SINGING MACHINE CO INC
Form 10-Q
February 14, 2014

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-Q**

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934
For quarter ended December 31, 2013

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to ______.

*Commission File Number* 0 - 24968

**THE SINGING MACHINE COMPANY, INC.**

(Exact Name of Registrant as Specified in its Charter)

| DELAWARE | 95-3795478 |
|---|---|
| (State of Incorporation) | (IRS Employer I.D. No.) |

6301 NW 5th Way, STE 2900, Fort Lauderdale FL 33309
(Address of principal executive offices)

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller Reporting Company x

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

**APPLICABLE ONLY TO ISSUES INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| CLASS | NUMBER OF SHARES OUTSTANDING |
| --- | --- |
| Common Stock, $0.01 par value | 38,070,642 as of February 14, 2014 |

**THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARIES**

INDEX


| | | Page No. |
|---|---|---|
| | PART I. FINANCIAL INFORMATION | |
| Item 1. | Financial Statements | |
| | Condensed Consolidated Balance Sheets  December 31, 2013 (Unaudited) and March 31, 2013 | 3 |
| | Condensed Consolidated Statements of Operations  Three months and nine months ended December 31, 2013 and 2012(Unaudited) | 4 |
| | Condensed Consolidated Statements of Cash Flows - Nine months ended December 31, 2013 and 2012 (Unaudited) | 5 |
| | Notes to Condensed Consolidated Financial Statements - December 31, 2013 (Unaudited) | 6-12 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 12-17 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 17 |
| Item 4. | Controls and Procedures | 17 |
| | PART II. OTHER INFORMATION | |
| Item 1. | Legal Proceedings | 17 |
| Item 1A. | Risk Factors | 18 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 18 |
| Item 3. | Defaults Upon Senior Securities | 18 |
| Item 4. | Mine Safety Disclosures | 18 |
| Item 5. | Other Information | 18 |
| Item 6. | Exhibits | 18 |
| SIGNATURES | | 18 |

**The Singing Machine Company, Inc. and Subsidiaries**
**CONDENSED CONSOLIDATED BALANCE SHEETS**

| | December 31, 2013 (Unaudited) | | March 31, 2013 (Audited) | |
|---|---|---|---|---|
| Assets | | | | |
| Current Assets | | | | |
| Cash | $ | 2,356,028 | $ | 1,652,996 |
| Restricted cash | | 137,967 | | - |
| Accounts receivable, net of allowances of $296,732 and $180,306, respectively | | 6,069,648 | | 1,100,475 |
| Due from Crestmark Bank | | 212,505 | | - |
| Due from related party - Starlight Consumer Electronics USA, Inc. | | 284,182 | | 291,343 |
| Due from related party - Starlight Electronics USA, Inc. | | 51,196 | | 50,501 |
| Due from related party - Cosmo Communications Canada, Ltd | | 235,439 | | 61,310 |
| Inventories, net | | 5,723,801 | | 4,123,407 |
| Prepaid expenses and other current assets | | 86,318 | | 84,441 |
| Deferred tax asset, net | | 294,427 | | 421,340 |
| Total Current Assets | | 15,451,511 | | 7,785,813 |
| | | | | |
| Property and equipment, net | | 609,381 | | 482,777 |
| Other non-current assets | | 17,630 | | 159,956 |
| Deferred tax asset, net non-current portion | | 836,948 | | 1,198,119 |
| Total Assets | $ | 16,915,470 | $ | 9,626,665 |
| | | | | |
| Liabilities and Shareholders' Equity | | | | |
| Current Liabilities | | | | |
| Accounts payable | $ | 4,214,078 | $ | 1,135,125 |
| Due to related party - Starlight Marketing Development, Ltd. | | 1,111,212 | | 1,107,678 |
| Subordinated related party debt - Starlight Marketing Development, Ltd. | | 816,753 | | |
| Due to related party - Starfair Electronics Company, Ltd. | | 166,228 | | - |
| Subordinated related party debt - Ram Light Management, Ltd. | | 1,683,247 | | - |
| Due to related party - Starlight R&D, Ltd. | | 238,429 | | 419,600 |
| Due to related party - Starlight Consumer Electronics Co., Ltd. | | 2,927,285 | | 585,125 |
| Due to related parties - Other Starlight Group Companies | | 13,260 | | 3,534 |
| Accrued expenses | | 1,310,234 | | 686,012 |
| Current portion of capital lease | | 11,942 | | - |
| Obligations to clients for returns and allowances | | 355,717 | | 376,289 |
| Warranty provisions | | 773,966 | | 215,471 |
| Total Current Liabilities | | 13,622,351 | | 4,528,834 |
| | | | | |
| Long-term capital lease, net of current portion | | 16,776 | | - |
| Subordinated related party debt - Starlight Marketing Development, Ltd., net of current portion | | - | | 816,753 |
| Subordinated related party debt - Ram Light Management, Ltd. | | - | | 1,683,247 |
| Total Liabilities | | 13,639,127 | | 7,028,834 |

| | | | | |
|---|---|---|---|---|
| Shareholders' Equity | | | | |
| Preferred stock, $1.00 par value; 1,000,000 shares authorized; no shares issued and outstanding | | - | | - |
| Common stock, Class A, $0.01 par value; 100,000 shares authorized; no shares issued and outstanding | | - | | - |
| Common stock, $0.01 par value; 100,000,000 shares authorized; 38,070,642 and 38,028,975 shares issued and outstanding, respectively | | 380,706 | | 380,289 |
| Additional paid-in capital | | 19,229,729 | | 19,155,193 |
| Accumulated deficit | | (16,334,092) | | (16,937,651) |
| Total Shareholders' Equity | | 3,276,343 | | 2,597,831 |
| Total Liabilities and Shareholders' Equity | $ | 16,915,470 | $ | 9,626,665 |

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

**The Singing Machine Company, Inc. and Subsidiaries**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Unaudited)**

| | For Three Months Ended | | For Nine Months Ended | |
|---|---|---|---|---|
| | December 31, 2013 | December 31, 2012 | December 31, 2013 | December 31, 2012 |
| Net Sales | $ 16,814,794 | $ 16,617,000 | $ 29,062,931 | $ 32,755,791 |
| Cost of Goods Sold | 12,707,912 | 12,594,626 | 22,251,890 | 24,818,560 |
| Gross Profit | 4,106,882 | 4,022,374 | 6,811,041 | 7,937,231 |
| Operating Expenses | | | | |
| Selling expenses | 1,218,688 | 1,445,728 | 2,401,528 | 2,945,018 |
| General and administrative expenses | 1,344,634 | 1,123,998 | 3,154,577 | 2,509,824 |
| Depreciation | 54,506 | 24,145 | 112,483 | 90,996 |
| Total Operating Expenses | 2,617,828 | 2,593,871 | 5,668,588 | 5,545,838 |
| Income from Operations | 1,489,054 | 1,428,503 | 1,142,453 | 2,391,393 |
| Other Expenses | | | | |
| Interest expense | (41,102) | (31,433) | (50,810) | (39,875) |
| Income before provision for income taxes | 1,447,952 | 1,397,070 | 1,091,643 | 2,351,518 |
| Provision for income taxes | (627,278) | - | (488,084) | - |
| Net Income | $ 820,674 | $ 1,397,070 | $ 603,559 | $ 2,351,518 |
| Income per Common Share | | | | |
| Basic | $ 0.02 | $ 0.04 | $ 0.02 | $ 0.06 |
| Diluted | $ 0.02 | $ 0.04 | $ 0.02 | $ 0.06 |
| Weighted Average Common and Common Equivalent Shares: | | | | |
| Basic and Diluted | 38,070,642 | 37,960,794 | 38,053,458 | 37,960,794 |
| Diluted | 38,650,355 | 38,286,865 | 38,633,171 | 38,286,865 |

