

SINGING MACHINE CO INC
Form 10-Q
August 23, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For quarter ended June 30, 2010

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
(State of Incorporation)

95-3795478
(IRS Employer I.D. No.)

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

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

Indicate 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 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

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

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

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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 | 37,585,794 as of August 13, 2010 |

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARIES

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

| | June 30, 2010 (Unaudited) | March 31, 2010 (Audited) |
|--|------------------------------|-----------------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 282,060 | \$ 865,777 |
| Accounts receivable, net of allowances of \$207,557 and \$185,407, respectively | 1,444,981 | 983,791 |
| Due from factor | 147,427 | 14,987 |
| Inventories, net | 2,824,212 | 2,804,848 |
| Prepaid expenses and other current assets | 98,677 | 118,465 |
| Total Current Assets | 4,797,357 | 4,787,868 |
| Property and Equipment, net | 614,915 | 736,966 |
| Other Non-Current Assets | 164,644 | 164,644 |
| Total Assets | \$ 5,576,916 | \$ 5,689,478 |
| Liabilities and Shareholders' Deficit | | |
| Current Liabilities | | |
| Accounts payable | \$ 1,663,443 | \$ 895,713 |
| Due to related parties - net | 3,523,895 | 3,033,801 |
| Accrued expenses | 192,239 | 227,257 |
| Short-term loan - bank | 280,533 | 1,091,828 |
| Current portion of long-term financing obligation | 18,186 | 18,186 |
| Customer credits on account | 703,353 | 742,009 |
| Deferred gross profit on estimated returns | 120,412 | 123,708 |
| Total Current Liabilities | 6,502,061 | 6,132,502 |
| Long-term financing obligation, less current portion | 1,516 | 4,547 |
| Total Liabilities | 6,503,577 | 6,137,049 |
| Shareholders' Deficit | | |
| 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, \$0.01 par value; 100,000,000 shares authorized; 37,585,794 and 37,585,794 shares issued and outstanding | 375,857 | 375,857 |
| Additional paid-in capital | 19,099,096 | 19,098,726 |
| Accumulated deficit | (20,401,614) | (19,922,154) |
| Total Shareholders' Deficit | (926,661) | (447,571) |
| Total Liabilities and Shareholders' Deficit | \$ 5,576,916 | \$ 5,689,478 |

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

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

| | For Three Months Ended | |
|--|------------------------|----------------|
| | June 30, 2010 | June 30, 2009 |
| Net Sales | \$ 2,091,627 | \$ 814,008 |
| Cost of Goods Sold | 1,515,734 | 1,099,630 |
| Gross (Loss) Profit | 575,893 | (285,622) |
| Operating Expenses | | |
| Selling expenses | 249,089 | 304,141 |
| General and administrative expenses | 675,576 | 860,254 |
| Depreciation and amortization | 122,052 | 99,752 |
| Total Operating Expenses | 1,046,717 | 1,264,147 |
| Loss from Operations | (470,824) | (1,549,769) |
| Other Expenses | | |
| Interest expense | (8,636) | (3,268) |
| Net Loss | \$ (479,460) | \$ (1,553,037) |
| Loss per Common Share | | |
| Basic and Diluted | \$ (0.01) | \$ (0.04) |
| Weighted Average Common and Common Equivalent Shares: | | |
| Basic and Diluted | 37,585,794 | 37,449,432 |

