes | 1.5% | 13.1% | 12.0% |
| Provision (benefit) for income taxes | 0.2% | 3.0% | 1.4% |
| Income (loss) | 1.3% | 10.1% | 10.6% |

YEAR ENDED MARCH 31, 2003 COMPARED TO THE YEAR ENDED MARCH 31, 2002

NET SALES

Net sales for the fiscal year ended March 31, 2003 increased 53.0% to \$95,613,766 compared to \$62,475,753 for the fiscal year ended March 31, 2002. The Company's growth was driven in large part by the addition of International sales in Europe, Asia, and Australia. This new market area is in its infant stage and the Company expects continued future growth in this area.

Strong sales of the Company's licensed merchandise and the introduction of new karaoke machines and music titles were also driving forces in our revenue growth for fiscal 2003. In fiscal 2003, our sales of music increased to \$8,894,743 or 9.3% of sales as compared to \$6,306,547 or 10.2% in fiscal 2002.

Sales in fiscal 2003 were reduced by a charge against sales of \$2.5 million as a result of the end of a guaranteed margin agreement with a customer.

GROSS PROFIT

Gross profit for the fiscal year ended March 31, 2003 was \$23,284,731

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or 24.4% of sales as compared to \$21,622,913 or 34.6% of sales for the fiscal year ended March 31, 2002. The decrease in gross margin compared to the prior year is due primarily to the following factors: (i) increased sales from our Hong Kong subsidiary both to domestic and international customers; (ii) a write down of the value of inventory and (iii) a reduction of sales due to a guaranteed margin contract.

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International sales were primarily in Europe, Canada and Australia. Sales to international customers historically maintain a lower gross profit margin because there are no other variable expenses from these sales. Other variable expenses that are normally included with sales are advertising allowances, returns and commissions.

The Company also undertook a revaluation of its current inventory. It was determined that due to liquidation sales, inventory would be sold at a loss; therefore, a decrease in the value of these specific items was made. The total amount of the provision for inventory was \$3,715,357.

In fiscal 2003, the Company entered into a guaranteed gross margin contract which completed on January 15, 2003. The Company entered into an agreement with a retail customer in April 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 15, 2003. Under the agreement, the Company agreed to reimburse the customer for the difference between the customer's gross margin on sales and the minimum guarantee. As of the settlement date of the contract, January 15, 2003, the net loss on the agreement was \$2,570,047. The Company also realized the consignment sales made by this customer at January 15, 2003, in the amount of \$2,441,483. As of March 31, 2003 the total amount due under this agreement has been paid.

OPERATING EXPENSES

Operating expenses were \$21,646,615 or 22.9% of total revenues in fiscal 2003, up from \$13,387,533 or 16.1% of total revenues, in the third quarter of the prior year. The primary factors that contributed to the increase of approximately \$8,259,082 in operating expenses for the fiscal year 2003 are:

- (i) increased advertising expenses of \$2,654,729 due to increases with our outside firm, the production of a television commercial, as well as cooperative advertising with customers, which is variable based on the level of sales
- (ii) the increase in depreciation in the amount of \$239,686 due to the addition of molds for new product additions for fiscal year 2003,
- (iii) compensation expense in the amount of \$1,151,012 due to the addition of key personnel in Florida, in our California facility and at our Hong Kong subsidiary,
- (iv) increased freight and handling charges to customers \$869,525
- (v) expansion of the California warehouse and its associated expenses in the amount of \$873,919,
- (vi) expansion of International SMC's operations and its related expenses, in the amount of \$580,906.
- (vii) increases in product development fees for development of future product \$571,370.

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 royalty expenses, show expenses, and other selling expenses.

Our advertising expense, as discussed in (i) above, increased

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\$2,654,729 for the fiscal year ended March 31, 2003 as compared to fiscal 2002. Advertising expense consists of two components: Co-operative advertising and direct advertising expense. Co-operative advertising is paid directly to the customer and is based directly on the amount of sales. The customer has complete discretion as to the use of these funds. Co-operative advertising expenses accounted for \$2,320,705 of the increase in advertising expenses. In fiscal 2002, the Company embarked on its first television advertising and continued with the use of print advertising, radio spots, sponsorships, promotions and other media. The increased costs for our advertising firm were \$334,024 over the prior year.

DEPRECIATION AND AMORTIZATION

The Company's depreciation and amortization expenses were \$634,142 for the fiscal year ended March 31, 2003 as compared to \$394,456 for the fiscal year ended March 31, 2002. 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, as well as minimal costs for additional computer equipment and furniture for additional personnel.

OTHER EXPENSES

Other expenses were \$197,646 for the fiscal year ended March 31, 2003 as compared with net expenses of \$50,821 for the fiscal year ended March 31, 2002. Our interest expense increased during the fiscal year ended March 31, 2003 compared to the same period of the prior year primarily due to our increased use of our credit facility with LaSalle during this period. Prior to August 2002, the Company had cash reserves to fund operations and did not need to borrow on the revolving credit facility. Our interest income increased from \$2,475 during the fiscal year 2002 to \$11,943 during the fiscal year 2003 because we earned income on our cash balances held by our lender by investing in 24 hour commercial paper investments.

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INCOME BEFORE INCOME TAX EXPENSE

The Company's income before income taxes decreased to \$1,416,584 at March 31, 2003 from \$8,184,559 at March 31, 2002. The decreases are a direct effect of the increased operating expenses.

INCOME TAX EXPENSE

Our accrual for income taxes is based on two components: (i) taxes which we are paying pursuant to Section under Section 956 of the Internal Revenue Code on intercompany loans and (ii) taxes on International SMC's business operations in Hong Kong. Total income tax expense for fiscal 2003 was \$198,772.

NET INCOME

As a result of the foregoing, the Company's net income was \$1,217,812 for the fiscal year ended March 31, 2003.

YEAR ENDED MARCH 31, 2002 COMPARED TO YEAR ENDED MARCH 31, 2001

NET SALES

Net sales for the fiscal year ended March 31, 2002 increased 80.2% to \$62,475,753 compared to \$34,875,351 for the fiscal year ended March 31, 2001. The Company's growth was driven by strong sales of the Company's MTV licensed

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merchandise and the introduction of new karaoke machines and music titles. We generated \$23,354,270 million or 37.8% of our net sales from products sold under the MTV license. In fiscal 2002, our sales of music increased to \$6,306,547 or 10.2% of our net sales compared with \$3,087,615 or 9% of our net sales in fiscal 2001.

GROSS PROFIT

Gross profit for the fiscal year ended March 31, 2002 was \$21,622,913 or 33% of sales compared to \$12,716,300 or 34.5% of sales for the fiscal year ended March 31, 2001. The decrease in gross margin compared to the prior year is due to the realization of volume discounts by our largest customers. This was offset to some degree by reduced prices that we paid our manufacturers for our karaoke machines because of our increased purchases.

OPERATING EXPENSES

Operating expenses increased to \$13,387,533, or 19.7% of sales, for the year ended March 31, 2002 from \$7,688,707, or 19.8% of sales, for the year ended March 31, 2001. This increase in operating expenses was primarily attributed to the increase in expenses associated with: (1) the opening of the Company's Hong Kong office, (2) the Company's first advertising campaign and (3) certain expenses which are considered variable as they relate directly to the level of sales.

In December 2000, the Company's wholly-owned subsidiary, International SMC, opened a Hong Kong office. For the fiscal year ended March 31, 2002, this office incurred SG&A expenses of approximately \$1,144,734 compared to \$418,618 in the prior year. By opening this office, the Company saved the manufacturers agency fees, which were paid on each shipment in prior years. The Hong Kong office has fixed overhead expenses every month, as opposed to per shipment agency fees. We realized the greatest benefit from our Hong Kong office in the third quarter of fiscal 2002, when we purchased the largest amount of inventory.

Our advertising expense increased to \$2,377,638 for the fiscal year ended March 31, 2002 compared to \$921,359 for the fiscal year ended March 31, 2001. Advertising expense consists of two components: Co-operative advertising and direct advertising expense. Co-operative advertising is paid directly to the customer and is based directly on the amount of sales. The customer has complete discretion as to the use of these funds. Co-operative advertising expenses accounted for \$972,000 of the increase in advertising expenses. In fiscal 2002, the Company embarked on its first formal advertising campaign, which used print advertising, radio spots, sponsorships, promotions and other media. The cost for this advertising campaign was approximately \$484,000 and this is a direct advertising expense.

Other expenses, termed variable expenses, contributed to the increase in operating expenses. These expenses included royalty expense, sales commissions, warehouse expenses, and travel. The largest increase can be seen in royalty expense, which increased approximately \$1,713,000 over the prior year, primarily from the sale of items under the MTV licensing agreement. Our commissions payable to our independent sales representatives increased by \$457,000 during fiscal 2002, because of increased sales. Our warehouse related expenses also increased by \$478,000. These expenses are due to the increased importing of the Company's karaoke machines from Hong Kong. Compensation expenses increased \$569,935. We grew from 22 employees at March 31, 2001 to 47 employees at March 31, 2002.

DEPRECIATION AND AMORTIZATION

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The Company's depreciation and amortization expenses were \$394,456 for the fiscal year ended March 31, 2002, up from \$301,064 in the prior year. The increase in depreciation and amortization expenses can be attributed to the Company's acquisition of new fixed assets during fiscal 2002, which included computers, furniture and other equipment in all of the Company's locations in Florida, California and Hong Kong. It also included the addition of new molds for our expanded product line. The amortization expense includes the amortization of a fee paid to LaSalle Bank for our line of credit facility and the amortization of remaining deferred guarantee fees related to the factoring agreement we terminated in April 2001.

OTHER EXPENSES

Other expenses were \$50,821 for the fiscal year ended March 31, 2002 compared with net expenses of \$839,572 for the fiscal year ended March 31, 2001. The Company had a large decrease in these miscellaneous items primarily because of the elimination of factoring fees and a decrease in interest expense resulting in a net decrease of \$543,279. The Company terminated its factoring agreement in April 2001 and no longer incurs the fees and interest associated with it. The Company replaced the factoring agreement with a lower cost credit facility with LaSalle Business Credit in April 2001. The Company has also begun to generate income from royalty payments received in Hong Kong for the use of Company owned molds by other parties.

INCOME BEFORE INCOME TAX EXPENSE

The Company's income before income taxes increased 95.4% to \$8,184,559 for the fiscal year ended March 31, 2002, compared to \$4,188,021 for the fiscal year ended March 31, 2001. This increase in profit is due primarily to the increase in sales.

INCOME TAX EXPENSE

Our income tax expense was restated for fiscal 2002. Our accrual for income taxes is based on two components: (i) taxes which we are paying pursuant to Section under Section 956 of the Internal Revenue Code on an intercompany loans and (ii) taxes on International SMC's business operations in Hong Kong. The total income tax expense for fiscal 2002 was \$1,895,494.

NET INCOME

As a result of the foregoing, the Company's net income increased 41.3% to \$6,289,065 for the fiscal year ended March 31, 2002, compared to \$3,696,277 for the fiscal year ended March 31, 2001.

YEAR ENDED MARCH 31, 2001 COMPARED TO YEAR ENDED MARCH 31, 2000

NET SALES

Net sales increased 80.3% in the fiscal year ended March 31, 2001. The increase in revenue from \$19,032,320 in fiscal 2000 to \$34,875,351 in fiscal 2001 can be attributed to the addition of a major customer and increased awareness of karaoke in the retail community. The addition of this customer alone added 20% to our revenues for fiscal 2001. Our sales of karaoke machines and karaoke music comprised 93% and 7%, respectively, of our sales in fiscal 2000.

GROSS PROFIT

Gross profit for fiscal 2001 was 34.5% of sales compared to 27.9% of sales in fiscal year 2000. The increased gross margin in fiscal 2001 is due to a

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favorable decrease in the cost of products, both hardware and music, resulting primarily from volume discounts. Another factor of increased gross margin is the increased percentage of music sales as compared to hardware sales. Overall, the gross profit on music sales is higher than that of hardware.

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OPERATING EXPENSES

Operating expenses increased by 80.1% in fiscal 2001 compared to fiscal 2000. A good portion of this increase in operating expenses was due to the significant increase in sales and its impact on variable selling expenses such as freight expense, sales commissions, cooperative advertising, and travel expenses, among others. Another factor of this change is the addition of personnel, increasing compensation expense. The Company grew from 12 employees at March 31, 2000 to 22 employees at March 31, 2001. The accrual for management bonus also attributed to the increase in operating expenses. This expense is due largely to increased sales, but also to fairly stable expenses for the fiscal year.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses increased from \$116,369 in fiscal 2000 to \$301,064 in fiscal 2001. The addition of new product molds in Hong Kong and the opening of a new Hong Kong office contributed to this increase. Also contributing to this increase was the expansion of our home office in Coconut Creek into another unit next to our existing office space.

OTHER EXPENSES

Other expenses decreased from \$947,982 in fiscal year 2000 to \$839,572 in fiscal year 2001. This is primarily due to the expense in fiscal 2000 of non-cash based guarantee fees.

Loss on accounts receivable due to factoring was 0.25% of total revenues in fiscal 2001 compared to 2.3% of total revenues in fiscal 2000. This decrease is due to the favorable factoring rates negotiated for the year.

INCOME TAX EXPENSE

The Company files separate tax returns for the parent and for the Hong Kong Subsidiary. The income tax expense (benefit) consists of taxes associated with federal, foreign and state income taxes in the consolidated statement of income.

During fiscal 2001, the Company showed a profit in both the U.S. parent company and International SMC, its wholly-owned Hong Kong subsidiary. The U.S. parent company's tax liability was eliminated due to the utilization of operating loss carryforwards from prior years. As a result of this, the income tax recognized in fiscal 2001 in the amount of \$23,320 is a result of the federal alternative minimum tax. Although the Company's NOL expires on various dates through 2019, the Company expects to utilize the remaining NOL in fiscal year 2003.

The Company's Hong Kong subsidiary applied for a Hong Kong offshore claim income tax exemption for the calendar year ended March 31, 2001. Management believes that the exemption will be approved because the source of all profits of the Hong Kong subsidiary is from exporting to customers outside of Hong Kong. As of June 20, 2002, the Hong Kong offshore claim exemption for fiscal 2001 has not been approved. A provision was made in the restated statement of operations for fiscal 2001 in the amount of 468,424.

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NET INCOME

Net income after tax for the fiscal year ended March 31, 2001 and 2000 was \$3,696,277 and \$737,985, respectively. The increase in sales and stability of general expenses are attributed to the increased bottom line. The Company has remaining net operating loss carry forwards to cover US taxes that may have been due on the profitability of the Company.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, the Company had cash on hand of \$268,265 compared to \$5,520,147 at March 31, 2002. Our current liabilities increased to \$21,249,930 as of March 31, 2003, compared to \$5,177,763 at March 31, 2002.

Because we had minimal liquidity as of June 24, 2003 and had defaulted under a credit agreement with our commercial lender, we received a going concern qualification from our independent auditors for our financial statements for fiscal 2003. On March 14, 2003, we received a letter from LaSalle informing us that we were in violation of a net worth covenant in our credit agreement. In this letter, LaSalle also advised us that we were in default under the credit agreement and that it could accelerate the payment of all liabilities due under this agreement at any time. In June 2003, LaSalle amended the agreement through July 31, 2003 but did not waive the condition of default. One of the conditions of this last amendment was that we obtain \$2 million in subordinated debt financing by July 10, 2003.

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As of July 10, 2003, we have obtained \$1 million in subordinated debt financing. On or about July 10, 2003, certain officers and directors advanced \$1 million to the Company. We have not finalized the terms of this management loan; however, the Company has immediate use and access to the \$1 million in funding. It is presently expected that the loan will be a short-term loan, which will be due on or before October 31, 2003. However, we have not yet determined the interest rate or if any compensation, such as warrants, will be awarded to the management investment group for their loan. We are also in the process of finalizing a \$1 million loan from an outside investment group and hope to close this transaction by July 16, 2003. There can be no assurance that this financing will be completed on time on the terms presently contemplated.