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

**The Singing Machine Company, Inc. and Subsidiaries**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**

| | For Nine Months Ended December 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| Cash flows from operating activities | | | | |
| Net Income | $ | 603,559 | $ | 2,351,518 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation | | 112,483 | | 90,996 |
| Change in inventory reserve | | 25,000 | | (110,000) |
| Change in allowance for bad debts | | 116,426 | | 84,067 |
| Loss from disposal of property and equipment | | 4,479 | | - |
| Stock based compensation | | 74,953 | | 4,921 |
| Warranty provisions | | 558,495 | | 650,106 |
| Change in net deferred tax assets | | 488,084 | | - |
| Changes in operating assets and liabilities: | | | | |
| (Increase) Decrease in: | | | | |
| Accounts receivable | | (5,085,599) | | (4,518,889) |
| Due from Crestmark Bank | | (212,505) | | (477,577) |
| Inventories | | (1,625,394) | | (676,495) |
| Prepaid expenses and other current assets | | (1,877) | | 803 |
| Other non-current assets | | 142,326 | | (282) |
| Increase (Decrease) in: | | | | |
| Accounts payable | | 3,078,953 | | 2,214,862 |
| Net due to related parties | | 2,172,814 | | 2,264,154 |
| Accrued expenses | | 624,222 | | 1,678,542 |
| Obligations to clients for returns and allowances | | (20,572) | | (128,069) |
| Net cash provided by operating activities | | 1,055,847 | | 3,428,657 |
| Cash flows from investing activities | | | | |
| Purchase of property and equipment | | (207,178) | | (148,262) |
| Deposit of restricted cash | | (137,967) | | - |
| Net cash used in investing activities | | (345,145) | | (148,262) |
| Cash flows from financing activities | | | | |
| Payments on long-term capital lease | | (7,670) | | - |
| Net cash used in financing activities | | (7,670) | | - |
| Change in cash | | 703,032 | | 3,280,395 |
| | | | | |
| Cash at beginning of period | | 1,652,996 | | 267,465 |
| Cash at end of period | $ | 2,356,028 | $ | 3,547,860 |
| | | | | |
| Supplemental Disclosures of Cash Flow Information: | | | | |
| Cash paid for interest | $ | 50,810 | $ | 39,875 |
| Supplemental Disclosures of Non-cash Investing Activities: | | | | |
| Property and equipment purchased under capital lease | $ | 36,388 | $ | - |

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

5

**THE SINGING MACHINE COMPANY, INC AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**
**December 31, 2013**

## NOTE 1 BASIS OF PRESENTATION

### OVERVIEW

The Singing Machine Company, Inc., a Delaware corporation (the "Company", "SMC", "The Singing Machine") and wholly-owned subsidiaries SMC (Comercial Offshore De Macau) Limitada ("Macau Subsidiary"), SMC Logistics, Inc. ("SMC-L"), SMC-Music, Inc.("SMC-M"), and Singing Machine Holdings Ltd. (a B.V.I. company) are primarily engaged in the development, marketing, and sale of consumer karaoke audio equipment, accessories, musical instruments and musical recordings. The products are sold directly to distributors and retail customers.

The preparation of The Singing Machine's condensed consolidated 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 condensed consolidated 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 condensed consolidated 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.

## NOTE 2-SUMMARY OF ACCOUNTING POLICIES

### PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements include the accounts of the Company, Macau Subsidiary, SMC-L, SMC-M and Singing Machine Holdings Ltd. (a B.V.I. company). All inter-company accounts and transactions have been eliminated in consolidation for all periods presented.

### INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements for the three and nine months ended December 31, 2013 and 2012 are unaudited. In the opinion of management, such condensed consolidated financial statements include all adjustments (consisting of normal recurring accruals) necessary for the fair presentation of the condensed consolidated financial position and the condensed consolidated results of operations. The condensed consolidated results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet information as of March 31, 2013 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K. The interim condensed consolidated financial statements should be read in conjunction with that report.

### 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 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.

### FOREIGN CURRENCY TRANSLATION

The functional currency of the Macau Subsidiary is the Hong Kong dollar. Such financial statements are translated to U.S. 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 and translations were not material during the periods presented.

**Concentration of Credit Risk**

At times, the Company maintains cash in United States bank accounts that are in excess of the Federal Deposit Insurance Corporation ("FDIC") insured amounts of up to $250,000. As of December 31, 2013 and March 31, 2013, the Company had cash deposits of $422,851 and $1,007,894, respectively that exceeded the FDIC insurance limit. In addition, the Company deposited $137,967 in a restricted certificate of deposit with Wells Fargo Bank as collateral for a stand-by letter of credit issued to Majestic Realty (California warehouse's landlord) as a security deposit required by the property lease. The Company maintains cash balances in foreign financial institutions. The amounts in foreign financial institutions at December 31, 2013 and March 31, 2013 were $1,682,077 and $256,035, respectively.

**INVENTORY**

Inventories are comprised of electronic karaoke equipment, accessories, electronic musical instruments, electronic toys and compact discs and are stated at the lower of cost or market, as determined using the first in, first out method. The Singing Machine reduces inventory on hand to its net realizable value 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.

**COMPUTATION OF EARNINGS PER SHARE**
Income per common share is computed by dividing net income by the weighted average of common shares outstanding during the period. Diluted net income per share is presented as the conversion of stock options would have a dilutive effect. As of December 31, 2013 and 2012 total potential dilutive shares amounted to approximately 580,000 and 326,000 shares, respectively. These shares were included in the computation of diluted earnings per share for the three and nine months ended December 31, 2013 and 2012.

**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 and 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 actual and estimated future returns, discounts and volume rebates.

**STOCK BASED COMPENSATION**
The Company follows the provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 718, "Compensation Stock Compensation Awards Classified as Equity". ASC 718 requires all share-based payments to employees including grants of employee stock options, be measured at fair value and expensed in the condensed consolidated statement of operations over the service period (generally the vesting period). The Company uses the Black-Scholes option valuation model to value stock options. Employee stock option compensation expense for the three and nine months ended December 31, 2013 and 2012 includes the estimated fair value of options granted, amortized on a straight-line basis over the requisite service period for the entire portion of the award. For the three months ended December 31, 2013 and 2012 the stock option expense was $52,678 and $1,640, respectively. For the nine months ended December 31, 2013 and 2012 the stock option expense was $67,454, and $4,921, respectively.