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

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

| | For Three Months Ended | |
|--|------------------------|----------------|
| | June 30, 2010 | June 30, 2009 |
| Cash flows from operating activities | | |
| Net Loss | \$ (479,460) | \$ (1,553,037) |
| Adjustments to reconcile net loss to net cash and cash equivalents provided by (used in) operating activities: | | |
| Depreciation and amortization | 122,052 | 99,751 |
| Change in allowance for bad debts | 22,150 | 65,313 |
| Change due to lower of cost or market write-off | - | (181,142) |
| Stock compensation | 370 | 3,939 |
| Deferred gross profit on estimated sales returns | (3,296) | (214,914) |
| Changes in assets and liabilities: | | |
| (Increase) Decrease in: | | |
| Accounts receivable | 50,590 | 950,861 |
| Inventories | (19,364) | 698,890 |
| Prepaid expenses and other current assets | 19,788 | 105,739 |
| Increase (Decrease) in: | | |
| Accounts payable | 767,730 | (1,236,244) |
| Accounts payable - related party | 264,341 | (878,822) |
| Accrued expenses | (35,019) | (74,028) |
| Customer credits on account | (38,656) | 735,545 |
| Net cash provided by (used in) operating activities | 671,226 | (1,478,149) |
| Cash flows from investing activities | | |
| Purchase of property and equipment | - | (35,377) |
| Net cash used in investing activities | - | (35,377) |
| Cash flows from financing activities | | |
| (Retention by) borrowings from factor, net | (132,440) | 69,850 |
| Net payments pursuant to factoring facility | (533,929) | (635,731) |
| Net (repayment of) proceeds from short-term bank loan | (811,295) | 1,742,140 |
| Payments on long-term financing obligation | (3,031) | (3,031) |
| Net loan proceeds from related parties | 225,752 | - |
| Net cash (used in) provided by financing activities | (1,254,943) | 1,173,228 |
| Change in cash and cash equivalents | (583,717) | (340,298) |
| Cash and cash equivalents at beginning of period | 865,777 | 957,163 |
| Cash and cash equivalents at end of period | \$ 282,060 | \$ 616,865 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid for Interest | \$ 8,636 | \$ 3,268 |

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

THE SINGING MACHINE COMPANY, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
June 30, 2010

NOTE 1 – BASIS OF PRESENTATION

OVERVIEW

The Singing Machine Company, Inc., a Delaware corporation (the "Company," "SMC", "The Singing Machine", "we" or "us"), 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 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.

NOTE 2-SUMMARY OF ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

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

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements for the three months ended June 30, 2010 and 2009 are unaudited. In the opinion of management, such consolidated financial statements include all adjustments (consisting of normal recurring accruals) necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. The consolidated results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheet information as of March 31, 2010 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K. The interim consolidated financial statements should be read in conjunction with that report.

USE OF ESTIMATES

The Singing Machine makes estimates and assumptions in the ordinary course of business relating to sales returns and allowances, inventory reserves, warranty reserves, and reserves for promotional incentives that affect the reported amounts of assets and liabilities and of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. 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.

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.

ACCOUNTS RECEIVABLE FACTORING

The Company's factoring facility, which was canceled on June 8, 2010, only financed non-recourse accounts receivable. Such receivables are considered to have been sold in accordance with Financial Accounting Standard Board ("FASB"), Accounting Standard Codification ("ASC") 860-30, Transfers and Servicing Secured Borrowing and Collateral. Accordingly, advances received pursuant to the factoring facility have been netted against the accounts receivable on the accompanying consolidated balance sheet for March 31, 2010.

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

The Company maintains cash balances in foreign financial institutions. The amounts at June 30, 2010 and March 31, 2010 are \$139,596 and \$734,908, respectively. 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 June 30, 2010 and March 31, 2010 there were no amounts in United States bank accounts that were uninsured.

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.

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 began to apply the provisions FASB ASC 718-20, Compensation – Stock Compensation Awards Classified as Equity ("ASC 718-20") starting on January 1, 2006. ASC 718-20 requires all share-based payments to employees including grants of employee stock options, be measured at fair value and expensed in the consolidated statement of operations over the service period (generally the vesting period). Upon adoption, the Company transitioned to ASC 718-20 using the modified prospective application, whereby compensation cost is only recognized in the consolidated statements of operations beginning with the first period that ASC 718-20 is effective and thereafter, with prior periods' stock-based compensation still presented on a pro forma basis. Under the modified prospective approach, the provisions of ASC 718-20 are to be applied to new employee awards and to employee awards modified, repurchased, or cancelled after the required effective date. Additionally, compensation cost for the portion of employee awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the requisite service is rendered on or after the required effective date. The compensation cost for that portion of employee awards shall be based on the grant-date fair value of those awards as calculated for either recognition or pro-forma disclosures under ASC 718-20. The Company continues to use the Black-Scholes option valuation model to value stock options. For the three months ended June 30, 2010 and June 30, 2009, the stock option expense was \$370 and \$3,939 respectively. Employee stock option compensation expense in fiscal years 2011 and 2010 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.