We are currently in negotiations with LaSalle to restructure the loan for the remainder of fiscal 2004. We hope that these negotiations will be successful and that a restructured loan agreement will be in place prior to August 1, 2003. We entered into our credit facility with LaSalle in April 2001 and have entered into several amendments subsequently. We last amended the credit facility effective as of June 30, 2003 and it provides that the agreement expires on July 31, 2003. Under the amended credit facility, LaSalle Bank will advance up to 70% of the Company's eligible accounts receivable, plus up to 20% of eligible inventory, plus us up to 40% of commercial letters of credit issue by LaSalle minus reserves as set forth in the loan documents. The loan is secured by a first lien on all present and future assets of the Company, except specific tooling located in China.

Due to the increased level of inventory and accounts payable as of March 31, 2003, the Company has an increased need for working capital. As of March 31, 2003, the Company had current assets of \$34.6 million, which consisted primarily of accounts receivable and inventory; and current liabilities of approximately \$21.2 million. The most significant current liabilities include (i) approximately \$8.4 million in accounts payable, of which approximately \$4 million is amounts payable to the Company's factories in China and (ii) \$6.8

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million outstanding under the Company's credit facility with LaSalle Bank. Over the past few months, the Company has had discussions with its factories in China and they have indicated that they are willing to extend the payment dates for the Company's obligations. The Company also has been negotiating with LaSalle Bank to increase the credit available to the Company and has identified other sources of capital.

Our Hong Kong subsidiary, International SMC, has letters of credit facilities available to finance its inventory purchases. These facilities are (1) a \$2.5 million facility at Hong Kong Shanghai Banking Corporation and (2) a \$1 million facility at Fortis Bank. The Subsidiary also has a short term loan with the Hong Kong Shanghai Banking Corporation for \$2 million which expires in December 2003. The Subsidiary also has a \$400,000 short term loan with a director of the Company which is payable within 120 days at a rate of 8% per annum.

In the event that we are not able to renegotiate an agreement with LaSalle, we have considered alternative sources of financing, including but not limited to inventory and accounts receivable financing and other high risk financing such as venture capital funds. Without such financing, our ability to continue our operations is in significant doubt.

In fiscal 2004, we do not expect that our working capital requirements will be as extensive as they were in fiscal 2003. Because we have a significant amount of inventory on hand as of March 31, 2003, we do not plan on significantly increasing our inventory levels. During fiscal 2004, we intend to liquidate the excess \$25 million in inventory that we own as of March 31, 2003. We believe that this inventory is highly saleable and marketable; however, there can be no assurances that we will be able to liquidate this inventory during our upcoming fiscal year. We intend on spending approximately \$10 to \$15 million on new inventory in fiscal 2004. However, we may change this amount, depending on business conditions. We are currently in the process of seeking to amend our existing line of credit to provide this working capital financing. If these efforts are unsuccessful, we will need to seek alternative facilities. To finance seasonal working capital requirements of our Hong Kong subsidiary, we expect to use short-term foreign credit lines with a number of banks. Our foreign credit lines total approximately \$5 million.

The Company's commitments for debt and other contractual arrangements are summarized as follows:

| | Years ending March 31, | | | | | |
|-------------------------------|------------------------|-------------|------------|------------|------------|----------|
| | Total | 2004 | 2005 | 2006 | 2007 | 2008 |
| Merchandise License Guarantee | \$1,595,000 | \$1,395,000 | \$ 150,000 | \$ 50,000 | -- | |
| Property Leases | \$3,638,771 | \$1,330,158 | \$ 924,338 | \$ 517,071 | \$ 495,545 | \$ 371,6 |
| Equipment Leases | \$ 86,016 | \$ 46,525 | \$ 19,965 | \$ 10,322 | \$ 7,969 | \$ 1,2 |

We should be able to satisfy our liquidity requirements until July 30,

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2003 by using credit that has been extended to us under our credit agreement with LaSalle. However, we are currently in default of the loan and LaSalle could accelerate the loan at any time. We hope that our renegotiations are successful, but can not guarantee that this will occur.

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.

Cash flows used in operating activities were \$11,524,680 during the fiscal year ended March 31, 2003. Cash flows were used in operating activities primarily due to increases in accounts receivable in the amount of \$2,619,778 and inventory in the amount of \$19,635,351 during fiscal 2003. We purchased a higher level of inventory in fiscal 2003 as we had anticipated a higher demand for our products.

Cash used in investing activities during the fiscal year ended March 31, 2003 was \$1,468,791. Cash used in investing activities resulted primarily from the purchase of fixed assets in the amount of \$1,144,064. 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 three years.

Cash flows provided by financing activities were \$7,741,589 during the fiscal year ended March 31, 2003. This consisted of proceeds from the exercise of warrants and options in the amount of \$242,119. The Company also had a short term loan with a director in the amount of \$400,000. 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 \$6,782,824.

EXCHANGE RATES

We sell all of our products in U.S. dollars and pay for all of our manufacturing costs in either U.S. or Hong Kong dollars. Operating expenses of the Hong Kong office are paid in Hong Kong dollars. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at HK\$7.80 to U.S. \$1.00 and, accordingly, has not represented a currency exchange risk to the U.S. dollar. We cannot assure you that the exchange rate between the United States and Hong Kong currencies will continue to be fixed or that exchange rate fluctuations will not have a material adverse effect on our business, financial condition or results of operations.

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. Sales in the Company's fiscal second and third quarter, combined, accounted for approximately 85% of net sales in fiscal 2003, 81% of net sales in fiscal 2002 and 75% of net sales in fiscal 2001.

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

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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 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 realization of the deferred tax asset, calculation of our allowance for doubtful accounts and the Hong Kong income tax exemption.

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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 March 31, 2003, the accrual was approximately \$324,000.

Realization of Deferred Tax Asset. The Company has revised its deferred tax asset based on the current year's loss in the United States. The Company expects to realize this asset within the next fiscal year.

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 \$405,759 at March 31, 2003.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Set forth below and elsewhere in this Annual Report on Form 10-K 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.

FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF STOCK

WE RECEIVED A GOING CONCERN QUALIFICATION FROM OUR INDEPENDENT AUDITORS

We received a going concern qualification from our independent auditors for the fiscal year ended March 31, 2003. We have minimal liquidity as of June 24, 2003, the date of the audit report, and our commercial lender has declared us in default under the terms of our credit agreement, which expires on July 31, 2003. For these reasons, our independent auditors were concerned about our ability to continue as a going concern. We are currently in the process of renegotiating a restructuring of our credit agreement with our commercial lender. We are also seeking other sources of long and short term capital.

Because we have a going concern qualification, it may be more difficult for us to raise capital.

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

If we are not able to restructure our credit agreement with LaSalle by July 31, 2003, we will need to seek additional funds to operate our business. Although we

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have been looking for alternative sources of capital, there can be no assurances that additional financing will be available when needed on favorable terms, or at all. If we do not have adequate financing, it will have a material adverse effect on our business, results of operation and financial condition. If these funds are not available when we need them, we may need to change our business strategy or reduce our operations. If we do not have adequate financing to operate our business, we may even be required to file a petition for Chapter 11 or enter into some liquidation or reorganization proceeding. In addition, any issuance of additional equity securities will dilute the ownership interest of our existing stockholders and issuance of debt securities may increase the perceived risk of investing in us.

WE ARE CURRENTLY IN DEFAULT UNDER OUR CREDIT AGREEMENT WITH OUR COMMERCIAL LENDER

On March 14, 2003, we received a letter from LaSalle informing us that we were in breach of our credit agreement as a result of our failure to maintain the minimum tangible net worth requirement. In this letter, LaSalle also advised us that it could accelerate the payment of all liabilities due under the credit agreement at any time. As of July 10, 2003, we have not remedied the tangible net worth requirement and LaSalle has not filed a lawsuit against us to accelerate the payment of any liabilities due under the credit agreement. If LaSalle were to exercise its right to foreclose on our assets, primarily our accounts receivable and inventory, this action might disrupt our current business operations. If LaSalle were to liquidate a significant amount of our inventory at one time, it might be more difficult for us to place inventory with other retailers. We would also need to find financing from a third party and there are no assurances that we will be able to do so.

CLASS ACTION LITIGATION

From July 2, 2003 through July 8, 2003, six securities class action lawsuits were filed against our company and certain of our officers and directors in the United States District Court for the Southern District of Florida on behalf of all persons who purchased the Singing Machine's securities during the various class action periods specified in the complaints. While the specific factual allegations vary slightly in each case, the complaints generally allege that defendants falsely represented the Singing Machine's financial results during the relevant class periods.

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While we believe that the allegations in the complaint are without merit, an unfavorable resolution of pending litigation could have a material adverse effect on our financial condition. Litigation may result in substantial costs and expenses and significantly divert the attention of the Singing Machine's management regardless of the outcome. There can be no assurance that the Singing Machine will be able to achieve a favorable settlement of pending litigation or obtain a favorable resolution of litigation if it is not settled. In addition, current litigation could lead to increased costs or interruptions of normal business operations of the Singing Machine.

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 March 31, 2003, 2002 and 2001 were approximately 67%, 77% and 87% respectively. In fiscal 2003, three major customers accounted for 21%, 17% and 15% 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

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

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.

OUR LICENSING AGREEMENTS ARE IMPORTANT TO OUR BUSINESS

We value all of our merchandise license agreements and feel that if any of them were to be terminated or fail 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 merchandise license agreements did not exist.

INVENTORY MANAGEMENT AND CONSIGNMENT ARRANGEMENTS

Because of our reliance on manufacturers in Asia for our machine production, 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 March 31, 2003, we had \$25 million in inventory. We will attempt to liquidate this excess inventory during fiscal 2004. We believe that this entire inventory is highly marketable and saleable; however, there can be no assurances that we will be able to liquidate this inventory during our upcoming fiscal year.

As of March 31, 2003, we had one remaining consignment agreement with a customer. Only one product line is included in this consignment agreement, our music. The Company does not believe that any changes to this arrangement will 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 Craig, Curtis, Grand

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Prix and Memorex. 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, Sybersound, UAV 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 2003, we produced new lines of karaoke machines. However, many of our competitors 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 85.6% of net sales in fiscal 2003, 81% of net sales in fiscal 2002 and 75% of net sales in fiscal 2001.

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.

As economic conditions fluctuate, retail environments adjust their buying patterns accordingly in order to decrease their position in inventory on hand. Although the sales of the Company's product were high, on a retail level, during fiscal 2003, the sales of other product lines not affiliated with consumer electronics were not. This had a direct effect on the decreased amount of reorders received by the Company in fiscal 2003.

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.

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 three warehouses, which are located in Compton, California, Rancho Dominguez, 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.

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

During fiscal 2003, approximately 48% of our sales were domestic sales, which were made from our warehouses in California and Florida. During the third quarter of fiscal 2003, the dock strike on the West Coast affected sales of two of our karaoke products and we estimate that we lost between \$3 and \$5 million in orders because we couldn't get the containers of these products off the pier. If another strike or work slow-down were to occur and we do not have a sufficient level of inventory, a strike or work slow-down would result in increased costs to our company and may reduce our profitability.

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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.

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

We experienced rapid growth in net sales and net income over the last few years. Our net sales for the fiscal year ended March 31, 2003 increased 53% to \$95.6 million compared to \$62.5 million for the fiscal year ended March 31, 2002. Our net income for fiscal 2003 was \$1.2 million compared to \$6.3 million for fiscal 2002. 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 and innovative 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.

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:

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- 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 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, and 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.

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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.

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

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. In the unlikely event, that the exemption is not approved, the Company has restated our 2001 and 2002 financial statements to include an accrual for these taxes, as well as for fiscal 2003. In the event the exemption is not approved, the Company has restated its financial statements for the years 2001 and 2002 and has provided for taxes on the Hong Kong subsidiary's profits at a flat rate of 16% resulting in an income tax expense of \$1,230,650, \$748,672 and \$468,424 for the fiscal years 2003, 2002 and 2001, respectively.

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

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entered into employment contracts with Edward Steele, our Chief Executive Officer; Yi Ping Chan, our Chief Operating Officer, April Green, our Chief Financial 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 or Jack Dromgold, if the need should arise, and any loss or interruption of Mr. Steele or Mr. Dromgold's services could adversely affect our business, financial condition and results of operations.

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

Our employment agreements with Eddie Steele, Yi Ping Chan, 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 shareholders. 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 March 31, 2003, there were 8,171,678 shares of our common stock outstanding. We have filed two registration statements registering an aggregate 3,794,250 of 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 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 March 31, 2003, we had 8,171,678 shares of common stock issued and outstanding and an aggregate of 1,513,250 outstanding options and warrants. As such, our Board of Directors has the power, without stockholder approval, to issue up to 9,215,072 shares of common stock.

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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. 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.

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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 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

The financial statements and supplemental data required pursuant to this Item 8 are included in this Annual Report on Form 10-K, as a separate section commencing on page F-1 and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Change of Accountants in March 2003

On March 27, 2003, we engaged Grant Thornton LLP ("Grant Thornton") as our independent auditor with respect to the preparation of OUR financial statements for fiscal 2003 and dismissed Salberg & Company, P.A. ("Salberg & Company"), our prior independent auditor on March 24, 2003. Our decision to change accountants was approved by our Audit Committee on March 24, 2003. As of March 24, 2003, we did not have any change or disagreement with Salberg & Company with respect to the preparation of the Company's financial statements for the two (2) most recent fiscal years contained in this Annual Report on Form 10-K, namely the fiscal years ended March 31, 2002 and March 31, 2001.

The report of Salberg & Company on our financial statements for fiscal 2002, fiscal 2001 and all subsequent interim periods, did not contain an adverse opinion or disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principles for fiscal 2002, fiscal 2001 and all subsequent interim periods. Furthermore, Salberg & Company did not advise the Company that:

- 1) internal controls necessary to develop reliable financial

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- statements do not exist, or
- 2) information has come to the attention of Salberg & Company which made in unwilling to rely upon management's representations or made it unwilling to be associated with the financial statement prepared by management, or
 - 3) the scope of the audit should be expanded significantly, or information has come to the attention of Salberg & Company that they have concluded will, or if further investigated might, materially impact the fairness or reliability of a previously issued audit report or the underlying financial statements, or the financial statements issued or to be issued covering the fiscal periods subsequent to March 31, 2002 (including information that may prevent it from rendering an unqualified audit report on those financial statements) or made in unwilling to rely on management's representations or to be associated with the financial statements prepared by management or,
 - 4) information has come to the attention of Salberg & Company that they have concluded will, or if further investigated might, materially impact the fairness or reliability of a previously issued audit report or the underlying financial statements or the financial statements issued or to be issued covering the fiscal periods subsequent to March 31, 2002 through March 28, 2003, the date of the Form 8-K filing reporting our change in accountants, that had not been resolved to the satisfaction of Salberg & Company or which would have prevented Salberg & Company from rendering an unqualified audit report on such financial statements.

During fiscal 2002, fiscal 2001 and all subsequent interim periods, there were no disagreements with Salberg & Company on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which, if not resolved to the satisfaction of Salberg & Company would have caused it to make reference to the subject matter of the disagreements in connection with its reports on these financial statements for those periods. We did not consult with Grant Thornton regarding the application of accounting principles to a specific transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, and no written or oral advice was provided by Grant Thornton that was a factor considered by us in reaching a decision as to the accounting, auditing or financial reporting issues.

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Restatement

In July 2003, Grant Thornton informed the company and the Audit Committee that the Company needed to restate its financial statements for fiscal 2002 and 2001 because the accrual for income tax needed to be increased for those years. We discussed this issue with Salberg & Company and they agreed to restate our financial statements for fiscal 2002 and 2001, which are included in this Annual Report on Form 10-K , to increase our accrual for income taxes.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information with respect to our executive officers and directors as of July 1, 2003.

| Name | Age | Position |
|------|-----|----------|
|------|-----|----------|

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| | | |
|--------------------|----|---|
| Edward Steele | 73 | Chief Executive Officer & Chairman |
| Yi Ping Chan | 38 | Interim Chief Operating Officer, Secretary |
| Jack S. Dromgold | 59 | Executive Vice-president of Sales & Marketing |
| April J. Green | 39 | Chief Financial Officer |
| Josef A. Bauer | 65 | Director |
| Howard W. Moore | 72 | Director |
| Robert J. Weinberg | 54 | Director |
| John F. Klecha | 52 | Director |

Edward Steele has served as the Chief Executive Officer and as a director of the Singing Machine from September 1991 through the present date. He also served as our President from September 1991 through March 2001 and oversaw our reorganization in our Chapter 11 proceeding which began in April 1997 and was completed in June 1998. From October 1988 to September 1991, Mr. Steele was our sales director and was responsible for the development of our electronic hardware products in Asia. Prior to joining us, Mr. Steele served in executive capacities at a number of companies in the toy and electronics fields, including as managing director in charge of worldwide sales of Concept 2000, a manufacturer of consumer electronics from 1971 to 1978; as President of Wicely Corp., a distributor of electronic toys and consumer electronics from 1978 to 1983; and as President of Justin Products Corp., an electronic toy manufacturer from 1983 to 1988.