**ADVERTISING**
Costs incurred for producing and publishing advertising of the Company are charged to operations the first time the advertising takes place. The Company has entered into cooperative advertising agreements with its major customers that specifically indicated that the customer has to spend the cooperative advertising fund upon the occurrence of mutually agreed events. The percentage of the cooperative advertising allowance ranges from 2% to 7% of the purchase. The customers have to advertise the Company's products in the customer's catalog, local newspaper and other advertising media. The customer must submit the proof of the performance (such as a copy of the advertising showing the Company's products) to the Company to request for the allowance. The customer 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 three months ended December 31, 2013 and 2012 was $656,963 and $806,920, respectively. Advertising expense for the nine months ended December 31, 2013 and 2012 was $1,383,897 and $1,666,056, respectively.

**RESEARCH AND DEVELOPMENT COSTS**
All research and development costs are charged to results of operations as incurred. These expenses are shown as a component of selling, general and administrative expenses in the condensed consolidated statements of operations. For the three months ended December 31, 2013 and 2012, these amounts totaled $110,949 and $38,000, respectively. For the nine months ended December 31, 2013 and 2012, these amounts totaled $167,951 and $71,240, respectively.

**FAIR VALUE OF FINANCIAL INSTRUMENTS**
The Company adopted FASB ASC 825, which 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, obligations to clients for returns and allowances, warranty provision, accrued expenses and net due to related parties approximates fair value due to the relatively short period to maturity for these instruments.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2013, FASB issued Accounting Standards Update (“ASU”) 2013-11 “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”). ASU 2013-11 requires that an unrecognized or portions of an unrecognized tax benefit be presented on the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward unless certain conditions exist. This amendment was adopted by the company as of December 31, 2013 and the adoption of this standard is did not have any impact on the Company’s financial statements.

**NOTE 3- INCOME TAXES**

The Company analyzes its deferred tax assets and liabilities at the end of each interim period and based on management’s best estimate of its full year effective tax rate recognizes cumulative adjustments to its deferred tax assets and liabilities. The Company’s effective tax rate for the fiscal year ending March 31, 2014 is estimated to be approximately 45%. The effective tax rate for the fiscal year ended March 31, 2013 was 41%. The increase in the tax rate was primarily due to a decrease in deemed dividends from the company’s Macau subsidiary as well as changes in timing differences in book versus tax deductions.

As of December 31, 2013 and March 31, 2013, The Singing Machine had gross deferred tax assets of approximately $2.8 million and $3.2 million, respectively, against which the Company recorded valuation allowances totaling approximately $1.6 million. A valuation allowance was recorded against deferred tax assets because it is more likely than not that a portion of the tax benefits from the gross deferred tax assets will not be realized. For the three month period ended December 31, 2013, the Company recorded income before provision for income taxes of approximately $1,448,000 which generated a decrease in current deferred tax assets and an income tax provision of approximately $627,000. For the nine month period ended December 31, 2013, the Company recorded income before provision for income taxes of approximately $1,092,000 which generated a decrease in current deferred tax assets and an income tax provision of approximately $488,000.

As of December 31, 2013 the Company is subject to U.S. Federal income tax examinations for the tax years ended March 31, 2011 through March 31, 2013.

**NOTE 4 DUE FROM CRESTMARK BANK**

In connection with the Company's line of credit financing with Crestmark Bank ("Crestmark") cash collected by Crestmark on pledged accounts receivable may exceed amounts borrowed on the line of credit from time to time (See Note 7 LINE of CREDIT). As of December 31, 2013 and March 31, 2013, Crestmark owed the Company $212,505 and $0, respectively which represented cash received by Crestmark on accounts receivable in excess of amounts borrowed against the line of credit.

**NOTE 5- INVENTORIES**

Inventories are comprised of the following components:

| | December 31 2013 (unaudited) | | March 31, 2013 | |
|---|---|---|---|---|
| Finished Goods | $ | 6,144,329 | $ | 4,626,407 |
| Inventory in Transit | | 107,472 | | - |
| Inventory Reserve | | (528,000) | | (503,000) |
| Inventories, net | $ | 5,723,801 | $ | 4,123,407 |

Inventory consigned to a distribution center at December 31, 2013 and March 31, 2013 was $353,201 and was fully reserved at December 31, 2013 and March 31, 2013.

**NOTE 6 - PROPERTY AND EQUIPMENT**

A summary of property and equipment is as follows:

| | USEFUL LIFE | December 31, 2013 (unaudited) | | March 31, 2013 | |
|---|---|---|---|---|---|
| Computer and office equipment | 5 years | $ | 282,921 | $ | 279,742 |
| Furniture and fixtures | 7 years | | 4,312 | | 4,312 |
| Leasehold improvements | * | | - | | 5,500 |
| Warehouse equipment | 7 years | | 224,106 | | 136,521 |
| Molds and tooling | 3-5 years | | 2,316,620 | | 1,849,245 |
| Molds and tooling under development | ** | | - | | 329,500 |
| | | | 2,827,959 | | 2,604,820 |

| | | | | |
|---|---|---|---|---|
| Accumulated depreciation | | (2,218,578) | | (2,122,043) |
| Property and equipment, net | $ | 609,381 | $ | 482,777 |

* Shorter of remaining term of lease or useful life

** As of December 31, 2013 and March 31, 2013 the Company had outstanding commitments for molds and tooling in process in the amounts of approximately $0 and $140,000, respectively.

Depreciation expense for the three months ended December 31, 2013 and December 31, 2012 was $54,506 and $24,145, respectively.
Depreciation expense for the nine months ended December 31, 2013 and December 31, 2012 was $112,483 and $90,996, respectively.

**NOTE 7 LINE OF CREDIT**

On October 19, 2012, the Company executed a two-year Accounts Receivable Ledgered Line of Credit Facility ("line of credit") with Crestmark Bank ("Crestmark") of Troy, Michigan which allows the Company to receive an advance of up to 70% of qualified accounts receivable. The outstanding loan balance on the line of credit cannot exceed $5,000,000 during our peak selling season between August 2 and February 14 and cannot exceed $500,000 between February 15 and August 1 of each year that the agreement is in effect. The Company has agreed to pledge all of its domestic accounts receivable shipped from North America (except drop shipment and related party invoices) to Crestmark and will assume all of the credit risk on accounts receivable pledged to Crestmark.