Yi Ping Chan has served as our Interim Chief Operating Officer from May 2, 2003. Prior to this appointment, Chan was a consultant to Singing Machine. Mr. Chan was a founder of MaxValue Capital Ltd., a Hong Kong-based management consulting and investment firm, and co-founder of E Technologies Ltd., Hong Kong, which specialized in health care technology transfer from April 1996 to March 2003. Prior to that, he was Chief Strategist and Interim CFO from January 2000 to June 2002, a Hong Kong-based IT and business process consulting firm with operations in Hong Kong, China and the US. He also held a senior management position with a Hong Kong-based venture capital and technology holding company with operations in Hong Kong, China and the US. From 1994 to 1997, Mr. Chan was Business Development Manager for AlliedSignal Inc. (now part of Honeywell International, inc.) and Knorr-Bremse Far East Ltd., where he focused on joint ventures and acquisitions in China and Japan. Earlier, he was Senior Associate Engineer for IBM in New York, and began his career as a member of the technical staff of TRW Corporation in Redondo Beach, California. Mr. Chan received a BSEE with Magna Cum Laude in 1987 from Polytechnic University, New York. Under IBM sponsorship, Mr. Chan earned an MBA in 1994 and a MSEE in 1990 from Columbia University. Mr. Chan was a member of the Young Entrepreneurs' Organization, serving as a board member of the Hong Kong chapter in 2002 and 2003. He also served as a development advisor and associate for the Global Chinese Business Initiative at the Wharton School, University of Pennsylvania from 1998 to 2001.

Jack Dromgold has served as our Executive Vice President of Sales and Marketing since April 16, 2002 through the present date. Prior to joining us, Mr. Dromgold served as Vice President of Sales for Hasbro Games from 1993 through April 2002. Mr. Dromgold is a 35-year veteran of the toy and game industry and has been involved in the development of sales programs to support the launch of many new products over the years.

April Green has served as our Chief Financial Officer since March 15, 2002. Ms. Green joined our company in June 1999 as our controller and was promoted to the position of Director of Finance & Administration in January 1, 2000. Prior to joining us, Ms. Green held various positions of increasing responsibility with Monogram International, a large, Florida-based novelty and toy company from February 1993 to June 1999. At Monogram, Ms. Green rose from Staff Accountant to Controller. Prior to June 1999, she served in a variety of financial positions in the automotive industry in the Tampa area. Ms. Green is a Certified Public Accountant, a member of the American Institute of Certified Public Accountants (AICPA) and a member of the AWSCPA (American Woman's Society

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of CPA's).

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John Klecha has served as a director of our company since October 10, 1997. Mr. Klecha served as our President from March 2001 through May 2, 2003, as our Chief Operating Officer from March 2001 through May 2, 2003 and as our Chief Financial Officer, Secretary and Treasurer from October 10, 1997 through April 15, 2002. Mr. Klecha joined our company to assist us from emerging from our Chapter 11 reorganization proceedings. Prior to joining us, Mr. Klecha served in executive and senior management capacities at a number of companies in the toy and other consumer products industries, including as a senior financial and administrative executive of a privately held toy design, manufacturing and distribution company from 1987 through 1997; as Vice President, Director and Chief Financial Officer of Sussex Nautilus from 1984 to 1987; and Vice President of Finance and Administration for Lazzaroni Sarrono, Ltd. from 1982 to 1984.

Josef A. Bauer has served as a director from October 15, 1999. Mr. Bauer previously served as a director of the Singing Machine from February 1990 until September 1991 and from February 1995 until July 1997, when we began our Chapter 11 proceeding. Mr. Bauer presently serves as the Chief Executive Officer of the following three companies: Banisa Corporation, a privately owned investment company, since 1975; Trianon, a jewelry manufacturing and retail sales companies since 1978 and Seamon Schepps, also a jewelry manufacturing and retail sales company since 1999.).

Howard Moore has served as a director since August 2000. From 1984, when Mr. Moore joined Toys 'R Us as executive vice president and general merchandise manager, until 1990, when he retired, sales increased from \$480 million to \$4.8 billion. Mr. Moore served on the Toys 'R' Us board of directors from 1984 until June 2000. He is also founder and president of Howard Moore Associates, a company, which provides marketing, product licensing, packaging and merchandising consulting to the toy industry. Previously, he was president and CEO of Toy Town, USA, Inc. after founding and operating two other toy chain stores. Mr. Moore is currently serving as the Chairman of the Advisory Board of Leapfrog Enterprises, Inc.

Robert Weinberg has served as a director from March 9, 2001. Mr. Weinberg has considerable experience in toy products, marketing, licensing, merchandising and packaging. He is currently the founder and president of RJW & Associates, a marketing consulting firm based in Saddle River, New Jersey. Previously, he served in various positions of increasing responsibility with Toys `R Us, rising through the ranks from buyer trainee in 1971 to Senior Vice President - General Merchandise Manager in 1997. In these later positions, he was responsible for purchasing advertising/marketing, imports, product development, store planning and allocations. He retired from Toys `R' Us in March 2000.

Our directors serve for a term of one year, or until their successors shall have been elected and qualified. Our executive officers are appointed and serve at the discretion of the Board of Directors. There are no family relationships among any of our directors and executive officers. However, one of our key personnel, John Steele, our Director of Sales - International, is the son of Edward Steele, our Chief Executive Officer and Director.

BOARD COMMITTEES

We have an audit committee, an executive compensation/stock option committee and a nominating committee. The audit committee consists of Messrs. Bauer, Moore and Weinberg. The audit committee recommends the engagement of independent auditors to the board, initiates and oversees investigations into

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matters relating to audit functions, reviews the plans and results of audits with our independent auditors, reviews our internal accounting controls, and approves services to be performed by our independent auditors. The executive compensation/stock option committee consists of Messrs. Bauer, Moore and Weinberg. The executive compensation/stock option committee considers and authorizes remuneration arrangements for senior management and grants options under, and administers our employee stock option plan. The entire Board of Directors operates as a nominating committee. The nominating committee is responsible for reviewing the qualifications of potential nominees for election to the Board of Directors and recommending the nominees to the Board of Directors for such election.

DIRECTOR'S COMPENSATION

During fiscal 2002, our non-employee directors received a \$1,000 cash stipend for serving on our Board and reimbursement for all reasonable expenses incurred in attending meetings. During fiscal 2003, we increased our annual cash stipend to non-employee directors to \$10,000 per year. We also grant each of our outside directors 10,000 options for each year of service on the Board. Effective as of July 2, 2002, we granted each of our three outside directors' options to purchase 30,000 shares of the Company's common stock, with 10,000 options vesting each year on the day before our annual shareholder's meetings. The exercise price of the options will be equal to the fair market value of the Company's common stock on the grant date. The options will be vested over the three year period and are exercisable for a period of five years after the vesting date.

COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

To our knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required, the Company believes that during the year ended March 31, 2002, its officers, directors and 10% shareholders complied with all Section 16(a) filing requirements except that Mr. Bauer, Mr. Klecha, Mr. Moore, Mr. Steele and Mr. Weinberg each filed one Form 4 late in which they each reported the receipt of a grant of stock options. Mr. Dromgold filed one Form 4 late in which he reported the receipt of 2 options grants.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth certain compensation information for the fiscal years ended March 31, 2000, 2001, 2002 and 2003 with regard to Edward Steele, our Chief Executive Officer, and each of our other executive officers whose compensation exceeded \$100,000 on an annual basis (the "Named Officers"):

| Summary Compensation Table | | | | | | |
|---|------|--------|-------|------------------------------|-----------------------------------|-------------|
| Annual Compensation | | | | | | |
| Name of Individual and Principal Position | Year | Salary | Bonus | Other Annual Compensation(1) | Restricted Stock | Secur Under |
| | | | | | Award(s) Options / SAR's | |

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| | | | | | | |
|--|------|-----------|-----------|----------|---|-------|
| Edward Steele, CEO | 2003 | \$382,352 | \$0 | \$8,671 | 0 | |
| | 2002 | \$364,145 | \$192,133 | \$8,258 | 0 | 15,0 |
| | 2001 | \$320,865 | \$256,289 | \$7,938 | 0 | 315,0 |
| John Klecha, President, COO (3) | 2003 | \$300,117 | \$0 | \$6,555 | 0 | |
| | 2002 | \$286,111 | \$157,200 | \$6,242 | 0 | 15,0 |
| | 2001 | \$255,777 | \$205,031 | \$6,000 | 0 | 300,0 |
| April Green, CFO (7) | 2003 | \$122,200 | \$25,000 | \$3,900 | 0 | 20,0 |
| | 2002 | \$88,825 | \$25,000 | \$3,900 | 0 | 30,0 |
| | 2001 | \$83,658 | \$17,000 | \$3,900 | 0 | 7,5 |
| Jack Dromgold, Executive Vice-president, Sales & Marketing (4) (5) (6) | 2003 | \$210,277 | \$50,000 | \$51,067 | 0 | 150,0 |

- (1) The amounts disclosed in this column for fiscal 2003, 2002 and 2001 include automobile expense allowances which are provided pursuant to the executive's employment agreements.
- (2) Includes the Company's matching contributions under its 401(k) savings plan and medical insurance pursuant to the executive's employment agreements.
- (3) Mr. Klecha resigned as our President and Chief Operating Officer effective as of May 2, 2003.
- (4) Mr. Dromgold joined our company on April 15, 2003.
- (5) Mr. Dromgold received \$50,000 as a signing bonus when he joined our company pursuant to his employment agreement.
- (6) Includes relocation expenses of \$45,529. After one year of employment, Mr. Dromgold had the right to sell the 50,000 options that were granted to him under his employment agreement back to the Company at a price of \$100,000. Mr. Dromgold did not elect to exercise this right during fiscal 2003.
- (7) Ms. Green has served as our Chief Financial Officer since March 15, 2002. She served as the Director of Finance and Administration from January 1, 2000 through March 14, 2002 and as our controller from June 1999 through December 2000.

OPTION GRANTS IN FISCAL 2003

The following table sets forth information concerning all options granted to our officers and directors during the year ended March 31, 2002. No stock appreciation rights ("SAR's") were granted.

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| Name | Shares Underlying Options Granted(1) | Total Options Granted to Employees in Fiscal Year Per | Exercise Price Share | Expiration Date | Value at Annual Rates Price Appr for Option 5% |
|---------------|--------------------------------------|---|----------------------|-----------------|--|
| Edward Steele | 30,000 | 5.25% | \$ 14.30 | 7/15/08 | |
| John Klecha | 24,000 | 4.28% | \$ 14.30 | 7/15/08 | |
| Jack Dromgold | 50,000 | 8.76% | \$ 8.61 | 8/14/07 | |
| | 50,000 | (4) | \$ 9.00 | 12/31/08 | |
| April Green | 20,000 (4) | 3.50% | \$ 9.00 | 12/31/08 | |

- (1) All options were granted pursuant to the Year 2001 Stock Option Plan. Option exercise prices were at the market when granted.
- (2) The dollar amounts under these columns are the result of calculations based on the market price on the date of grant at an assumed annual rate of appreciation over the maximum term of the option at 5% and 10% as required by applicable regulations of the SEC and, therefore, are not intended to forecast possible future appreciation, if any of the common stock price. Assumes all options are exercised at the end of their respective terms. Actual gains, if any, on stock option exercises depend on the future performance of the common stock.
- (3) Half of these options, 25,000 vested on April 15, 2003 and the remaining 25,000 vest on April 15, 2004.
- (4) Twenty percent of the options are exercisable on January 1, 2004 and 20% exercisable each January 1st thereafter with the last 20% becoming exercisable on January 1, 2008. These options expire with varying expiration dates from December 31, 2009 through December 31, 2013.

Aggregated Option Exercises In Fiscal Year Ended March 31, 2002 And Option Values

The following table sets forth information as to the exercise of stock options during the fiscal year ended March 31, 2002 by our officers listed in our Summary Compensation Table and the fiscal year-end value of unexercised options.

| Name of Individual | Shares Acquired Upon Exercise | Value Realized(1) | Number of Unexercised Options at Fiscal Year End | Value of Unexercised In-the-Money Options at Fiscal Year End(2) |
|--------------------|-------------------------------|-------------------|--|---|
| Edward Steele | 0 | 0 | 352,500/0 | \$2,251,050/0 |
| John Klecha | 0 | 0 | 382,500/0 | \$2,502,330/0 |
| Jack Dromgold | 0 | 0 | 50,000/50,000 | \$0/0 |

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April Green 1,000 \$ 3,940 26,000/20,000 \$ 128,440/0

- (1) Value realized is based on the difference between the closing price of our common stock on the date of exercise and the option exercise prices times the number of outstanding options.
- (2) Value of unexercised options equals \$6.98, the average of the high and low trading prices on March 31, 2003, less the option exercise price multiplied by the number of shares exercisable or unexercisable.

EMPLOYMENT AND CONSULTING AGREEMENTS

Edward Steele. Mr. Steele is employed as our Chief Executive Officer pursuant to an employment agreement dated March 1, 1998, as amended on May 5, 2000. Mr. Steele's employment agreement expires on February 28, 2004. Under this agreement, his annual compensation was \$367,500 for fiscal 2003. The agreement also provides for a discretionary bonuses determined by our Board of Directors. Mr. Steele did not receive a discretionary bonus for fiscal 2003. In the event of a termination of Mr. Steele's employment in the event of a change in control, Mr. Steele would be entitled to a lump sum payment of 300% of the amount of his total compensation in the twelve months preceding such termination. During the term of his employment agreement and for a period of one year after his termination for cause or his voluntary termination of his employment, Mr. Steele can not directly or indirectly compete with our company in the karaoke industry in the United States.

Jack Dromgold. On April 15, 2002, we entered into a three-year employment agreement with Jack Dromgold, expiring on April 14, 2005. We hired Mr. Dromgold to be our Executive Vice President of Sales and Marketing. Mr. Dromgold's employment agreement will be automatically be extended for an additional year, unless either party gives written notice at least sixty days prior to the end of the three-year term. Pursuant to Mr. Dromgold's employment agreement, he is entitled to receive base compensation of \$220,000 per year, which amount automatically increases during the second and third fiscal years by not less than the greater of 5% or the annual increase in the consume price index.

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As a signing bonus, we agreed to pay Mr. Dromgold a signing bonus in the amount of \$50,000 and options to purchase 50,000 shares of our common stock. We also gave Mr. Dromgold the right to sell the 50,000 options back to us for \$100,000 after his first year of employment with the company. Mr. Dromgold did not exercise this right after his first year of employment and in May 2003 we verbally extend his put option for another year until April 15, 2004. We also agreed to grant Mr. Dromgold a minimum of 50,000 options for each year of his employment with the company. During his first year of employment, Mr. Dromgold's bonus is equal to 1% of new accounts shipped, but will be equal to a minimum of \$50,000. During the second year of his employment, Mr. Dromgold's bonus will be switched to 10% of the Company's then current bonus plan. We also agreed to pay Mr. Dromgold's certain moving expenses in connection with his move from Massachusetts to Florida. Mr. Dromgold's moving expenses were \$39,000.

In the event of a termination of Mr. Dromgold's employment in the event of a change in control, Mr. Dromgold would be entitled to a lump sum payment of 50% of the amount of his total compensation in the twelve months preceding such termination. During the term of his employment agreement and for a period of one year after his termination for cause or his voluntary termination of his employment, Mr. Dromgold can not directly or indirectly compete with our company in the karaoke industry in the United States.

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April Green. On March 15, 2002, we entered into a three-year employment agreement with April Green, our Chief Financial Officer. Pursuant to Ms. Green's employment agreement, she is entitled to receive base compensation of \$122,200 per year, which amount automatically increases during the second and third fiscal years by not less than the greater of 5% or the annual increase in the consumer price index. The agreement also provides for discretionary bonuses based on a percentage of the Company's current bonus pool. In the event of a termination of her employment following a change of control, Ms. Green would be entitled to a lump sum payment of 50% of the amount of her total compensation in the twelve months preceding such termination. During the term of her employment agreement and for a period of one year after her termination for cause, Ms. Green can not directly or indirectly compete with our company in the karaoke industry in the United States.

Yi Ping Chan On March 28, 2003, we entered into a three-year employment agreement with Yi Ping Chan, our Chief Operating Officer. Mr. Chan is entitled to receive bonuses and increases in his annual salary, at the sole discretion of the Company's Board of Directors. We also agreed to grant Mr. Chan options to purchase 150,000 shares of the Company's common stock, of which 50,000 options will vest each year.

In the event of a termination of her employment following a change of control, Mr. Chan would be entitled to a lump sum payment of 100% of the amount of his total compensation in the twelve months preceding such termination. During the term of his employment agreement and for a period of one year after her termination for cause, Mr. Chan can not directly or indirectly compete with our company in the karaoke industry in the United States.

John Klecha. Mr. Klecha was employed as our Chief Operating Officer pursuant to an employment dated July 1, 2000. Under his agreement, Mr. Klecha received a base salary of \$275,000 during fiscal 2003 and a bonus determined at the sole discretion of the Board of Directors. During fiscal 2003, Mr. Klecha did not receive a discretionary bonus. In the event of a termination of his employment following a change-in-control, Mr. Klecha would be entitled to a lump sum payment of 200% of the amount of his total compensation in the twelve months preceding such termination. During the term of his employment agreement and for a period of one year after his termination for cause, or his voluntary termination of his employment agreement, Mr. Klecha could not directly or indirectly compete with our company in the karaoke industry in the United States.

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Mr. Klecha's employment agreement was to expire on May 31, 2003 and would automatically extend for an additional year, until May 31, 2004, unless either party gave written notice at least sixty days prior to the end of the three-year term. We gave Mr. Klecha notice that we would not renew his employment agreement in February 2003. Mr. Klecha resigned as our Chief Operating Officer and President, effective as of May 2, 2003. In connection with his resignation, we entered into a separation and release agreement. Under this agreement, we agreed to provide Mr. Klecha with a severance payment equal to \$183,707, which consisted of (i) salary and auto allowance through May 31, 2003, (ii) four weeks of accrued vacation time, (iii) four months of salary and automobile allowance payments and (iv) seven months COBRA reimbursement payments. In exchange, Mr. Klecha agreed to release the Company from any liability in connection with termination of employment.

Equity Compensation Plans And 401(K) Plan

The Company has two stock option plans: the 1994 Amended and Restated Stock Option Plan ("1994 Plan") and the Year 2001 Stock Option Plan ("Year 2001

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Plan"). Both the 1994 Plan and the Year 2001 Plan provide for the granting of incentive stock options and non-qualified stock options to our employees, officers, directors and consultants As of March 31, 2001, we had 970,225 options issued and outstanding under our 1994 Plan and 81,750 options are issued and outstanding under our Year 2001 Plan.

The following table gives information about equity awards under our 1994 Plan, the Year 2001 Plan.

| Plan Category | Number of securities to be issued upon exercise or outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Num av (ex |
|--|---|---|------------------|
| Equity Compensation Plans approved by Security holders | 1,513,250 | \$4.38 | |
| Equity Compensation Plans Not approved by Security Holders | 0 | | |

1994 Plan

Our 1994 Plan was originally adopted by our Board of Directors in May 1994 and it was approved by our shareholders on June 29, 1994. Our shareholders approved amendments to our 1994 Plan in March 1999 and September 2000. The 1994 Plan reserved for issuance up to 1,950,000 million share of our common stock pursuant to the exercise of options granted under the Plan. As of March 31, 2003, we had granted all the options that are available for grant under our 1994 Plan. As of March 31, 2003, we have 970,225 options issued and outstanding under the 1994 Plan and all of these options are fully vested as of March 31, 2003.

Year 2001 Plan

On June 1, 2001, our Board of Directors approved the Year 2001 Plan and it was approved by our shareholders at our special meeting held September 6, 2001. The Year 2001 Plan was developed to provide a means whereby directors and selected employees, officers, consultants, and advisors of the Company may be granted incentive or non-qualified stock options to purchase common stock of the Company. The Year 2001 Plan authorizes an aggregate of 1,950,000 shares of the Company's common stock and a maximum of 450,000 shares to any one individual in any one fiscal year. The shares of common stock available under the Year 2001 Plan are subject to adjustment for any stock split, declaration of a stock dividend or similar event. At March 31, 2003, we have granted 745,200 options under the Year 2001 Plan, 233,200 of which are fully vested.

The Year 2001 Plan is administered by our Stock Option Committee ("Committee"), which consists of two or more directors chosen by our Board. The Committee has the full power in its discretion to (i) grant options under the Year 2001 Plan, (ii) determine the terms of the options (e.g. - vesting, exercise price), (iii) to interpret the provisions of the Year 2001 Plan and (iv) to take such action as it deems necessary or advisable for the administration of the Year 2001 Plan.

Options granted to eligible individuals under the Year 2001 Plan may be either incentive stock options ("ISO's"), which satisfy the requirements of Code Section 422, or non-statutory options ("NSO's"), which are not intended to

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satisfy such requirements. Options granted to outside directors, consultants and advisors may only be NSO's. The option exercise price will not be less than 100% of the fair market value of the Company's common stock on the date of grant. ISO's must have an exercise price greater to or equal to the fair market value of the shares underlying the option on the date of grant (or, if granted to a

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holder of 10% or more of our common stock, an exercise price of at least 110% of the under underlying shares fair market value on the date of grant). The maximum exercise period of ISO's is 10 years from the date of grant (or five years in the case of a holder with 10% or more of our common stock). The aggregate fair market value (determined at the date the option is granted) of shares with respect to which an ISO are exercisable for the first time by the holder of the option during any calendar year may not exceed \$100,000. If that amounts exceeds \$100,000, our Board of the Committee may designate those shares that will be treated as NSO's.

Options granted under the Year 2001 Plan are not transferable except by will or applicable laws of descent and distribution. Except as expressly determined by the Committee, no option shall be exercisable after thirty (30) days following an individual's termination of employment with the Company or a subsidiary, unless such termination of employment occurs by reason of such individual's disability, retirement or death. The Committee may in its sole discretion, provide in a grant instrument that upon a change of control (as defined in the Year 2001 Plan) that all outstanding option issued to the grantee shall automatically, accelerate and become full exercisable. Additionally, the obligations of the Company under the Year 2001 Plan are binding on (1) any successor corporation or organization resulting from the merger, consolidation or other reorganization of the Company or (2) any successor corporation or organization succeeding to all or substantially all of the assets and business of the Company. In the event of any of the foregoing, the Committee may, at its discretion, prior to the consummation of the transaction, offer to purchase, cancel, exchange, adjust or modify any outstanding options, as such time and in such manner as the Committee deems appropriate.

401(K) Plan

Effective January 1, 2001, we adopted a voluntary 401(k) plan. All employees with at least one year of service are eligible to participate in our 401(k) plan. In fiscal 2002, we made a matching contribution of 100% of salary deferral contributions up to 3% of pay, plus 50% of salary deferral contributions from 3% to 5% of pay for each payroll period. The amounts charged to earnings for contributions to this plan and administrative costs during the years ended March 31, 2003, 2002 and 2001 totaled \$61,466, \$41,733 and \$8,682, respectively.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table set forth as of July 7, 2003, certain information concerning beneficial ownership of our common stock by:

- all directors of the Singing Machine,
- all executive officers of the Singing Machine.
- persons known to own more than 5% of our common stock;

Unless otherwise indicated, the address for each person is The Singing Machine Company, Inc., 6601 Lyons Road, Building A-7, Coconut Creek, Florida 33073.

As of July 7, 2003, we had 8,300,233 shares of our common stock issued and outstanding.

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As used herein, the term beneficial ownership with respect to a security is defined by Rule 13d-3 under the Securities Exchange Act of 1934 as consisting of sole or shared voting power (including the power to vote or direct the vote) and/or sole or shared investment power (including the power to dispose or direct the disposition of) with respect to the security through any contract, arrangement, understanding, relationship or otherwise, including a right to acquire such power(s) during the next 60 days. Unless otherwise noted, beneficial ownership consists of sole ownership, voting and investment rights.

| Shares of Common Name | Common Stock | Percentage of Common Stock |
|--|-----------------|----------------------------------|
| Eddie Steele Chief Executive Officer and Chairman of the Board | 1,102,910 (1) | 12.77% |
| Y.P. Chan 0(2) * Chief Operating Officer | | |
| April Green Chief Financial Officer | 27,050 (3) | * |
| Jack Dromgold Executive Vice President | 25,600 (4) | * |
| Joseph Bauer Director | 968,272 (5) | 11.69% |
| Howard Moore Director | 388,220 (6) | 4.07% |
| Robert Weinberg Director | 58,300 (7) | * |
| John Klecha Director | 1,084,600 (8) | 12.66% |
| Wellington Management Company, LLP | 945,000 (9) | 11.39% |
| All Directors and Executive Officers as a Group | 3,654,952 (10) | 40.10% |

* Less than 1%.

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- (1) Includes 337,500 shares issuable upon the exercise of stock options that are exercisable within 60 days of May 5, 2003.
- (2) Mr. Chan owns options to purchase 150,000 shares of the Company's common stock, with 1/3 of the options vesting on December 31, 2003. Because these options are not exercisable within 60 days, Mr. Chan is not deemed to be the beneficial owner under the Exchange Act.
- (3) Includes 26,000 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.

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- (4) Includes 50,000 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.
- (5) Includes 167,197 shares which are held by Mr. Bauer directly, 360,000 shares held by Mr. Bauer's pension plan, 169,600 shares held by the Bauer Family Limited Partnership, 200,000 shares held by Mr. Bauer's wife, 51,475 shares held by Mr. Bauer and his wife directly and 20,000 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.
- (6) Includes 243,150 shares held by the Howard & Helen Moore Living Trust, 49,250 shares held by Howard Moore Associates, Inc. Defined Benefit Pension Plan, 2,077 shares held by the Howard & Helen Moore Insurance Trust and 43,750 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.
- (7) Includes 55,000 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.
- (8) Includes 309,000 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.
- (9) The address of Wellington Management Company, LLP is 78 State Street, Boston, Massachusetts 02109. All of the information presented in this item with respect to this beneficial owner was extracted solely from their Scheduled 13G filed on February 14, 2003.
- (10) Includes 816,250 shares issuable upon the exercise of stock options that are exercisable within 60 days of July 7, 2003.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On or about July 10, 2003, certain officers and directors of our company advanced \$1 million to the Company. The officer was Yi Ping Chan and the directors were Jay Bauer and Howard Moore. Additionally, Maureen LaRoche, a business associate of Mr. Bauer, participated in the financing. We have not finalized the terms of this management loan. It is presently expected that the loan will be a short-term loan, which will be due on or before October 31, 2003. However, we have not yet determined the interest rate or if any compensation, such as warrants, will be awarded to the management investment group for their loan

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On July 1, 1999, we loaned \$55,000 to each of Eddie Steele and John Klecha to purchase 2 units in our private placement. These loans bore interest at the rate of 9% per annum and were due on June 28, 2001. Mr. Klecha and Mr. Steele repaid these loans and all accrued interest in June 2001.

In June 1999, we arranged a credit facility with Main Factors, whereby Main Factors purchased certain of our accounts receivable. To secure the credit facility, John Klecha, our Chief Operating Officer and Chief Financial Officer, provided his personal payment guaranty. In July 1999, we entered into an agreement with EPK Financial Corporation ("EPK") whereby EPK provided letters of credit with our factories to import inventory for distribution to our customers. To secure the EPK facility, Edward Steele and John Klecha provided their personal guarantees. In consideration for providing their personal guarantees of these credit facilities, we issued 200,000 shares of our common stock to Mr. Steele and 150,000 shares of our common stock to Mr. Klecha in June 1999. Both agreements with Main Factors and EPK were terminated in April 2001. We amortized the value of these deferred guarantee fees over a two year period, which was

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completed in the first quarter of fiscal 2002.

ITEM 14. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation (the "Evaluation") of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-14(c) and 15d-15(c) under the Securities Exchange Act of 1934, within 90 days of the filing date of this report (the "Evaluation Date"). In the course of the Evaluation, we identified significant and material weaknesses in our internal disclosure controls and procedures. As a result of certain deficiencies relating to unrecorded liabilities related to income taxes, we needed to restate our financial statements for fiscal 2002 and 2001 to include a higher accrual for income taxes. We performed additional procedures ("Additional Procedures") to supplement our internal controls in order to mitigate the effect of certain weaknesses and deficiencies that had been identified in the Evaluation and to prevent misstatements or omissions in our consolidated financial statements resulting from such factors. Based on the Evaluation, our Chief Executive Officer, and our Chief Financial Officer concluded, as of the Evaluation Date, that the Company's disclosure controls and procedures, including the Additional Procedures, were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

We intend to take substantial corrective actions to eliminate weaknesses in our disclosure controls and procedures. We will retain outside professional advisors to review our disclosure controls and procedures and to provide us with a comprehensive action plan to improve this process. As part of this plan, we expect to implement more control policies and procedures and to provide more formalized training of finance, sales and other staff. and will provide our finance staff with more training. We will continue to evaluate and implement corrective actions to improve the effectiveness of our disclosure controls and procedures and will take further actions dictated by such continuing reviews.

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.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Exhibits

- 3.1 Certificate of Incorporation of the Singing Machine filed with the Delaware Secretary of State on February 15, 1994 and amendments through April 15, 1999 (incorporated by reference to Exhibit 3.1 in the Company's registration statement on Form SB-2 filed with the SEC on March 7, 2000).
- 3.2 Certificate of Amendment of the Singing Machine filed with the Delaware Secretary of State on September 29, 2000 (incorporated by reference to Exhibit 3.1 in the Company's Quarterly Report on Form 10-QSB for the period ended September 30, 1999 filed with the SEC on November 14, 2000).

- 3.3 Certificates of Correction filed with the Delaware Secretary of State on

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- March 29 and 30, 2001 correcting the Amendment to our Certificate of Incorporation dated April 20, 1998 (incorporated by reference to Exhibit 3.11 in the Company's registration statement on Form SB-2 filed with the SEC on April 11, 2000).
- 3.4 Amended By-Laws of the Singing Machine Company (incorporated by reference to Exhibit 3.14 in the Company's Annual Report on Form 10-KSB for the year ended March 31, 2001 filed with the SEC on June 29, 2001).
- 4.1 Form of Certificate Evidencing Shares of Common Stock (incorporated by reference to Exhibit 3.3. of the Company's registration statement on Form SB-2 filed with the SEC on March 7, 2000)
- 10.1 Employment Agreement dated May 1, 1998 between the Singing Machine and Edward Steele (incorporated by reference to Exhibit 10.1 of the Company's registration statement on Form SB-2 filed with SEC on March 7, 2000).
- 10.2 Employment Agreement dated June 1, 2000 between the Singing Machine and John Klecha (incorporated by reference to Exhibit 10.5 of the Company's registration statement on Form SB-2 filed with the SEC March 28, 2001).
- 10.3 Separation and Release Agreement effective as of May 2, 2003 between the Singing Machine and John Klecha.*
- 10.4 Employment Agreement dated March 15, 2002 between the Singing Machine and April Green (incorporated by reference to Exhibit 10.21 of the Company's Annual Report on Form 10-KSB/A filed with the SEC on July 23, 2002).
- 10.5 Employment Agreement dated April 14, 2002 between the Singing Machine and Jack Dromgold (incorporated by reference to Exhibit 10.20 of the Company's Annual Report on Form 10-KSB/A filed with the SEC on July 23, 2003).
- 10.6 Employment Agreement dated May 2, 2003 between the Singing Machine and Yi Ping Chan.*
- 10.7 Domestic Merchandise License Agreement dated November 1, 2000 between MTV Networks, a division of Viacom International, Inc. and the Company (incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003, filed with the SEC on February 14, 2003).
- 10.8 Amendment dated January 1, 2002 to Domestic Merchandise License Agreement between MTV Networks, a division of Viacom International, Inc. and the Company ((incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003, filed with the SEC on February 14, 2003).
- 10.9 Second Amendment as of November 13, 2002 to Domestic Merchandise License Agreement between MTV Networks, a division of Viacom International, Inc. and the Company ((incorporated by reference to Exhibit 10.5 of the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003, filed with the SEC on February 14, 2003).
- 10.10 Third Amendment as of February 26, 2003 to Domestic Merchandise License Agreement between MTV Networks, a division of Viacom International, Inc. and the Company (portions of this Exhibit 10.10 have been omitted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission).
- 10.11 Industrial Lease dated March 1, 2002, by and between AMP Properties, L.P. and The Singing Machine Company, Inc. for warehouse space in Compton, California (incorporated by reference to Exhibit 10.20 of the Company's Annual Report on Form 10-KSB/A filed with the SEC on July 23, 2002).