Interest on the line of credit and discounting charges on accounts receivable advances is accrued at a rate of 2% per annum over the prime rate as published by the Wall Street Journal and at no time shall the effective rate be less than 5.25% per annum. For the three months ended December 31, 2013 and 2012 the amount of interest expense related to the line of credit was $34,735 and $23,200, respectively. For the nine months ended December 31, 2013 and 2012 the amount of interest related to the line of credit was $43,531 and $23,200, respectively. The credit facility is secured with all assets of the Company as well as related-party debt subordination agreements totaling $2,500,000 from Ram Light Management, Ltd. in the amount of $1,683,247 and Starlight Marketing Development, Ltd. in the amount of $816,753. There is a commission fee of 1% of the gross invoice for all domestic accounts receivable pledged. For the three months ended December 31, 2013 and 2012 the amount of commission expense related to the line of credit was $104,458 and $110,330 respectively. For the nine months ended December 31, 2013 and 2012 the amount of commission expense related to the line of credit was $171,591 and $110,330, respectively. There were no amounts outstanding on the line of credit as of December 31, 2013 and March 31, 2013.

**NOTE 8 LONG-TERM CAPITAL LEASE**

On April 13, 2013, the company entered into a long-term capital leasing arrangement with Wells Fargo Equipment Finance ("Wells Fargo") to finance the lease of two used forklift vehicles with a total purchase price of $39,312 of which $36,388 was financed under a capital lease. The lease requires monthly payments in the amount of $1,082 per month over a total lease term of 36 months which commenced on May 19, 2013. The agreement has an effective interest rate of 4.5% and the company has the option to purchase the equipment at the end of the lease term for one dollar. As of December 31, 2013 and March 31, 2013 the outstanding amount due to Wells Fargo was $28,718 and $0, respectively.

As of December 31, 2013 and March 31, 2013, the Company had obligations under the capital lease repayable as follows:

| | December 31, 2013 | | March 31, 2013 | |
|---|---|---|---|---|
| Total minimum lease payments | | | | |
| Within one year | $ | 12,984 | $ | - |
| After one year but within 3 years | | 17,312 | | - |
| | | 30,296 | | - |
| Interest payments relating to future periods | | (1,578) | | - |
| Present Value of minimum lease payments | $ | 28,718 | $ | - |

For the three month periods ended December 31, 2013 and December 31, 2012 the amount of interest related to the capital lease were $343 and $0, respectively. For the nine month periods ended December 31, 2013 and December 31, 2012 the amount of interest related to the capital lease were $986 and $0, respectively.

**NOTE 9 - OBLIGATIONS TO CLIENTS FOR RETURNS AND ALLOWANCES**

Due to the seasonality of the business and length of time clients are given to return defective product, it is not uncommon for clients to accumulate credits from the Company's sales and allowance programs that are in excess of unpaid invoices in accounts receivable. All credit balances in clients' accounts receivable are reclassified to obligations to clients for returns and allowances in current liabilities on the condensed consolidated balance sheet. Client requests for payment of a credit balance are reclassified from obligations to clients for returns and allowances to accounts payable on the condensed consolidated balance sheets. When new invoices are processed prior to settlement of the credit balance and the client accepts settlement of open credits with new invoices, then the excess of new invoices over credits are netted in accounts receivable. As of the periods ended December 31, 2013 and March 31, 2013, obligations to clients for returns and allowances reclassified from accounts receivable were $355,717 and $376,289, respectively. There were no clients requesting refunds as of the period ended December 31, 2013 and

March 31, 2013 and as such no amounts were reclassified from obligations to clients for returns and allowances to accounts payable.

# NOTE 10 - COMMITMENTS AND CONTINGENCIES

**LEGAL MATTERS**
Management is currently not aware of any legal proceedings.

**INCOME TAXES**
In a letter dated July 21, 2008 the Internal Revenue Service (“IRS”) notified the former foreign subsidiary of an unpaid tax balance on Income Tax Return of a Foreign Corporation (Form 1120-F) for the period ending March 31, 2003 for International SMC (HK) Limited (“ISMC (HK)”), a former subsidiary. According to the notice ISMC (HK) has an unpaid balance due in the amount of $241,639 that includes an interest assessment of $74,125. ISMC (HK) was sold in its entirety by the Company on September 25, 2006 to a British Virgin Islands company (“Purchaser”). The sale and purchase agreement with the Purchaser of ISMC (HK) specifies that the Purchaser would ultimately be responsible for any liabilities, including tax matters. On June 3, 2009 the IRS filed a federal tax lien in the amount of approximately $170,000 against ISMC (HK) under ISMC (HK)’s federal Tax ID. Management sought independent legal counsel to assess the potential liability, if any, on the Company. In a memorandum from independent counsel, the conclusion based on the facts presented was that the IRS would not prevail against the Company for collection of the ISMC (HK) income tax liability based on:

- The IRS's asserted position that the Company is not the taxpayer.
- The 1120- F tax liability was recorded under the taxpayer identification number belonging to ISMC and not the Company's taxpayer identification number
- The IRS would be barred from recovery since it failed to assess or issue a notice of levy within the three year statute of limitations

Based on the conclusion reached in the legal memorandum, management does not believe that the Company will have any further liability with regards to this issue.

**LEASES**

The Company is committed to various operating lease agreements for office and warehouse facilities in Fort Lauderdale, Florida, Ontario, California and Macau expiring at varying dates. Rent expense for the three months ended December 31, 2013 and 2012 was $154,212 and $170,375, respectively. Rent expense for the nine months ended December 31, 2013 and 2012 was $457,867 and $547,984, respectively. In addition, the Company maintains various warehouse equipment and computer equipment operating leases. Included in rent expense is the cost for the warehouse facilities in City of Industry, California for which the operating lease expired on April 30, 2013 and was not renewed.

Future minimum lease payments under property and equipment leases with terms exceeding one year as of December 31, 2013 are as follows:

| | Property Leases | |
|---|---|---|
| For period ending | | |
| 2014 | $ | 530,237 |
| 2015 | | 530,715 |
| 2016 | | 554,695 |
| 2017 | | 487,672 |
| 2018 | | 509,021 |
| 2019 and beyond | | 873,786 |
| | $ | 3,486,126 |

**NOTE 11- SHAREHOLDERS' EQUITY**

**COMMON STOCK ISSUANCES**

On July 24, 2013 the Company issued 41,667 shares of its common stock to our Board of Directors at $0.18 per share, pursuant to our annual director compensation plan for the fiscal year ending March 31, 2014.

**STOCK OPTIONS**

On July 1, 2013 the Company granted 580,000 stock options that were issued to four key Company employees at an exercise price of $0.21 per share with a one year vesting period.

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option-pricing model with the assumptions outlined below. The expected volatility is based upon historical volatility of our stock and other contributing factors. The expected term is based upon observation of actual time elapsed between date of grant and exercise of options for all employees and other contributing factors.

- For the three and nine months ended December 31, 2013: expected dividend yield 0%, risk-free interest rate of 0.15%, volatility 304.1% and expected term of three years.

On June 1, 2001, the Board of Directors approved the 2001 Stock Option Plan (the “Plan”), which replaced the 1994 Stock Option Plan, as amended. The Plan was developed to provide a means whereby directors and selected employees, officers, consultants, and advisors of the Company were granted incentive or non-qualified stock options to purchase common stock of the Company. As of June 30, 2013, the Plan had expired and no shares were available to be issued.  As of December 31, 2013 there were 1,242,500 options still outstanding under the Plan. This does not include an additional 60,000 options issued on March 31, 2013 to three directors as compensation or 580,000 options issued on July 1, 2013 issued to key employees that were not issued from the Plan.