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- 10.12 Loan and Security Agreement dated April 2000 between LaSalle Business Credit, Inc. and the Singing Machine Company (incorporated by reference to Exhibit 3.1 in the Company's Quarterly Report on Form 10-QSB for the period ended September 30, 1999 filed with the SEC on November 14, 2000).
- 10.13 First through Fourth Amendment to Loan and Security Agreement dated October 1, 2001 through February 28, 2002 between LaSalle Business Credit, Inc. and the Singing Machine Company (incorporated by reference to Exhibits 10.11 through 10.14 of the Company's Annual Report on Form 10-KSB/A filed with the SEC on July 23, 2003).
- 10.14 Fifth Amendment to Loan and Security Agreement dated August 13, 2002 between LaSalle Business Credit, Inc. and the Singing Machine Company (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 filed with the SEC on November 14, 2002).
- 10.15 Sixth Amendment to Loan and Security Agreement dated November 28, 2001 between LaSalle Business Credit, Inc. and the Singing Machine Company (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2002, filed with the SEC on February 14, 2003).
- 10.16 Seventh through Tenth Amendment to Loan and Security Agreement dated February 2-, 2003 through March 28, 2003 between LaSalle Business Credit, Inc. and the Singing Machine Company, In (incorporated by reference to Exhibits 10.1 through 10.5 to the Form 8-K filed with the SEC on May 21, 2003).*
- 10.17 Eleven Amendment to Loan and Security Agreement dated February 28, 2002 between LaSalle Business Credit, Inc. and the Singing Machine Company, Inc. (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on June 4, 2003).
- 10.18 Twelfth Amendment to Loan and Security Agreement dated February 28, 2002 between LaSalle Business Credit, Inc. and the Singing Machine Company, Inc.* (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on July 7, 2003).

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- 10.19 Amended and Restated 1994 Management Stock Option Plan (incorporated by reference to Exhibit 10.6 to the Company's registration statement on Form SB-2 filed with the SEC on March 28, 2001).
- 10.20 Year 2001 Stock Option Plan (incorporated by reference to Exhibit 10.1 of the Company's registration statement on Form S-8 filed with the SEC on September 13, 2002).
- 10.21 Singing Machine's Amended Bankruptcy Plan of Reorganization dated December 17, 1997 and Bankruptcy Court's Order Confirming the Plan of Reorganization (incorporated by reference to Exhibit 10.5 of the Company's registration statement on Form SB-2 filed with the SEC on March 7, 2000).

21.1 List of Subsidiaries*

23.1 Consent of Grant, Thornton, LLP*

*Filed herewith

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Reports on Form 8-K

We filed a Current Report on Form 8-K dated March 24, and 27, 2003 reporting information contained in Item 4 - Change in Registrant's Certifying Accountant.

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SIGNATURES

In accordance with the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE SINGING MACHINE COMPANY, INC.

Dated: January 3, 2005 By: /s/ Yi Ping Chang

Yi Ping Chang
Chief Executive Officer

In accordance with the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

| Signature | Capacity | Date |
|-----------------------------|-------------------------|------------|
| ----- | ----- | ----- |
| /s/ Yi Ping Chan | Chief Executive Officer | January 5, |
| ----- Yi Ping Chang | | |
| /s/ Jeffrey Barocas | Chief Financial Officer | January 5, |
| ----- Jeffrey Barocas | | |
| /s/ Josef A. Bauer | Director | |
| ----- Josef A. Bauer | | |
| /s/ John F. Klecha | Director | |
| ----- John F. Klecha | | |
| /s/ Howard W. Moore | Director | |
| ----- Howard W. Moore | | |
| /s/ Robert J. Weinberg | Director | |
| ----- Robert J. Weinberg | | |

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The Singing Machine Company, Inc. and Subsidiary

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Consolidated Financial Statements

March 31, 2003

The Singing Machine Company, Inc.
and Subsidiary

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[GRANT THORNTON LETTERHEAD]

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
The Singing Machine Company, Inc.

We have audited the accompanying consolidated balance sheet of The Singing Machine Company, Inc. and subsidiary (the "Company") as of March 31, 2003 and the related consolidated statements of earnings, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Singing Machine Company, Inc. and subsidiary as of March 31, 2003 and the consolidated results of their operations and their consolidated cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II of The Singing Machine Company, Inc. and subsidiary for the year ended March 31, 2003. In our opinion, this schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information therein.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, on March 14, 2003, the Company was notified of its violation of the net worth covenant of its Loan and Security Agreement (the "Agreement") with its commercial lender (the "Lender") and the Company was declared in default under the Agreement. As of June 24, 2003, the Company has minimal liquidity. In June 2003, this Lender amended the Agreement through July 31, 2003 but did not waive the condition of default (see Note 9). This continuing condition of default raises substantial doubt about the Company's ability to continue as a going

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concern. Management's plans in regard to increasing liquidity and restructuring the Agreement are also described in Note 2 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Grant Thornton LLP

Miami, Florida

June 24, 2003 (except for Note 9, as to which the date is July 8, 2003 and Note 15, as to which the date is July 10, 2003)

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders:
The Singing Machine Company, Inc.
and Subsidiary

We have audited the accompanying consolidated balance sheet of The Singing Machine Company, Inc., and Subsidiary as of March 31, 2002, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years ended March 31, 2002 and 2001. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Singing Machine Company, Inc. and Subsidiary as of March 31, 2002, and the results of their operations and their cash flows for the years ended March 31, 2002 and 2001 in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Note 3 of the fiscal 2003, 2002 and 2001 consolidated financial statements, subsequent to the issuance of the Company's 2002 and 2001 consolidated financial statements and our report thereon dated May 23, 2002, management determined to restate the 2002 and 2001 consolidated financial statements to reflect a change in their position regarding taxation of certain corporate income and a resulting increase in the income tax provision for years 2002 and 2001. In our related report, we expressed an unqualified opinion. Our opinion on the revised consolidated financial statements, as expressed herein, remains unqualified.

/s/ SALBERG & COMPANY, P.A.

SALBERG & COMPANY, P.A.

Boca Raton, Florida

May 23, 2002 (except for Note 3 as to which the date is July 14, 2003)

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The Singing Machine Company, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEETS

| Assets | |
|---|---------------|
| Current Assets | |
| Cash and cash equivalents | \$ |
| Restricted cash | |
| Accounts receivable, less allowance for doubtful accounts of \$405,759 in 2003 and \$12,022 in 2002 | 5, |
| Due from manufacturer | 1, |
| Inventories | 25, |
| Prepaid expenses and other current assets | 1, |
| Deferred tax asset | 1, |
| Deposits | |
| Total Current Assets | 36, |
| Property and Equipment, at cost less accumulated depreciation of \$1,472,850 in 2003 and \$850,552 in 2002 | 1, |
| Other Assets | |
| Other non-current assets | 1, |
| Total Other Assets | 1, |
| Total Assets | \$38, ==== |
| Liabilities and Shareholders' Equity | |
| Current Liabilities | |
| Bank overdraft | \$ |
| Accounts payable | 8, |
| Accrued expenses | 1, |
| Due to related party | |
| Revolving credit facility | 6, |
| Income taxes payable | 3, |
| Total Current Liabilities | 21, |
| Shareholders' Equity | |
| Preferred stock, \$1.00 par value; 1,000,000 shares authorized, no shares issued and outstanding | |
| Common stock, Class A, \$.01 par value; 100,000 shares authorized; no shares issued and outstanding | |
| Common stock, \$.01 par value; 18,900,000 shares authorized; 8,171,678 and 8,020,027 shares issued and outstanding | |

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| | |
|--|-------|
| Additional paid-in capital | 4, |
| Retained earnings | 12, |
| | ----- |
| Total Shareholders' Equity | 17, |
| | ----- |
| Total liabilities and shareholders' equity | \$38, |
| | ===== |

The accompanying notes are an integral part of these financial statements

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The Singing Machine Company, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF EARNINGS

| | For the Years Ended | | |
|--|---------------------|---------------------------|---------------------------|
| | March 31, 2003 | March 31, 2002 | March 31, 2001 |
| | | (as restated) (Note 3) | (as restated) (Note 3) |
| Net Sales | \$ 95,613,766 | \$ 62,475,753 | \$ 34,875,000 |
| Cost of Sales | 72,329,035 | 40,852,840 | 22,159,000 |
| Gross Profit | 23,284,731 | 21,622,913 | 12,716,000 |
| Operating Expenses | | | |
| Advertising | 5,032,367 | 2,377,638 | 921,000 |
| Commissions | 997,529 | 1,294,543 | 837,000 |
| Compensation | 4,095,176 | 2,486,547 | 1,916,000 |
| Freight & Handling | 2,112,435 | 1,242,910 | 882,000 |
| Royalty Expense | 2,257,653 | 1,862,116 | 148,000 |
| Selling, general & administrative expenses | 7,175,341 | 4,123,779 | 2,982,000 |
| Total Operating Expenses | 21,670,501 | 13,387,533 | 7,688,000 |
| Earnings from Operations | 1,614,230 | 8,235,380 | 5,027,000 |
| Other Income (Expenses) | | | |
| Other income | 196,537 | 215,840 | 32,000 |
| Interest income | 11,943 | 16,934 | 50,000 |
| Interest expense | (406,126) | (112,123) | (424,000) |
| Stock based guarantee fees | - | (171,472) | (267,000) |
| Factoring fees | - | - | (231,000) |
| Net Other Expenses | (197,646) | (50,821) | (839,000) |
| Earnings Before Income Tax | 1,416,584 | 8,184,559 | 4,188,000 |
| Provision for Income Tax | 198,772 | 1,895,494 | 491,000 |

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| | | | | | | |
|---|----|-----------|----|-----------|----|-------|
| Net Earnings | \$ | 1,217,812 | \$ | 6,289,065 | \$ | 3,696 |
| ===== | | | | | | |
| Earnings per common share: | | | | | | |
| Basic | \$ | 0.15 | \$ | 0.88 | \$ | |
| Diluted | \$ | 0.14 | \$ | 0.79 | \$ | |
| Weighted Average Common and Common Equivalent Shares: | | | | | | |
| Basic | | 8,114,330 | | 7,159,142 | | 6,291 |
| Diluted | | 8,931,385 | | 7,943,473 | | 7,457 |

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

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The Singing Machine Company, Inc. and Subsidiary
CONSOLIDATED STATEMENT OF CASH FLOWS

| | For the y |
|---|------------------------|
| | ----- 2003 ----- |
| Cash flows from operating activities | |
| Net earnings | \$ 1,217,812 |
| Adjustments to reconcile net earnings to net cash (used in) provided by operating activities: | |
| Depreciation and amortization | 622,298 |
| Stock based expenses | -- |
| Bad debt | 393,737 |
| Provision for inventory losses | 3,715,357 |
| Deferred tax benefit | (1,734,194) |
| Changes in assets and liabilities: | |
| (Increase) decrease in: | |
| Accounts Receivable | (2,619,778) |
| Due from manufacturer | (603,573) |
| Inventories | (19,635,351) |
| Prepaid Expenses and other assets | (1,453,685) |
| Increase (decrease) in: | |
| Accounts payable | 6,639,771 |
| Accrued expenses | 153,809 |
| Income taxes payable | 1,779,117 |
| | ----- |
| Net Cash (Used in) Provided by Operating Activities | (11,524,680) |
| | ----- |
| Cash flows from investing activities | |
| Restricted cash | (324,727) |
| Purchase of property and equipment | (1,144,064) |
| Proceeds from investment in factor | -- |
| Proceeds from repayment of related party loans | -- |
| Investment in and Advances in unconsolidated subsidiary | -- |
| | ----- |
| Net cash (used in) provided by Investing Activities | (1,468,791) |
| | ----- |

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| | |
|--|--------------|
| Cash flows from financing activities | |
| Bank overdraft | 316,646 |
| Proceeds from revolving credit facility | 47,825,725 |
| Repayments on revolving credit facility | (41,042,901) |
| Proceeds from related party loan | 400,000 |
| Proceeds from exercise of stock options and warrants | 242,119 |
| Due from factor | -- |
| | ----- |
| Net cash provided by (used in) Financing Activities | 7,741,589 |
| | ----- |
| (Decrease) increase in cash and cash equivalents | (5,251,882) |
| Cash and cash equivalents at beginning of period | 5,520,147 |
| | ----- |
| Cash and cash equivalents at end of period | \$ 268,265 |
| | ===== |
| Supplemental Disclosures of Cash Flow Information: | |
| Cash paid during the year for interest | \$ 406,126 |
| | ===== |
| Cash paid during the year for income taxes | \$ 44,400 |
| | ===== |

The accompanying notes are an integral part of these financial statements

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Singing Machine Company, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY The

| | Preferred Stock | | Common Stock | |
|---|-----------------|--------------|--------------|-----------|
| | Shares | Amount | Shares | Amount |
| | ----- | ----- | ----- | ----- |
| Balance at March 31, 2000 | 1,000,000 | \$ 1,000,000 | 4,541,430 | \$ 45,414 |
| Net earnings | -- | -- | -- | 3,696,277 |
| Conversion of preferred stock | (1,000,000) | (1,000,000) | 1,500,000 | 15,000 |
| Exercise of warrants | -- | -- | 570,000 | 5,700 |
| Exercise of employee stock options | -- | -- | 2,250 | 23 |
| Cancellation of shares | -- | -- | (75,000) | (750) |
| Warrants issued for services and as loan fees | -- | -- | -- | -- |
| Amortization of deferred guarantee fees | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- |
| Balance at March 31, 2001, | | | | |

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| | | | | |
|---|-------|-------|-----------|-----------|
| restated | -- | -- | 6,538,680 | 65,387 |
| Net earnings | -- | -- | -- | -- |
| Exercise of warrants | -- | -- | 581,100 | 5,811 |
| Exercise of employee stock options | -- | -- | 900,525 | 9,005 |
| Fractional share adjustment pursuant to 3:2 stock split | -- | -- | (278) | (3) |
| Amortization of deferred guarantee fees | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- |
| Balance at March 31, 2002, restated | -- | -- | 8,020,027 | 80,200 |
| Net earnings | -- | -- | -- | -- |
| Exercise of warrants | -- | -- | 52,500 | 525 |
| Exercise of employee stock options | -- | -- | 99,151 | 992 |
| | ----- | ----- | ----- | ----- |
| Balance at March 31, 2003 | -- | \$ -- | 8,171,678 | \$ 81,717 |
| | ===== | ===== | ===== | ===== |

| | Retained Earnings | Deferred Guarantee Fees | Total |
|---|-------------------|-------------------------|--------------|
| | ----- | ----- | ----- |
| Balance at March 31, 2000 | \$ 1,557,063 | \$ (400,101) | \$ 3,906,286 |
| Net earnings | 3,696,277 | | |
| Conversion of preferred stock | -- | -- | -- |
| Exercise of warrants | -- | -- | 580,000 |
| Exercise of employee stock options | -- | -- | 645 |
| Cancellation of shares | -- | -- | -- |
| Warrants issued for services and as loan fees | -- | -- | 38,400 |
| Amortization of deferred guarantee fees | -- | 228,629 | 228,629 |
| | ----- | ----- | ----- |
| Balance at March 31, 2001, restated | 5,253,340 | (171,472) | 8,450,237 |
| Net earnings | 6,289,065 | -- | 6,289,065 |
| Exercise of warrants | -- | -- | 590,050 |
| Exercise of employee stock options | -- | -- | 729,140 |
| Fractional share adjustment pursuant to 3:2 stock split | -- | -- | (4,531) |

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| | | | |
|--|---------------|---------|---------------|
| Amortization of deferred guarantee fees | -- | 171,472 | 171,472 |
| | | | |
| Balance at March 31, 2002, restated | 11,542,405 | -- | 16,225,433 |
| Net earnings | 1,217,812 | -- | 1,217,812 |
| Exercise of warrants | -- | -- | 48,125 |
| Exercise of employee stock options | -- | -- | 193,994 |
| | | | |
| Balance at March 31, 2003 | \$ 12,760,217 | \$ -- | \$ 17,685,364 |
| | | | |

The accompanying notes are an integral part of these financial statements

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The Singing Machine Company, Inc and Subsidiary NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Accounting Policies

Overview

The Singing Machine Company, Inc., a Delaware corporation, and Subsidiary (the "Company", or "The Singing Machine") are primarily engaged in the production, marketing, and sale of consumer karaoke audio equipment, accessories, and musical recordings. The products are sold directly to distributors and retail customers.

The preparation of The Singing Machine's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the period. Future events and their effects cannot be determined with absolute certainty; therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the Company's financial statements. Management evaluates its estimates and assumptions continually. These estimates and assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances. These estimates and The Singing Machine's actual results are subject to the risk factors listed in Item 1. Business of the Form 10-K for the year ended March 31, 2003.

The management of the Company believes that a higher degree of judgment or complexity is involved in the following areas:

Collectibility of Accounts Receivable. The Singing Machine's allowance for doubtful accounts is based on management's estimates of the creditworthiness of its customers, current economic conditions and historical information, and, in the opinion of management, is believed to be an amount sufficient to respond to normal business conditions. Management sets 100% reserves for customers in

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bankruptcy and other reserves based upon historical collection experience. Should business conditions deteriorate or any major customer default on its obligations to the Company, this allowance may need to be significantly increased, which would have a negative impact on operations.

Reserves on Inventories. The Singing Machine establishes a reserve on inventory based on the expected net realizable value of inventory on an item by item basis when it is apparent that the expected realizable value of an inventory item falls below its original cost. A charge to cost of sales results when the estimated net realizable value of specific inventory items declines below cost. Management regularly reviews the Company's investment in inventories for such declines in value.

Income Taxes. Significant management judgment is required in developing The Singing Machine's provision for income taxes, including the determination of foreign tax liabilities, deferred tax assets and liabilities and any valuation allowances that might be required against the deferred tax assets. At March 31, 2003 and 2002, The Singing Machine had deferred tax assets of \$1.75 million and \$.45 million, respectively. Management evaluates its ability to realize its deferred tax assets on a quarterly basis and adjusts its valuation allowance when it believes that it is more likely than not that the asset will not be realized. There is no related valuation allowance at March 31, 2003 and 2002.

The Company's Subsidiary has applied for an exemption of income tax in Hong Kong. Therefore, no taxes have been expensed or provided for at the Subsidiary level. Although no decision has been reached by the governing body, the Parent Company has reached the decision to provide for the possibility that the exemption could be denied and accordingly has recorded a provision in fiscal 2003, 2002, and 2001.

The Company effectively repatriated approximately \$5.6 million, \$5.7 million and \$0 from its foreign operations in 2003, 2002 and 2001, respectively. Accordingly, these earnings were taxed as a deemed dividend based on U.S. statutory rates. No provision has been made for U.S. taxes on the remaining undistributed earnings of the Company's foreign subsidiaries of approximately \$3.6 million at March 31, 2003 and \$1.9 million at March 31, 2002, as it is anticipated that such earnings would be permanently reinvested in their respective operations.

The Company operates within multiple taxing jurisdictions and is subject to audit in those jurisdictions. Because of the complex issues involved, any claims can require an extended period to resolve. In management's opinion, adequate provisions for income taxes have been made.

Other Estimates. The Singing Machine makes other estimates in the ordinary course of business relating to sales returns and allowances, warranty reserves, and reserves for promotional incentives. Historically, past changes to these estimates have not had a material impact on the Company's financial condition. However, circumstances could change which may alter future expectations.

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Principles of Consolidation

The consolidated financial statements include the accounts of The Singing Machine Company, Inc. and its wholly-owned Hong Kong Subsidiary, International SMC (HK) Limited ("Hong Kong Subsidiary"). All intercompany accounts and transactions have been eliminated in consolidation.

Stock Splits

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On March 15, 2002, the Company effected a 3 for 2 stock split. All share and per share data have been retroactively restated in the accompanying consolidated financial statements to reflect the split.

Foreign Currency Translation

The functional currency of the Company's Hong Kong Subsidiary is the local currency. The financial statements of the subsidiary are translated to United States dollars using year-end rates of exchange for assets and liabilities, and average rates of exchange for the year for revenues, costs, and expenses. Net gains and losses resulting from foreign exchange transactions are included in the consolidated statements of earnings and were not material during the periods presented. The effect of exchange rate changes on cash at March 31, 2003, 2002 and 2001 were not material.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Cash balances at March 31, 2003 and 2002 include approximately \$73,000 and \$154,000, respectively, held in foreign banks by the Hong Kong Subsidiary.

Comprehensive Earnings

Other comprehensive earnings (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, including foreign currency translation adjustments and unrealized gains and losses on derivatives designated as cash flow hedges. For the years ended March 31, 2003, 2002 and 2001 comprehensive earnings was equal to net earnings.

Inventories

Inventories are comprised of electronic karaoke audio equipment, accessories, and compact discs and are stated at the lower of cost or market, as determined using the first in, first out method. Inventory reserves were \$3,715,357 and \$0 for March 31, 2003 and 2002, respectively. Inventory consigned to one customer at March 31, 2003 and 2002 was \$56,695 and \$2,020,172, respectively. The following table represents the major components of inventory at March 31.

| | 2003 | 2002 |
|------------------------|---------------|--------------|
| Finished goods | \$ 27,807,763 | \$ 7,476,237 |
| Inventory in transit | 1,101,940 | 1,798,115 |
| Less Inventory reserve | (3,715,357) | -- |
| Total Inventory | \$ 25,194,346 | \$ 9,274,352 |

Long-Lived Assets

The Company reviews long-lived assets for impairment whenever circumstances and situations change such that there is an indication that the carrying amounts may not be recoverable. If the undiscounted future cash flows attributable to the related assets are less than the carrying amount, the carrying amounts are reduced to fair value and an impairment loss is recognized in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

Shipping and Handling Costs

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Shipping and handling costs are classified as a separate operational expense and those billed to customers are recorded as revenue on the statement of earnings.

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Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Expenditures for repairs and maintenance are charged to expense as incurred. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to their estimated useful lives using accelerated and straight-line methods.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Due to Related Party

Due to related party on the balance sheet includes amounts due to a director of the Company. These amounts are unsecured and non-interest bearing.

Revenue Recognition

Revenue from the sale of equipment, accessories, and musical recordings are recognized upon the later of (a) the time of shipment or (b) when title passes to the customers, all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured. Revenues from sales of consigned inventory are recognized upon sale of the product by the consignee. Net sales are comprised of gross sales net of a provision for actual and estimated future returns, discounts and volume rebates. The provision for actual and estimated sales returns for fiscal year ended March 31, 2003, 2002 and 2001, was \$9.9 million, \$6.3 million and \$2.9 million, respectively. The total returns represents 10.4%, 10.0% and 8.4% of the net sales for fiscal year ended March 31, 2003, 2002 and 2001, respectively.

Due From Manufacturer

The Company's Hong Kong Subsidiary operates as an intermediary to purchase karaoke hardware from factories located in China on behalf of the Company. A manufacturer affiliated with a former director of the Company credited the Company for returns of machines to the factory for rework. The credit received for the returns of the machine were \$449,411, \$640,801 and \$0 for the year ended March 31, 2003, 2002 and 2001. The manufacturer also credited the Company \$740,940 for volume incentive rebates on purchases in fiscal 2003, which was recorded as reduction of the cost of good sold. There is no volume incentive rebates for the previous years. The balance as of March 31, 2003 and 2002 were \$1,091,871 and \$488,298.

Stock Based Compensation

The Company accounts for stock options issued to employees using the intrinsic value method in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation cost is measured on the date of grant as the excess of the current market price of the underlying stock over the exercise price. Such compensation amounts are amortized over the respective vesting periods of the option grant. The Company applied the disclosure provisions of Statement of Financial Accounting Standards No. 148,

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"Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123", which permits entities to provide pro forma net earnings (loss) and pro forma earnings (loss) per share disclosures for employee stock option grants as if the fair-valued based method defined in SFAS No. 123 had been applied to options granted.

Had compensation cost for the Company's stock-based compensation plan been determined using the fair value method for awards under that plan, consistent with Statement of Financial Accounting Standards (SFAS) No 123, "Accounting for Stock Based Compensation" (Statement No. 123). The Company's net earnings would have been changed to the pro-forma amounts indicated below for the years ended March 31:

| | | 2003 | 2002 (as restated) | 2001 (as restated) |
|----------------------------------|-------------|---------------|-----------------------|-----------------------|
| Net earnings | As reported | \$1,217,812 | \$6,289,065 | \$3,690,000 |
| | Pro forma | (\$1,563,156) | \$6,173,576 | \$3,690,000 |
| Net earnings per share - basic | As reported | \$0.15 | \$0.88 | |
| | Pro forma | (\$0.20) | \$0.86 | |
| Net earnings per share - diluted | As reported | \$0.14 | \$0.79 | |
| | Pro forma | (\$0.18) | \$0.78 | |

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The effect of applying Statement No. 123 is not likely to be representative of the effects on reported net earnings for future years due to, among other things, the effects of vesting.

For stock options and warrants issued to consultants, the Company applies SFAS 123. Accordingly, consulting expense of \$38,400 was charged to operations in 2001. There was no consulting expense relating to grants in 2003 and 2002.

For financial statement disclosure purposes and for purposes of valuing stock options and warrants issued to consultants, the fair market value of each stock option granted was estimated on the date of grant using the Black-Scholes Option-Pricing Model in accordance with SFAS 123 using the following weighted-average assumptions:

Fiscal 2003: expected dividend yield 0%, risk-free interest rate of 4%, volatility 71% and expected term of three years.

Fiscal 2002: expected dividend yield 0%, risk-free interest rate of 6.08% to 6.81%, volatility 42% and expected term of two years.

Fiscal 2001: no options were issued; therefore there would be no change in net earnings

Advertising

Costs incurred for producing and communicating advertising of the Company, are charged to operations as incurred. The Company had entered the cooperative advertising agreements with its major clients, which specifically indicated that the client have to spend the cooperative advertising fund in mutually agreed events. The percentage of the cooperative advertising allowance ranges from 2% to 5% of the purchase. The clients have to advertise the Company's products in the client's catalog, local news paper and other

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advertising media. The client must submit the proof of the performance (such as copy of the advertising show the Registrant product) to the Company to request for the allowance. The client does not have the ability to spend the allowance at their discretion. The Company believes that the identifiable benefit from the cooperative advertising program, and the fair value of the advertising benefit is equal or greater than the cooperative advertising expense. Advertising expense for the years ended March 31, 2003, 2002 and 2001 was \$5,032,367, \$2,377,638 and \$921,359, respectively.

Research and Development Costs

All research and development costs are charged to the results of operations when they are incurred. These expenses are shown in the selling, general & administrative expenses on the consolidated statements of earnings. For the years ended March 31, 2003, 2002 and 2001, the amounts expensed were \$674,925, \$181,866 and \$55,376, respectively.

Earnings Per Share

In accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share", basic earnings per share is computed by dividing the net earnings for the period by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding including the effect of common stock equivalents.

The following table presents a reconciliation of basic and diluted earnings per share:

| | 2003 | 2002 (as restated) |
|---|-------------|-----------------------|
| Net earnings | \$1,217,812 | \$6,289,065 |
| Income available to common shares | \$1,217,812 | \$6,289,065 |
| Weighted average shares outstanding - basic | 8,114,330 | 7,159,142 |
| Earnings per share - Basic | \$0.15 | \$0.88 |
| | ===== | ===== |
| Income available to common shares | \$1,217,812 | \$6,289,065 |
| Weighted average shares outstanding - basic | 8,114,330 | 7,159,142 |
| Effect of dilutive securities: | | |
| Stock options | 817,055 | 784,331 |
| Warrants | -- | -- |
| | ----- | ----- |
| Weighted average shares outstanding - diluted | 8,931,385 | 7,943,473 |
| Earnings per share - Diluted | \$0.14 | \$0.79 |
| | ===== | ===== |

In 2003, 2002 and 2001, 90,000, 0 and 2,529,000 common stock equivalents (as restated for the 3 for 2 stock split) with exercise price greater than \$10.66 in 2003 and \$4.11 in 2001 were not included in the computation of diluted earnings per share as their effect would have been antidilutive.

Fair Value of Financial Instruments

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Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments," requires disclosures of information about the fair value of certain financial instruments for which it is practicable to estimate that value. For purposes of this disclosure, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation.

The carrying amounts of the Company's short-term financial instruments, including accounts receivable, accounts payable, accrued expenses, revolving credit facility and income taxes payable, approximate fair value due to the relatively short period to maturity for these instruments.

Recent Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 144 retained substantially all of the requirements of SFAS No. 121 while resolving certain implementation issues. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The impact of adopting SFAS No. 144 was not material.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Under Statement No. 4, all gains and losses from extinguishments of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. This Statement eliminates Statement No. 4 and as a result, gains and losses from extinguishment of debt should be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Additionally, this Statement amends SFAS No. 13, "Accounting for Leases," such that lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in a similar manner as a sale- leaseback. This Statement is generally effective for financial statements issued on or after May 15, 2002. The impact of adopting SFAS No. 145 was not material to the Company.

In July 2002, the FASB issued Statement No. 146, "Accounting for Restructuring Costs," ("SFAS 146"). SFAS 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts and relocating plant facilities or personnel. SFAS 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002, with earlier adoption encouraged. The adoption of this standard did not a material impact on the financial statements.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123" ("SFAS 143"). SFAS 148 amends FASB Statement No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation and to require prominent disclosures about the effects on reported net earnings of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS 148 also amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosures about those effects in interim financial information. The Singing Machine currently accounts for its stock-based compensation awards to employees

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and directors, under accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS No. 123. The Singing Machine currently intends to continue to account for its stock-based compensation awards to employees and directors using the intrinsic value method of accounting as prescribed by Accounting Principles Board Opinion No. 25.

In December 2002, the FASB issued Interpretation 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. For a guarantee subject to FASB Interpretation 45, a guarantor is required to:

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- o measure and recognize the fair value of the guarantee at inception (for many guarantees, fair value will be determined using a present value method); and
- o provide new disclosures regarding the nature of any guarantees, the maximum potential amount of future guarantee payments, the current carrying amount of the guarantee liability, and the nature of any recourse provisions or assets held as collateral that could be liquidated and allow the guarantor to recover all or a portion of its payments in the event guarantee payments are required.

The disclosure requirement of this Interpretation is effective for financial statements for fiscal years ending after December 15, 2002 and did not have a material effect on the Company's financial statements. The initial recognition and measurement provision are effective prospectively for guarantees issued or modified on or after January 1, 2003 and the Company does not believe that the adoption of these provisions will have a material impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities (and Interpretation of ARB No. 51)" ("FIN 46"). FIN 46 addresses consolidation by business enterprises of certain variable interest entities, commonly referred to as special purpose entities. The Company will be required to implement the other provisions of FIN 46 in 2003. The Company does not anticipate that the adoption of FIN 46 will have a material effect on the Company's financial statement presentation or disclosures.