**NOTE 12 - GEOGRAPHICAL INFORMATION**

The majority of sales to customers outside of the United States for the three and nine months ended December 31, 2013 and 2012 were made by the Macau Subsidiary.  Sales by geographic region for the periods presented are as follows:

| | FOR THE THREE MONTHS ENDED December 31, 2013 | 2012 | FOR THE NINE MONTHS ENDED December 31, 2013 | 2012 |
|---|---|---|---|---|
| North America | $ 16,814,794 | $ 16,617,000 | $ 29,062,931 | $ 32,363,355 |
| Europe | - | - | - | 392,436 |
| | $ 16,814,794 | $ 16,617,000 | $ 29,062,931 | $ 32,755,791 |

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

**NOTE 13 DUE TO / FROM RELATED PARTIES, NET**

As of December 31, 2013 and March 31, 2013 the Company had amounts due to related parties in the amounts of $6,956,414 and $4,615,937, respectively consisting primarily of trade payables due to Starlight affiliates. As of December 31, 2013 and March 31, 2013 the Company had amounts due from related parties in the amounts of $570,817 and $403,154, respectively consisting primarily of trade receivables due from Starlight affiliates. Starlight Electronics Company, Ltd (related-party company) charges interest on current year intercompany trade payables that are past due at a rate of 4.5% per annum. For both the three and nine month periods ended December 31, 2013 and December 31, 2012 the Company incurred interest expense in the amounts of $0 and $5,575, respectively.

**NOTE 14 RELATED PARTY TRANSACTIONS**

During the three months ended December 31, 2013 and December 31, 2012 the Company sold approximately $357,000 and $647,000, respectively to Starlight Electronics Company, Ltd. During the nine months ended December 31, 2013 and December 31, 2012 the Company sold approximately $1,773,000 and $1,813,000, respectively to Starlight Electronics Company, Ltd. These goods were sold at a discounted price, similar to prices granted to major direct import customers shipped internationally with freight prepaid. The average gross profit margin on sales to Starlight Electronics for the three months ended December 31, 2013 and December 31, 2012 was 15.1% and 12.4%, respectively. The average gross profit margin on sales to Starlight Electronics for the nine months ended December 31, 2013 and December 31, 2012 was 14.8% and 12.6%, respectively. The product was drop shipped to Cosmo Communications of Canada (“Cosmo”), the Company’s primary distributor of its products to Canada. During the three months ended December 31, 2013 and December 31, 2012 the Company sold an additional $537,756 and $36,150, respectively of product to Cosmo from our California warehouse facility. During the nine months ended December 31, 2013 and December 31, 2012 the Company sold an additional $1,317,941 and $361,824 respectively of product to Cosmo from our California warehouse facility. These amounts were included as a component of cost of goods sold in the accompanying condensed consolidated statements of operations.

The Company purchased products from Starlight Consumer Electronics USA, Inc. (“SCE”) a subsidiary of Starlight International Holding Ltd. The purchases from SCE for the three month period ended December 31, 2013 and 2012 were $1,104,447 and $2,346,387, respectively. The purchases from SCE for the nine month period ended December 31, 2013 and 2012 were $8,920,712 and $7,306,460, respectively. The Company purchased product services from Starlight R&D, Ltd, (“SLRD”) a subsidiary of Starlight International Holding Ltd. The purchases from SLRD for the three month period ended December 31, 2013 and 2012 were $328,861 and $0, respectively. The purchases from SLRD for the nine month period ended December 31, 2013 and 2012 were $535,023 and $0, respectively. The Company purchased products from Starfair Electronics Co., Ltd, (“SFE”) a subsidiary of Starlight International Holding Ltd. The purchases from SFE for the three month period ended December 31, 2013 and 2012 were $242,931 and $0, respectively. The purchases from SFE for the nine month period ended December 31, 2013 and 2012 were $984,798 and $0, respectively. These amounts were included as a component of cost of goods sold in the accompanying condensed consolidated statements of operations.

Effective April 1, 2013, SMC-L entered into a service and logistics agreement with Starlight Consumer Electronics (USA), Inc. (“Starlight USA”), an indirect wholly-owned subsidiary of Starlight International, Cosmo USA, Inc.

(“Cosmo USA”) and Starlight Electronics USA, Inc. (“Starlight Electronics USA”) to provide logistics, fulfillment, and warehousing services for Starlight USA, Cosmo USA and Starlight Electronic USA’s domestic sales. For these services, Starlight USA, Cosmo USA and Starlight Electronics USA have agreed to reimburse the Company for actual warehouse space occupied by these companies at $0.50 per square foot and for logistics services performed based on an agreed to fee schedule specified in the agreement. The Company received $72,939 and $0 in service fees from these affiliates during the three months ended December 31, 2013 and December 31, 2012, respectively. The Company received $264,243 and $0 in service fees from these affiliates during the nine months ended December 31, 2013 and December 31, 2012, respectively. The agreement was expected to terminate on March 31, 2014 and to generate approximately $370,000 in expense reimbursements during the term of the contract. However, due to the significant decrease in logistics support to these affiliates, both parties have agreed to terminate the agreement effective December 31, 2013 and no further logistics agreements are expected to be consummated with these affiliates in the future. The company is actively seeking independent clients to perform similar logistics services for to replace the expense reimbursements received from the terminated contract.

On July 1, 2012, SMC-L entered into a service and logistics agreement with Starlight Consumer Electronics (USA), Inc. (“Starlight USA”), an indirect wholly-owned subsidiary of Starlight International, Cosmo USA, Inc. (“Cosmo USA”) and Starlight Electronics USA, Inc. (“Starlight Electronics USA”) to provide logistics, fulfillment, and warehousing services for Starlight USA, Cosmo USA and Starlight Electronic USA’s domestic sales. For these services, Starlight USA, Cosmo USA and Starlight Electronics USA agreed to pay the Company annual service fees totaling approximately $435,000 payable monthly beginning July 1, 2012. The Company received $0 and $133,219 in service fees from these affiliates during the three months ended December 31, 2013 and December 31, 2012, respectively. The Company received $0 and $266,238 in service fees from these affiliates during the nine months ended December 31, 2013 and December 31, 2012, respectively. This agreement terminated on March 31, 2013 and was replaced by a new agreement effective April 1, 2013.

On August 1, 2011, SMC-L entered into a service and logistics agreement with affiliates Starlight Consumer Electronics (USA), Inc., Starlight USA, Inc. and Cosmo USA to provide logistics, fulfillment, and warehousing services for these affiliates' domestic sales. The Company received $0 and $249,999 in service fees from these affiliates during the nine months ended December 31, 2013 and December 31, 2012, respectively.