Note 2 - Going Concern

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company is attempting to restructure and extend its revolving credit facility. Based upon cash flow projections, the Company believes the anticipated cash flow from operations and most importantly, the expected net proceeds from future earnings will be sufficient to finance the Company's operating needs until inventory is sold and the receivables subsequently collected. There can be no assurances that forecasted results will be achieved or that additional financing will be obtained. The financial statements do not include any adjustments relating to the recoverability and classification of asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

On March 14, 2003, the Company was notified of its violation of the net worth covenant of its Loan and Security Agreement (the "Agreement") with its commercial lender and the Company was declared in default under the Agreement. The lender amended the Agreement on June 30, 2003 but did not waive the condition of default. This condition of default raises substantial doubt about the Company's ability to continue as a going concern.

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Although the Company had a larger than normal amount of currently saleable inventory at March 31, 2003 (based on the Company's recent sales trends and industry turnover standards), the Company has developed a fiscal 2004 sales plan that it believes will allow it to sell such inventory and recover the majority of its costs in the normal course of business. The Company has reduced selling prices on certain inventory items and accordingly, in the fourth quarter of fiscal 2003, the Company has taken a provision for loss against this inventory.

Note 3 - Restatement of Financial Statements for the Fiscal years 2002 and 2001

In June 2003, management revised its position on taxation of its subsidiary's income by the United States and by the Hong Kong tax authorities.

With regard to taxation in Hong Kong, the Company's subsidiary had previously applied for a Hong Kong offshore claim income 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 the consolidated financial statements as of March 31, 2002 and 2001. However, full disclosure was previously reflected in the audited financial statements for years ended March 31, 2002 and 2001 of the estimated amount that would be due to the Hong Kong tax authority should the exemption be denied. 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 has determined to restate the 2002 and 2001 consolidated financial statements to provide for such taxes. The effect of such restatement is to increase income tax expense by \$748,672 and \$468,424 in fiscal year 2002 and 2001, respectively. However, the Company can claim United States foreign tax credits in 2002 for these Hong Kong taxes, which is reflected in the final restated amounts.

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 96 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 \$1,027,545 in fiscal year 2002, 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 \$1,776,217 and \$468,424 in fiscal 2002 and 2001. The net effect on net income per share is to decrease net income per share basic and diluted by \$0.25 and \$0.23, respectively in fiscal 2002 and decrease net income per share basic and diluted by \$0.07 and \$0.06, respectively in fiscal 2001.

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In September, 2004, the management revised the cash flow for the period ending March 31, June 30, September 30, and December 31, 2003. The amendments are related to the reclassification of the "Restricted Cash" and "Bank Overdraft". There is no effect to the Statement of Operations. The following table shows the reclassification of the cash flow:

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY
COMPRESSED CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED EXCEPT FOR PERIOD ENDING 03/31/03)

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| | For Period Endi | |
|--|-----------------|--------------|
| | 03/31/03 | 03/31/03 |
| | As reported | As amended |
| Cash flows from operating activities | | |
| Net Income | \$ 1,217,812 | \$ 1,217,812 |
| Net Cash Used in Operating Activities | (11,532,761) | (11,524,680) |
| Cash flows from investing activities | | |
| Net cash used in Investing Activities | (1,144,064) | (1,468,791) |
| Cash flows from financing activities | | |
| Net cash provided by Financing Activities | 7,424,943 | 7,741,589 |
| Decrease in cash and cash equivalents | (5,251,882) | (5,251,882) |
| Cash and cash equivalents at beginning of period | 5,520,147 | 5,520,147 |
| Cash and cash equivalents at end of period | \$ 268,265 | \$ 268,265 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid during the year for interest | \$ 406,126 | \$ 406,126 |
| Cash paid during the year for income taxes | \$ 153,849 | \$ 153,849 |

| | For Period E | |
|--------------------------------------|--------------|------------|
| | 09/30/03 | 09/30/03 |
| | As reported | As amended |
| Cash flows from operating activities | | |

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| | | | | |
|--|----|-------------|----|-------------|
| Net Income | \$ | (2,974,021) | \$ | (2,974,021) |
| Net Cash Used in Operating Activities | | (4,678,328) | | (4,380,280) |
| Cash flows from investing activities | | | | |
| Net cash used in Investing Activities | | (157,178) | | (186,370) |
| Cash flows from financing activities | | | | |
| Net cash provided by Financing Activities | | 5,673,244 | | 5,404,388 |
| Decrease in cash and cash equivalents | | 837,738 | | 837,738 |
| Cash and cash equivalents at beginning of period | | 268,265 | | 268,265 |
| Cash and cash equivalents at end of period | \$ | 1,106,003 | \$ | 1,106,003 |
| Supplemental Disclosures of Cash Flow Information: | | | | |
| Cash paid during the year for interest | \$ | 350,192 | \$ | 350,192 |
| Cash paid during the year for income taxes | \$ | 205,000 | \$ | 205,000 |

Note 4 - Accounts Receivable and Factor Agreement

During 2001, the Company sold certain trade accounts receivable, primarily without recourse, pursuant to a factoring agreement. The Sales is treated as a Sale of receivable under SFAS 125. Since they were transferred without recourse and the Company surrendered the control of such transferred accounts. The Company terminated the factoring agreement in April 2001 upon obtaining a new Loan and Security Agreement with a commercial lender. (See Note 8) For the year ending March 31, 2001, the Company incurred \$429,509 in factoring fees and interest. The portion representing factor interest expense was \$198,208 of the \$429,506.

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During 2000, two officers of the Company entered into guarantee agreements related to the factor agreement resulting in deferred guarantee fees of \$400,101, which was being amortized over the term of the factor agreement, which expired on December 31, 2001. Upon termination of the factor agreement, the unamortized deferred guarantee fees of \$171,472 were charged to operations as amortization in fiscal 2002 and 2001.

Note 5 - Sale of Unconsolidated Subsidiary

In November 2000, the Company closed on an acquisition of 60% of the ordinary voting shares of a Hong Kong toy company for a total purchase price of \$170,000. The Company believed that the acquiree had agreed to extend the effective date to June 2001, but a dispute arose and the Company committed to dispose of the entire investment. Accordingly, pursuant to Statement of Financial Accounting Standards No. 94 "Consolidation of All Majority-Owned Subsidiaries," the Company treated the control of the subsidiary as temporary and recorded the investment of \$170,000 and advances of \$220,661 at cost. The Company completed a contract selling the 60% interest on September 11, 2001. The

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transaction resulted in a net loss on investment of \$48,912 included in selling, general, and administrative expenses. The advances due at March 31, 2002 were \$75,831 and were included in prepaid and other current assets. There were no advances due at March 31, 2003.

Note 6 - Property and Equipment

A summary of property and equipment at March 31, 2003 and 2002 is as follows:

| | Useful Lives | 2003 | 2002 |
|----------------------------------|--------------|-------------|------------|
| Computer and office equipment | 5 years | \$313,221 | \$ 230,025 |
| Furniture and fixtures | 5 - 7 years | 341,777 | 106,164 |
| Leasehold improvements | * | 110,841 | 62,483 |
| Molds and tooling | 3 years | 1,803,434 | 1,022,900 |
| | | ----- | ----- |
| | | 2,569,273 | 1,421,572 |
| Less: accumulated depreciation | | (1,472,850) | (846,915) |
| | | ----- | ----- |
| Total net property and equipment | | \$1,096,423 | \$574,657 |
| | | ===== | ===== |

* Shorter of remaining term of lease or useful life

Note 7 - Restricted Cash

The Company, through its Hong Kong subsidiary, maintains a letter of credit facility and short term loan with a major international bank. The Company's subsidiary is required to maintain a separate deposit account in the amount of \$838,411 and \$513,684 at March 31, 2003 and 2002, respectively. This amount is shown as restricted cash at March 31, 2003 and 2002.

Note 8 - Loans and Letters of Credit

Credit Facility

On May 19, 1999, as amended on February 14, 2000, the Company, through its Hong Kong Subsidiary, obtained a credit facility of \$500,000 from a Hong Kong subsidiary of a Belgian bank. This facility is a revolving line of credit based upon drawing down a maximum of 15% of the value of related export letters of credit with Belgian Bank. There is no expiration date to this agreement, except that Belgian 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%. The rate for this credit facility at March 31, 2003 was 5.5%. Repayment of principal plus interest shall be made upon negotiation of the export letters of credit, but not later than 90-days after the advance. As of March 31, 2003 and 2002, there was no outstanding balance or availability under this credit facility.

Loan and Security Agreement

On April 26, 2001, the Company executed a Loan and Security Agreement (the "Agreement") with a commercial lender (the "Lender"). This loan was last amended on June 30, 2003. The following is a description of the terms as amended.

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The Lender will advance up to 70% of the Company's eligible accounts receivable, plus up to 20% of the eligible inventory up to \$6,000,000, plus up to 40% of the commercial letters of credit opened for the purchase of eligible inventory up to \$3 million, less reserves at the discretion of the lender.

The outstanding loan limit varies between zero and \$10,000,000, as stipulated in the Agreement. The Lender also provides the Company the ability to issue commercial letters of credit up to \$3,000,000, which shall reduce the loan limits 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 or \$100,000 is payable. All amounts under the loan 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. This amendment expires July 31, 2003.

The Agreement contains a financial covenant stipulating a minimum tangible net worth of \$30,000,000 as of December 31, 2002 with escalations as defined in the Agreement. On March 15, 2003, the lender notified the Company that they are in default of this covenant and the agreement. The balance outstanding at March 31, 2003 was \$6,782,824 and was classified as a current liability under revolving credit facility on the balance sheet. At March 31, 2003, the Company was overadvanced under the agreement by approximately \$3 million. The June 30, 2003 amendment gave the Company an additional \$4.5 million in availability which gave the Company working capital and cured the overadvance.

The Company is currently negotiating a restructuring of the agreement with the lender.

Note 9 - Commitments and Contingencies

Leases

The Company has entered into various operating lease agreements for office and warehouse facilities in Coconut Creek, Florida, Compton, California, Rancho Dominguez, California, New York, New York and Kowloon, Hong Kong. The leases expire at varying dates. Rent expense for fiscal 2003, 2002 and 2001 was \$901,251, \$333,751 and 142,472, respectively.

In addition, the Company maintains various warehouse and computer equipment operating leases.

Future minimum lease payments under property and equipment leases with terms exceeding one year as of March 31, 2003 are as follows:

| | Property Leases | Equipment Leases |
|-----------------------|-----------------|------------------|
| Year ending March 31: | | |
| 2004 | \$1,330,158 | \$46,525 |
| 2005 | 924,338 | 19,965 |
| 2006 | 517,071 | 10,322 |
| 2007 | 495,545 | 7,969 |
| 2008 | 371,659 | 1,235 |

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\$3,638,771

\$86,016

Guarantees

The Company's Subsidiary guarantees the revolving credit facility at the lender by a pledge of 60% of its common stock. The Company also in turn guarantees all lines of credit of the Subsidiary.

Employment Agreements

The Company has employment contracts with four key officers as of March 31, 2003. The agreements provide for base salaries, with annual cost of living adjustments and travel allowances. The agreements also provide for aggregate Board approved performance bonuses of up to 10% of net earnings before those performance bonuses, interest, and taxes. During fiscal 2003, 2002 and 2001, the bonus percentages were 0%, 5% and 10%, respectively.

Merchandise License Agreements

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On November 1, 2000, as amended on November 29, 2001, as amended on December 27, 2002, the Company entered into a merchandise license agreement to license a name, trade name, and logo of a music oriented television network. The term of the agreement is from November 1, 2000 to December 31, 2003. However, shipment of related products did not begin until after March 31, 2001. Accordingly, none of the minimum royalty was charged to operations as of March 31, 2001. The Company pays a royalty rate of a percentage of stipulated sales, as defined in the agreement, with \$686,250 guaranteed minimum royalties for the term, payable on a scheduled basis as stipulated in the agreement. The initial minimum royalty guarantee was paid in fiscal year 2002. The new amendment places an additional guarantee for calendar year 2003 of \$1,500,000, payable on a scheduled basis as follows: \$500,000 on the signing of the amendment, December 27, 2002, \$333,333 on June 30, 2003, \$333,333 on September 30, 2003 and \$333,334 on December 31, 2003. Royalty reports are due on a quarterly basis under the terms of the agreement and the following table represents a summary of the agreement:

| | Total Expense | Prepaid Balance at March 31 | Accrued Expense at March 31 |
|------|---------------|-----------------------------|-----------------------------|
| 2003 | \$1,411,403 | \$355,931 | \$0 |
| 2002 | \$1,388,813 | \$0 | \$126,170 |
| 2001 | \$0 | \$50,000 | \$0 |

On December 1, 2001, the Company entered into an additional agreement with a division of above licensor for additional license properties and products. The license term is January 1, 2002 to December 31, 2004 with an initial stipulated ship date of August 15, 2002. The agreement stipulates a royalty rate as a percentage of net sales (defined as gross sales less discounts, allowances and damaged goods returns not to exceed 8% of gross sales), payable quarterly, with a guaranteed minimum royalty for the license term of \$450,000 payable as follows: \$25,000 on execution of agreement, \$85,000 on or before September 1, 2002, \$85,000 on or before December 1, 2002, \$85,000 on or before March 1, 2003, \$85,000 on or before June 1, 2003, and \$85,000 on or before September 1, 2003 and the following table represents a summary of the agreement:

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| | Total Expense | Prepaid Balance at March 31 | Accrued Expense at March 31 |
|------|---------------|-----------------------------|-----------------------------|
| 2003 | \$127,778 | \$152,222 | \$0 |
| 2002 | 0 | \$25,000 | \$0 |
| 2001 | 0 | 0 | \$0 |

In December 2002, the Company entered into an agreement with a division of a music and memorabilia restaurant and entertainment chain. The license term is January 1, 2003 to December 31, 2005. The Company pays a royalty rate of a percentage of stipulated sales, as defined in the agreement, with a \$250,000 guaranteed minimum royalties for the term, payable on a scheduled basis as follows: \$25,000 on signing of the contract and payments of \$25,000 at the end of each calendar quarter starting March 31, 2003 and ending September 30, 2004, with a final payment of \$50,000 due on December 31, 2004 and the following table represents a summary of the agreement:

| | Total Expense | Prepaid Balance at March 31 | Accrued Expense at March 31 |
|------|---------------|-----------------------------|-----------------------------|
| 2003 | \$16,656 | \$33,344 | \$0 |
| 2002 | 0 | 0 | \$0 |
| 2001 | 0 | 0 | \$0 |

In February 2003, the Company entered into an agreement with a large music and entertainment conglomerate. The license term is April 1, 2003 to March 31, 2006. The Company pays a royalty rate of a percentage of stipulated sales, as defined in the agreement, with a \$300,000 guaranteed minimum royalties for the term, payable on a scheduled basis as follows: \$25,000 on signing of the contract, \$50,000 on June 30, 2003 and payments of \$25,000 at the end of each calendar quarter starting September 30, 2003 and ending September 30, 2005 and the following table represents a summary of the agreement:

| | Total Expense | Prepaid Balance at March 31 | Accrued Expense at March 31 |
|------|---------------|-----------------------------|-----------------------------|
| 2003 | 0 | \$25,000 | \$0 |
| 2002 | 0 | 0 | \$0 |
| 2001 | 0 | 0 | \$0 |

Guaranteed royalty payments are non-refundable and not recoupable against other license agreements with the same licensor.

Significant Estimates

The Company records an accrual for product returns in the normal course of business. The accrual is estimated based on historical experience and is recorded as a liability equal to the gross profit on estimated returns. At March 31, 2003 and 2002, the accrual for product returns was \$324,422 and \$118,488 respectively and are included in accrued expenses on the consolidated balance sheets.

The Company estimates an allowance for doubtful accounts using the

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specific identification method since a majority of accounts receivable are concentrated with several customers. The allowance for doubtful accounts was \$405,759 and \$12,022 at March 31, 2003 and 2002, respectively.

Legal Matters

Class Action. From July 2, 2003 through July 8, 2003, six securities class action lawsuits were filed against The Singing Machine and certain of its officers and directors in the United States District Court for the Southern District of Florida on behalf of all persons who purchased The Singing Machine's securities during the various class action periods specified in the complaints. The Company expects that all of these actions will be consolidated in the United States District Court for the Southern District of Florida.