**NOTE 15 WARRANTY PROVISIONS**

A return program for defective goods is negotiated with each of our wholesale customers on a year-to-year basis. Customers are either allowed to return defective goods within a specified period of time after shipment (between 6 and 9 months) or granted a "defective allowance" consisting of a fixed percentage (between 1% and 5%) off of the invoice price in lieu of returning defective products. The Company records liabilities for its return goods programs and defective goods allowance program at the time of sale for the estimated costs that may be incurred. The liability for defective goods is included in warranty provisions on the condensed consolidated balance sheets.

Changes in the Company's obligations for return and allowance programs are presented in the following table:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | December 31, 2013 | December 31, 2012 | December 31, 2013 | December 31, 2012 |
| Estimated return and allowance liabilities at beginning of period | $ 365,467 | $ 462,387 | $ 215,471 | $ 219,760 |
| Costs accrued for new estimated returns and allowances | 536,131 | 559,551 | 911,635 | 1,097,615 |
| Return and allowance obligations honored | (127,632) | (152,072) | (353,140) | (447,509) |
| Estimated return and allowance liabilities at end of period | $ 773,966 | $ 869,866 | $ 773,966 | $ 869,866 |

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

**FORWARD-LOOKING STATEMENTS**

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included elsewhere in this quarterly report. This document contains certain forward-looking statements including, among others, anticipated trends in our financial condition and results of operations and our business strategy. (See Part II, Item 1A, "Risk Factors "). These forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements.

Statements included in this quarterly report that do not relate to present or historical conditions are called "forward-looking statements." Such forward-looking statements involve known and unknown risks and uncertainties and other factors that could cause actual results or outcomes to differ materially from those expressed in, or implied by, the forward-looking statements. Forward-looking statements may include, without limitation, statements relating to our plans, strategies, objectives, expectations and intentions. Words such as "believes," "forecasts," "intends," "possible," "estimates," "anticipates," "expects," "plans," "should," "could," "will," and similar expressions are intended to identify forward-looking statements. Our ability to predict or project future results or the effect of events on our operating results is inherently uncertain. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved.

Important factors to consider in evaluating such forward-looking statements include, but are not limited to: (i) changes in external factors or in our internal budgeting process which might impact trends in our results of operations; (ii) unanticipated working capital or other cash requirements; (iii) changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the industries in which we operate; and (iv) the effects of adverse general economic conditions, both within the United States and globally, (v) vendor price increases and decreased margins due to competitive pricing during the economic downturn (vi) various competitive market factors that may prevent us from competing successfully in the marketplace and (vii) other factors described in the risk factors section of our Annual Report on Form 10-K, this Quarterly Report on 10-Q, or in our other filings made with the SEC.

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

**OVERVIEW**

The Singing Machine Company, Inc., a Delaware corporation, (the “Singing Machine,” “we,” “us,” “our” or “the Company”) a our subsidiaries are primarily engaged in the design, marketing, and sale of consumer karaoke audio equipment, accessories and musical recordings. The Company’s products are sold directly to distributors and retail customers. Our electronic karaoke machines and audio software products are marketed under The Singing Machine(R) trademark.

12

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

Our karaoke machines and karaoke software are currently sold in such major retail outlets as Costco, Best Buy, Toys R Us, Target and Wal-Mart. Our business has historically been subject to significant seasonal fluctuations causing our revenues to vary from period to period and between the same periods in different fiscal years. Thus, it may be difficult for an investor to project our results of operations for any given future period. We are uncertain of how significantly our business will be harmed by a prolonged economic recession but, we anticipate that continued contraction of consumer spending will negatively affect our revenues and profit margins.

**RESULTS OF OPERATIONS**

The following table sets forth, for the periods indicated, certain items related to our condensed consolidated statements of operations as a percentage of net sales for the three months and nine months ended December 31, 2013 and 2012.

**The Singing Machine Company, Inc. and Subsidiaries**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

| | For Three Months Ended | | For Nine Months Ended | |
|---|---|---|---|---|
| | December 31, 2013 | December 31, 2012 | December 31, 2013 | December 31, 2012 |
| Net Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of Goods Sold | 75.6% | 75.8% | 76.6% | 75.8% |
| Gross Profit | 24.4% | 24.2% | 23.4% | 24.2% |
| Operating Expenses | | | | |
| Selling expenses | 7.2% | 8.7% | 8.3% | 9.0% |
| General and administrative expenses | 8.1% | 6.8% | 10.8% | 7.7% |
| Depreciation and amortization | 0.3% | 0.1% | 0.4% | 0.3% |
| Total Operating Expenses | 15.6% | 15.6% | 19.5% | 16.9% |
| Income from Operations | 8.8% | 8.6% | 3.9% | 7.3% |
| Other Expenses | | | | |
| Interest expense | -0.2% | -0.2% | -0.2% | -0.1% |
| Income before provision for income taxes | 8.6% | 8.4% | 3.7% | 7.2% |
| Provision for income taxes | -3.7% | 0.0% | -1.7% | 0.0% |
| Net Income | 4.9% | 8.4% | 2.0% | 7.2% |

# QUARTER ENDED DECEMBER 31, 2013 COMPARED TO THE QUARTER ENDED DECEMBER 31, 2012

**NET SALES**

Net sales for the quarter ended December 31, 2013 increased to $16,814,794 from $16,617,000, an increase of $197,794 as compared to the same period ended December 31, 2012. Orders that were originally scheduled to ship in the previous quarter ended September 30, 2013 were rescheduled and shipped during the third quarter ended December 31, 2013 due to several vendors who experienced production delays due to related quality concerns, weather delays, plant inspection and subcontract issues in the prior quarter. These rescheduled deliveries are the primary reason for the increase in net sales for the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012.

**GROSS PROFIT**

Gross profit for the quarter ended December 31, 2013 increased to $4,106,882 from $4,022,374 an increase of $84,508 as compared to the same period in the prior year. This increase is primarily due to the increase in net sales in the quarter as compared to the same quarter in the prior year.

Gross profit margin for the three month period ended December 31, 2013 was 24.4% compared to 24.2% for the three month period ended December 31, 2012. The mix of products sold during the quarter ended December 31, 2013 yielded approximately 0.2% more in gross profit as compared to the same quarter ended December 31, 2012 and accounted for the increase in gross profit margin for the comparable periods.

**OPERATING EXPENSES**

For the quarter ended December 31, 2013, total operating expenses increased to $2,617,828. This represents an increase of $23,957 from the same period's quarter ended total operating expenses of $2,593,871. This increase was primarily due a decrease of approximately $227,000 in variable selling expenses including freight, commissions and co-op advertising programs granted to major retail customers offset by an increase in general and administrative expenses of approximately $221,000 and an increase in depreciation expense of approximately $30,000.

Selling expenses decreased $227,040 for the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012. There was a reduction in advertising allowance expense of approximately $385,000 which included a reduction to a major customer that did not execute a planned two-day promotion as agreed to in their co-op advertising program and the company accordingly reduced their advertising allowance by approximately $96,000. There were additional decreases in commissions and royalties of approximately $77,000 offset by an increase in marketing and promotion expenses of approximately $235,000 related to rollout of the new Home product which accounted for the remaining variance in selling expenses.

General and administrative expenses increased $220,636 for the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012. There was approximately $41,000 of additional stock compensation expense accrued for financial consulting services provided by a third party investment banking firm. Stock option compensation increased by approximately $50,000 due to the issuance of 580,000 stock options to key employees during the second quarter ended September 30, 2013. There was an increase of approximately $72,000 in product development expenses associated with roll out of the new Home product. The company received approximately $60,000 less in related party warehouse expense reimbursements due to decreased volume from Starlight Group companies. The remaining $2,000 favorable variance was due to various other general and administrative expense variances.

Depreciation expense increased by approximately $30,000 during the three months ended December 31, 2013 compared to the three months ended December 31, 2012 primarily due to the commencement of depreciation on the Home product fixed assets.

**INCOME FROM OPERATIONS**

Income from operations increased $60,551 this quarter, to $1,489,054 for the three months ended December 31, 2013 compared to income from operations of $1,428,503 for the same period ended December 31, 2012. The increase in sales and gross profit combined with the decrease in operating expenses as explained above for the three months ended December 31, 2013 compared to the same period ended December 31, 2012 accounted for most of the variance.

**OTHER EXPENSES**

Other expenses (interest expense) increased to $41,102 from $31,433 for the same period a year ago primarily due to the increased borrowing activity related to the company's financing facility.

**INCOME TAXES**

For the three months ended December 31, 2013 the Company recognized an income tax provision of approximately $627,000 due to adjustments to its deferred tax assets based on management's best estimate of the Company's full year effective tax rate of approximately 45%. For the three months ended December 31, 2012, the Company did not record a tax provision because its deferred tax asset was fully reserved.

**NET INCOME**
For the three months ended December 31, 2013 net income decreased to $820,674 compared to net income of $1,397,070 for the same period a year ago. The decrease in net income was the same as explained in income from operations.

# NINE MONTHS ENDED DECEMBER 31, 2013 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2012

**NET SALES**
Net sales for the nine months ended December 31, 2013 decreased to $29,062,931 from $32,755,791, a decrease of $3,692,860 as compared to the same period ended December 31, 2012. This decrease in sales was partially due to the decrease in sales of approximately $2,000,000 to one major customer that was already carrying our assortment as a year-round program and therefore already had existing inventory and did not need to order as much product for their fall reset. In addition there was a loss of approximately $900,000 of direct import sales with one major customer due to vendor plant inspection deficiencies. Another major vendor opted to change their shipping terms from prepaid to collect which in turn decreased their selling price by approximately $450,000. The remaining net sales decrease was primarily from canceled orders due to late shipments from Chinese vendors due to quality concerns and weather related issues.

**GROSS PROFIT**
Our gross profit for the nine months ended December 31, 2013 decreased to $6,811,041 from $7,937,231, a decrease of $1,126,190 as compared to the same period in the prior year. The decrease in revenue as explained in Net Sales was the primary reason for the decrease of gross profit.

Gross profit margin for the nine month period ended December 31, 2013 was 23.4% compared to 24.2% for the nine month period ended December 31, 2012. The 0.8% decrease gross profit margin was adversely affected by a major vendor that changed their freight terms from prepaid to collect which contributed to approximately $450,000 or 0.3% in gross profit margin decrease. The remaining decrease of 0.5% in gross profit margin was primarily due to an unfavorable mix of products sold during the quarter ended December 31, 2013 compared to the same quarter ended December 31, 2012.

**OPERATING EXPENSES**

For the nine months ended December 31, 2013, total operating expenses increased to $5,668,588 from $5,545,838 for the nine months ended December 31, 2012, an increase of $122,750. This increase was primarily due a decrease of approximately $543,000 in variable selling expenses including freight, commissions and co-op advertising programs granted to major retail customers offset by an increase general and administrative of approximately $645,000 and an increase in depreciation expense of approximately $21,000.

Selling expenses decreased $543,490 for the nine months ended December 31, 2013 compared to the nine months ended December 31, 2012. Advertising allowance expenses decreased approximately $668,000 due to the decrease in net sales for the nine months ended December 31, 2013 and decreased co-op allowance due to the decrease in net sales and an allowance decrease to one major retail customer that did not execute a planned two-day promotion as agreed to in their co-op advertising program and the company accordingly reduced their advertising allowance. Freight and sales commission expenses decreased by approximately $248,000 due to the decrease in net sales and one major customer’s change of freight terms from prepaid to collect. These decreases were offset by an increase of approximately $386,000 in marketing expenses associated with the rollout of the Home product with the remaining variance due to other variable selling expenses.

General and administrative expenses increased $644,753 for the nine months ended December 31, 2013 compared to same period ended December 31, 2012. Stock option compensation increased by approximately $62,000 due to the issuance of 580,000 stock options to key employees in July, 2013. There was approximately $101,000 of additional stock warrant expense accrued for financial consulting services provided by a third party investment banking firm. There was an increase in finance commission fees of approximately $57,000 associated with the company’s credit facility. There was an increase of sample expenses and product development costs of approximately $43,000 and $97,000, respectively primarily associated with rollout of the new Home product. The company received approximately $252,000 less in related party warehouse expense reimbursements due to decreased volume from Starlight Group companies. The remaining variance was due to various other general and administrative expense increases.

Depreciation expense increased by approximately $21,000 during the nine months ended December 31, 2013 compared to the nine months ended December 31, 2012 primarily due to the commencement of depreciation on the Home product fixed assets.

**INCOME FROM OPERATIONS**

Income from operations decreased $1,248,940 to $1,142,453 for the nine months ended December 31, 2013 compared to income from operations of $2,391,393 for the same period ended December 31, 2012. This decrease is primarily due to the decrease in net sales and related gross profit as explained in Net Sales above.

**OTHER EXPENSES**

Our other expenses (interest expense) increased to $50,810 from $39,875 for the same period a year ago primarily due to the increased borrowing activity related to the company’s financing facility.

**INCOME TAXES**

For the nine months ended December 31, 2013 the Company recognized an income tax provision of approximately $488,000 due to adjustments to its deferred tax assets based on management's best estimate of the Company's full year effective tax rate of approximately 45%. For the nine months ended December 31, 2012, the Company did not record a tax provision because its deferred tax asset was fully reserved.

**NET INCOME**

We recognized net income of $603,559 for the nine months ended December 31, 2013 compared to a net income of $2,351,518 for the same period a year ago. The decrease in net income was the same as explained in income from operations.

**LIQUIDITY AND CAPITAL RESOURCES**

As of December 31, 2013, Singing Machine had cash on hand of $2,493,995 of which $137,967 was restricted as collateral for a stand-by letter of credit as compared to cash on hand of $1,652,996 with no restrictions as of March 31, 2013. We had working capital of $1,829,160 as of December 31, 2013.