The complaints that have been filed allege violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Rule 10(b)-5. The complaints seek compensatory damages, attorney's fees and injunctive relief. While the specific factual allegations vary slightly in each case, the complaints generally allege that defendants falsely represented the Company's financial results for the years ended March 31, 2002 and 2001.

The Company believes that the allegations in these cases are without merit and the Company intends to vigorously defend these actions. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur which could have a material affect on the Company's operations.

Other Matters. The Company is also subject to various other legal proceedings and other claims that arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability, if any, in excess of applicable insurance coverage, is not likely to have a material effect on the financial condition, results of operations or liquidity of the Company. However, as the outcome of litigation or other legal claims is difficult to predict, significant changes in the estimated exposures could occur, which could have a material impact on the Company's operations.

Note 10 - Stockholders' Equity

Amendment to Authorized Shares

During September 2000, the Company filed an amendment to its Articles of Incorporation decreasing the authorized shares of the Company's common stock to 18,900,000 shares and 100,000 Class A common shares.

Stock Split

On March 15, 2002, the Company effected a 3 for 2 stock split. All share and per share data have been retroactively restated in the accompanying consolidated financial statements to reflect the split.

Preferred Stock and Warrants

During April 1999, the Company issued a private placement memorandum, pursuant to Rule 506 of Regulation D of the 1933 Securities Act, as amended, to offer a minimum of 40 units and a maximum of 50 units of stock and warrants. Each unit consisted of 30,000 shares of the Company's 9% non-voting convertible preferred stock and 6,000 common stock purchase warrants. The purchase price for each unit was \$ 27,500. Each share of preferred stock was convertible, at the option of the holder, into one share of the Company's common stock at any time after issuance, and was to automatically convert into one share of common stock on April 1, 2000. All preferred shares automatically converted on April 1, 2000. Each warrant entitles the holder to purchase one share of the Company's common

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stock at \$2.00 per share. The warrants expire three years from the private placement memorandum date. Through June 1999, the maximum number of 50 units had been sold and \$1,375,000 gross funds were raised (\$1,331,017 after related costs), at which time the offer was closed. During 2000, 2001, and 2002, 24,000, 201,000, and 75,000 warrants were converted for \$32,000, \$268,000, and \$100,000, respectively leaving no warrants outstanding at March 31, 2002.

Common Stock Issuances

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During fiscal 2003, 2002 and 2001, the Company issued the following shares of stock upon exercise of outstanding options and warrants.

| | Number of Shares Issued | Proceeds to Company |
|------|-------------------------|---------------------|
| 2003 | 151,651 | \$242,119 |
| 2002 | 1,481,347 | \$1,314,659 |
| 2001 | 572,250 | \$580,645 |

Guarantee Fees

During the year ended March 31, 2000, the Company issued 525,000 shares of common stock to two officers of the Company in exchange for guarantees related to the Company's factor agreement, and letter of credit agreement. These guarantee fees totaled \$590,625 and were amortized over a period of 31 months. For the years ended March 31, 2002 and 2001 \$171,472 and \$228,629 of deferred fees were charged to operations included in stock based guarantee fees, respectively. There were no remaining deferred guarantee fees at March 31, 2002.

During the year ended March 31, 2001, the Company issued 37,500 common stock options for services and 45,000 common stock warrants to two investors as loan fees. The fair market value of the options totaling \$38,400 was charged to operations included in stock based guarantee fees. There were no transactions made in fiscal 2002 and 2003.

Stock Options

On June 1, 2001, the Board of Directors approved the 2001 Stock Option Plan, which replaced the 1994 Stock Option Plan, as amended, (the "Plan"). The Plan was developed to provide a means whereby directors and selected employees, officers, consultants, and advisors of the Company may be granted incentive or non-qualified stock options to purchase common stock of the Company. As of March 31, 2003, the Plan is authorized to grant options up to an aggregate of 1,950,000 shares of the Company's common stock and up to 300,000 shares for any one individual in any fiscal year. As of March 31, 2003, the Company had granted 745,200 options under the Year 2001 Plan, leaving 1,204,800 options available to be granted.

In accordance with SFAS 123, for options issued to employees, the Company applies the intrinsic value method of APB Opinion No. 25 and related interpretations in accounting for its options issued. The following table sets forth the issuances of stock options for fiscal 2003, and 2002.

The exercise price of common stock option issuances in 2003 and 2002 was equal to the fair market value on the date of grant. Accordingly, no compensation cost has been recognized for options issued under the Plan in 2003

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or 2002. A summary of the options issued as of March 31, 2003, 2002 and 2001 and changes during the years is presented below:

| Fiscal Year | Number of Options and Warrants 2003 | Weighted Average Exercise Price | Number of Options and Warrants 2002 | Weighted Average Exercise Price | Number Options Warrants |
|--|---|--|--|--|-------------------------------|
| Stock Options: | | | | | |
| Balance at beginning of period | 1,094,475 | \$2.11 | 2,433,300 | \$1.31 | 1,59 |
| Granted | 567,000 | \$7.88 | 82,800 | \$3.92 | 1,24 |
| Exercised | (143,725) | \$1.63 | (1,406,625) | \$0.87 | (371 |
| Forfeited | (4,500) | \$2.04 | (15,000) | \$2.04 | (34 |
| Balance at end of period | 1,513,250 | \$4.43 | 1,094,475 | \$2.11 | 2,43 |
| Options exercisable at end of period | 976,250 | \$2.45 | 647,738 | \$2.11 | 1,43 |
| Weighted average fair value of options granted during the period | | \$8.19 | | \$1.54 | |

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The following table summarizes information about employee stock options and consultant warrants outstanding at March 31, 2003:

| Range of Exercise Price | Number Outstanding at March 31, 2003 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number March |
|----------------------------|---|---|------------------------------------|-----------------|
| \$1.11 | 58,500 | 1.24 | \$1.11 | |
| \$2.04 | 785,300 | 3.67 | \$2.04 | |
| \$3.27 - \$4.23 | 102,450 | 3.20 | \$3.83 | |
| \$5.60 - \$7.26 | 190,000 | 5.69 | \$6.70 | |
| \$8.61 - \$11.09 | 377,000 | 6.76 | \$9.45 | |
| | 1,513,250 | | | |

Note 10 - Royalty Expense

The Company enters into licensing and royalty agreements with music publishers (the "Licensors") in the normal course of business. In addition, the Company pays royalties under merchandise license agreements. Royalty expense during 2003, 2002 and 2001 was \$2,257,653, \$1,862,116 and \$148,643,

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respectively.

Note 11 - Income Taxes

The Company files separate tax returns for the parent and for the Hong Kong Subsidiary. The income tax expense (benefit) for federal, foreign, and state income taxes in the consolidated statement of earnings consisted of the following components for 2003, 2002 and 2001:

| | 2003 | 2002 (as restated) (Note 3) | 2001 (as restated) (Note 3) |
|--------------|-------------|-----------------------------------|-----------------------------------|
| Current: | | | |
| U.S. Federal | \$ 663,816 | \$1,027,545 | \$21,320 |
| Foreign | 1,230,650 | 748,672 | 468,424 |
| State | 38,500 | 119,277 | 2,000 |
| Deferred | (1,734,194) | 0 | 0 |
| | ----- | ----- | ----- |
| | \$ 198,772 | \$1,895,494 | \$491,744 |
| | ===== | ===== | ===== |

The Company's 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. Although it could be likely that the exemption will be approved, the Parent is accruing for the applicable taxes. Accordingly, the provision for foreign income taxes on the profits of the Hong Kong subsidiary has been provided in the accompanying consolidated financial statements.

The actual tax expense differs from the "expected" tax expense for the years ended March 31, 2003, 2002 and 2001 (computed by applying the U.S. Federal Corporate tax rate of 34 percent to income before taxes) as follows:

| | 2003 | 2002 (as restated) (Note 3) | (as |
|---|-------------|-----------------------------------|-------|
| Expected tax expense | \$481,880 | \$2,782,750 | |
| State income taxes, net of Federal income tax benefit | (43,204) | 78,723 | |
| Permanent differences | 69,114 | 28,734 | |
| Deemed dividend | 1,011,628 | 1,027,545 | |
| Change in valuation allowance | -- | (1,059,089) | |
| Tax rate differential on foreign earnings | (1,326,368) | (812,739) | |
| Other | 10,334 | (135,571) | |
| Usage of net operating loss carryforward | (4,611) | -- | |
| | ----- | ----- | ----- |
| Actual tax expense | \$198,772 | \$1,910,353 | ===== |

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at March 31, 2003 and 2002 are as follows:

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| | 2003 | 2002 (as restated) |
|---|-------------|-----------------------|
| Deferred tax assets: | | |
| Inventory differences | \$1,491,021 | -- |
| State net operating loss carryforward | \$171,019 | \$ 89,315 |
| Bad debt reserve | 137,958 | 4,087 |
| Reserve for sales returns | 110,303 | 55,886 |
| Stock based expenses | -- | 13,056 |
| Amortization of reorganization intangible | 28,076 | 36,400 |
| | ----- | ----- |
| Total Gross Deferred Assets | 1,938,377 | 198,744 |
| Less valuation allowance | -- | -- |
| | ----- | ----- |
| Deferred tax liability | 1,938,377 | 198,744 |
| Depreciation | (12,765) | (7,326) |
| | ----- | ----- |
| Net Deferred Tax Asset | \$1,925,612 | \$191,418 |
| | ===== | ===== |

On September 3, 1991, the Company underwent a change of ownership (as defined by Internal Revenue Code Section 382). This change limits the Company's ability to utilize its approximately \$4,057,000 of net operating loss carryforwards (NOL's) to \$54,240 at a rate of \$13,560 per year (these NOL's expire from 2004 to 2007).

Note 12 - Concentrations of Credit Risk, Customers, Suppliers, and Financing

The Company derives primarily all 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 March 31, 2004, 56% of accounts receivable were due from four customers: two from the U.S. and two International Customers. Accounts receivable from three customers that individually owed over 10% of accounts receivable at March 31, 2004 was 33%, 24% and 10%. The Company performs ongoing credit evaluations of its customers and generally does not require collateral.

Revenues derived from five customers in 2004, 2003 and 2002 were 53%, 67% and 77% of revenues, respectively. Revenues derived from two customers in 2004, and three customers in 2003 and 2002, respectively, which individually purchased greater than 10% of the Company's total revenues, were 20%, 12% in 2004, 21%, 17%, and 15% in 2003 and 37%, 28% and 10% in 2002.

The Company is dependent upon foreign companies for the 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 years 2004, 2003 and 2002, manufacturers in the People's Republic of China (China) accounted for approximately 95%, 94% and 95% respectively of the Company's total product purchases, including all of the

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Company's hardware purchases.

The Company finances its sales primarily through a loan facility with one lender. (See Note 9) 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 \$43,139,241 in 2004, \$49,268,836 in 2003 and \$27,176,000 in 2002. The carrying value of net assets held by the Company's Hong Kong based subsidiary was \$14,371,588 at March 31, 2004.

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Note 13 - Segment Information

The Company operates in one segment and maintains its records accordingly. The majority of sales to customers outside of the United States are made by the Company's Subsidiary. Sales by customer geographic region for the years ended March 31 were as follows:

| SALES: | 2003 | 2002 | 2001 |
|--------------------------------|--------------|--------------|--------------|
| United States | \$76,777,138 | \$62,333,801 | \$34,391,540 |
| Asia | 21,310 | 49,314 | -- |
| Australia | 814,334 | -- | -- |
| Canada | 919,642 | 47,565 | 11,420 |
| Central America | 96,836 | 5,756 | -- |
| Europe | 15,714,846 | -- | 433,821 |
| Mexico | 1,225,111 | -- | -- |
| South America | 44,549 | 39,317 | 38,570 |
| | ----- | ----- | ----- |
| Consolidated Net Sales | \$95,613,766 | \$62,475,753 | \$34,875,351 |
| | ===== | ===== | ===== |
| LONG LIVED ASSETS: | | | |
| United States operations | \$570,065 | \$311,590 | \$355,028 |
| Hong Kong operations | \$1,800,191 | \$1,144,503 | \$185,823 |
| Eliminations | (13) | (13) | (13) |
| | ----- | ----- | ----- |
| Consolidated long-lived assets | \$2,370,243 | \$1,456,080 | \$540,838 |
| | ===== | ===== | ===== |

The geographic area of sales is based primarily on the location where the product is delivered.

Note 14 - Employee Benefit Plans

The Company has a 401(k) plan for its employees to which the Company makes contributions at rates dependent on the level of each employee's contributions. Contributions made by the Company are limited to the maximum allowable for federal income tax purposes. The amounts charged to earnings for contributions to this plan and administrative costs during the years ended March 31, 2003, 2002 and 2001 totaled \$61,466, \$41,733 and \$8,682, respectively. The Company does not provide any post employment benefits to retirees.

Note 15 - Subsequent Events

As of July 10, 2003, the Company obtained \$1 million in subordinated

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debt financing. On or about July 10, 2003, certain officers and directors advanced \$1 million to the Company. The terms of this management loan have not been finalized; however, the Company has immediate use and access to the \$1 million in funding. It is presently expected that the loan will be a short-term loan, which will be due on or before October 31, 2003. However, the Company has not yet determined the interest rate or if any compensation, such as warrants, will be awarded to the management investment group for their loan. The Company is also in the process of finalizing a \$1 million loan from an outside investment group and hope to close this transaction by July 16, 2003. There can be no assurance that this financing will be completed on time on the terms presently contemplated..

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Supplemental Data

Schedule I

Quarterly Financial Data (Unaudited)

The following financial information reflects all normal recurring adjustments that are, in the opinion of management, necessary for a fair statement of the results of the interim periods. The quarterly results for the years 2003 and 2002 are set forth in the following table:

| | Sales | Gross Profit | Net Earnings (Loss) | |
|--------------------|---------------|---------------|------------------------|----|
| 2003 | | | | |
| First quarter | \$ 4,151,983 | \$ 1,060,470 | \$ (1,358,780) | \$ |
| Second quarter | 32,976,624 | 9,415,798 | 4,837,926 | |
| Third quarter | 48,869,776 | 13,431,356 | 3,846,894 | |
| Fourth quarter | 9,615,383 | (622,893) | (6,108,228) | |
| Total | \$ 95,613,766 | \$ 23,284,731 | \$ 1,217,812 | \$ |
| 2002 (as restated) | | | | |
| First quarter | \$ 5,523,734 | \$ 1,861,088 | \$ (470,447) | \$ |
| Second quarter | 15,749,241 | 5,310,267 | 1,881,321 | |
| Third quarter | 34,158,513 | 11,438,583 | 5,444,081 | |
| Fourth quarter | 7,044,265 | 3,012,975 | (565,890) | |
| Total | \$ 62,475,753 | \$ 21,622,913 | \$ 6,289,065 | \$ |

(1) In the fourth quarter of 2003, the Company took expenses relating to a loss on a guaranteed margin contract, \$2.5 million and a reserve for inventory loss of \$3.7 million. The guaranteed margin contract reduced sales and the reserve for inventory loss reduced cost of sales.

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

| Description | Balance at Beginning of Period | Charged to Costs and Expenses | Credited Costs and Expense |
|-------------|--------------------------------------|-------------------------------------|----------------------------------|
|-------------|--------------------------------------|-------------------------------------|----------------------------------|

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Year ended March 31, 2003

Reserves deducted from assets to which they apply:

| | | | |
|---------------------------------|-----------|-------------|-----------|
| Allowance for doubtful accounts | \$ 12,022 | \$ 412,055 | \$ (18,31 |
| Inventory reserves | \$ -- | \$3,715,357 | \$ |

Year ended March 31, 2002

Reserves deducted from assets to which they apply:

| | | | |
|---------------------------------|----------|----------|------|
| Allowance for doubtful accounts | \$ 9,812 | \$ 2,210 | \$ - |
| Inventory reserves | \$ -- | \$ -- | \$ - |

Year ended March 31, 2001

Reserves deducted from assets to which they apply:

| | | | |
|---------------------------------|-------|----------|------|
| Allowance for doubtful accounts | \$ -- | \$ 9,812 | \$ - |
| Inventory reserves | \$ -- | \$ -- | \$ - |

(1) Recoveries of amounts previously written off against the reserve.