Net cash provided by operating activities was $1,055,847 for the nine months ended December 31, 2013, as compared to $3,428,657 provided by operating activities during the same period a year ago. In addition to approximately $604,000 in net income from operations and approximately $1,380,000 of net changes to non-cash balance sheet items there was an increase of accounts payable (primarily inventory vendors) of approximately $3,079,000, increase in related party debt (primarily for goods manufactured by related parties) of approximately $2,173,000 and increases in accrued expenses of approximately $624,000 commensurate with the increase in seasonal sales. These increases provided by operations were offset by uses of operating cash from product shipment delays from vendors and a decrease in net sales resulting in an increase in inventory of approximately $1,625,000. Accounts receivable also increased by approximately $5,086,000 due primarily to seasonal increases in customer shipments during the second quarter ended December 31, 2013. These changes accounted for 92% of the cash used in operations with the remaining 8% due to seasonal changes in other operating assets and liabilities.

Net cash provided by operating activities was $3,428,657 for the nine months ended December 31, 2012. During the nine months ended December 31, 2012 there was a net income of approximately $2,352,000. During the nine months ended December 31, 2012 accounts receivable increased by approximately $4,519,000 due to the increase in seasonal shipments and inventory increased approximately $676,000. These uses of cash were offset by increases in accounts payable of approximately $2,215,000 (primarily inventory vendors), an increase in related party debt of approximately $2,264,000 and an increase of approximately $1,679,000 in accrued expenses. These changes accounted for 97% of the cash provided by operations with the remaining 3% due to seasonal changes in other operating assets and liabilities.

Net cash used by investing activities for the nine months ended December 31, 2013 was $345,145 as compared to $148,262 used by investing activities for the same period ended a year ago. This increase in investment activity was due to additional investment of tooling and molds for new products as well as forklift trucks, furniture and warehouse racking for the new California warehouse facility totaling approximately $207,000 during the nine month period ended December 31, 2013. In addition we deposited approximately $138,000 in a restricted certificate of deposit with Wells Fargo Bank as collateral for a stand-by letter of credit issued to Majestic Realty (new California warehouse's landlord) as a security deposit required by the property lease. Net cash used of $148,262 during the nine months ended December 31, 2012 was primarily due to additional investment of tooling and molds for new products.

Net cash by financing activities was $7,670 for the nine months ended December 31, 2013, as compared to net cash provided by financing activities of $0 for the same period ended a year ago. On April 13, 2013, the company entered into a long-term capital leasing arrangement with Wells Fargo Equipment Finance ("Wells Fargo") to finance the lease of two used forklift vehicles in the amount of $39,312. As of December 31, 2013 the outstanding amount due Wells Fargo was $28,718. During the nine month period ending December 31, 2013, the Company made eight lease payments totaling $7,670.

In addition to our current financing arrangements, the Starlight Group ("Group") has expressed their willingness and ability to provide extended payment terms to us for key vendor payments primarily by extending longer payment terms for goods they manufacture for us. We do not believe we will require any bridge financing from the Group for the fiscal year ending March 31, 2014, however we will continue to take advantage of extended terms for trade payables with the Group throughout the year. During the nine months ended December 31, 2013, our related party debt increased by approximately $2,173,000 primarily due to amounts owed for product shipped to the company during the period. Taking into account internally generated funds and credit facilities available to the Group we have concluded that our parent will have sufficient working capital to provide extended trade payable terms to us for at least the next 12 months.

Our average monthly general and administrative expenses are approximately $345,000. We expect that we will require approximately $1,035,000 for working capital during the next three-month period.

During the next 12 month period, we plan on financing our operation needs by:

- Raising additional working capital;
- Collecting our existing accounts receivable;
- Selling existing inventory;
- Vendor financing;
- Borrowing from bank credit facility;
- Extended payment terms from our majority shareholder;
- Fees for fulfillment, delivery and returns services from related parties.

Our sources of cash for working capital in the long term, 12 months and beyond are essentially the same as our sources during the short term. We are actively seeking additional financing facilities and capital investments to

maintain and grow our business. If we need to obtain additional financing and fail to do so, it may have a material adverse effect on our ability to meet our financial obligations and to continue as a going concern.

**INVENTORY SELL THROUGH**

We monitor the inventory levels and sell through activity of our major customers to properly anticipate returns and maintain the appropriate level of inventory. We believe that we have proper return reserves to cover potential returns based on historical return ratios and information available from the customers.

**SEASONAL AND QUARTERLY RESULTS**

Historically, our operations have been seasonal, with the highest net sales occurring in our second and third fiscal quarters (reflecting increased orders for equipment and music merchandise during the Christmas holiday season) and to a lesser extent the first and fourth quarters of the fiscal year. Sales in our second and third fiscal quarters, combined, accounted for approximately 90.0% and 87.9% of net sales in fiscal 2013 and 2012, respectively.

Our 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.

We are currently developing and considering selling products other than those within the karaoke category during the slow season to fulfill the revenue shortfall.

**INFLATION**
Inflation has not had a significant impact on our operations. We generally have adjusted our prices to track changes in the Consumer Price Index since prices we charge are generally not fixed by long-term contracts.

**OFF-BALANCE SHEET ARRANGEMENTS**
We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, results of operations, liquidity or capital expenditures.

**CRITICAL ACCOUNTING POLICIES**
We prepared our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. As such, management is required to make certain estimates, judgments and assumptions that it believes are reasonable based on the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the periods presented. The significant accounting policies which management believes are the most critical to aid in fully understanding and evaluating our reported financial results include: accounts receivable allowance for doubtful accounts, reserves on inventory, deferred tax assets.

COLLECTIBILITY OF ACCOUNTS RECEIVABLE. Our allowance for doubtful accounts is based on management's estimates of the creditworthiness of our 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 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. We establish 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 our 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. 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.

We operate within multiple taxing jurisdictions and are 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 potential income taxes in the jurisdiction have been made.

**USE OF OTHER ESTIMATES**
We make 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 our financial condition. However, circumstances could change which may alter future expectations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**
Not required for smaller reporting companies.

**ITEM 4. CONTROLS AND PROCEDURES**

(a) ***Evaluation of Disclosure Controls and Procedures.*** As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act). Based upon this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) ***Changes in Internal Controls.*** There was no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 under the Exchange Act that occurred during the end of the period covered by this report that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Management is currently not aware of any legal proceedings.

**ITEM 1A. RISK FACTORS**
Not applicable for smaller reporting companies

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**
None

# ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

**ITEM 4. MINE SAFETY DISCLOSURES**
None.

**ITEM 5. OTHER INFORMATION**
None.

**ITEM 6. EXHIBITS**
31.1 Certification of Gary Atkinson, Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.*

31.2 Certification of Lionel Marquis, Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.*

32.1 Certifying Statement of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act.*

32.2 Certifying Statement of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act.*

* Filed herewith

**SIGNATURES**

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

**THE SINGING MACHINE COMPANY, INC.**

Date: February 14, 2014

*By:*

*/s/ Gary Atkinson*
Gary Atkinson
Chief Executive Officer

*/s/ Lionel Marquis*
Lionel Marquis
Chief Financial Officer