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. For the quarter ended June 30, 2010, the Company took into consideration guidance under ASC 718-20 and SEC Staff Accounting Bulletin No. 107 when reviewing and updating assumptions. 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. Previously such assumptions were determined based on historical data.

- For the three months ended June 30, 2010: expected dividend yield 0%, risk-free interest rate of 0.41%, volatility 268.4% and expected term of three years.
- For the three months ended June 30, 2009: expected dividend yield 0%, risk-free interest rate of 0.57% to 1.41%, volatility 70.22% and 80.07% and expected term of three years.

ADVERTISING

Costs incurred for producing and publishing advertising of the Company are charged to operations as incurred. The Company has entered into cooperative advertising agreements with its major clients that specifically indicated that the client 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 5% of the purchase. The clients have to advertise the Company's products in the client's catalog, local newspaper and other advertising media. The client 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 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 three months ended June 30, 2010 and 2009 was \$110,212 and \$64,599, 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 consolidated statements of operations. For the three months ended June 30, 2010 and 2009, these amounts totaled \$7,000 and \$43,495, respectively.

FAIR VALUE OF FINANCIAL INSTRUMENTS

We have adopted FASB ASC 825, Financial Instruments, 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, due from factors, accounts payable, customer credits on account, accrued expenses and loans payable to related parties approximates fair value due to the relatively short period to maturity for these instruments.

RECLASSIFICATIONS

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

SUBSEQUENT EVENTS

We adopted the provisions of FASB ASC 855, Subsequent Events ("ASC 855"). The purpose of ASC 855 is to establish a general standard of accounting for the disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The statement outlines the following:

- The period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements
- The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements
- The disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

NOTE 3- INCOME TAXES

The Company follows FASB ASC 740 10-25, Accounting for Uncertainty in Income Taxes which defines a recognition threshold and measurement attribute for financial statement recognition and measurements of tax positions taken or expected to be taken in a tax return. As of June 30, 2010 this position did not result in any adjustment to the Company's provision for income taxes.

As of June 30, 2010 and March 31, 2010, The Singing Machine had gross deferred tax assets of approximately \$4.3 million and \$4.0 million, respectively, against which the Company recorded valuation allowances totaling approximately \$4.3 million and \$4.0 million, respectively.

As of June 30, 2010 the Company is subject to U.S. Federal income tax examinations for the tax years ended March 31, 2007 through March 31, 2010.

NOTE 4- INVENTORIES

Inventories are comprised of the following components:

| | June 30, 2010 (unaudited) | March 31, 2010 |
|-------------------------|---------------------------------|-------------------|
| Finished Goods | \$ 2,704,902 | \$ 3,153,917 |
| Inventory in Transit | 468,379 | - |
| Less: Inventory Reserve | (349,069) | (349,069) |
| Net Inventories | \$ 2,824,212 | \$ 2,804,848 |

Inventory consigned to customers at June 30, 2010 and March 31, 2010 were \$353,557 and \$353,557, respectively.

NOTE 5 - ACCOUNTS RECEIVABLE FACTORING FACILITY

On June 8, 2010 the Company was notified by DBS Bank (Hong Kong) Limited (“DBS” or “Lender”) that our credit and factoring facilities totaling \$13.0M were being withdrawn effective upon receipt of amounts due on both factoring and accounts payable financing facilities. As of the financial statement date of issue, the Company had no outstanding amounts due to DBS with respect to the financing facility. Our parent company, The Starlight Group, has committed to provide bridge financing until the Company secures a new financing facility.

The factoring facility was established on August 28, 2008, pursuant to a three-party Banking Facility agreement between the Company’s wholly owned subsidiary SMC (Commercial Offshore De Macau) Limitada (“Borrower”), DBS and Branch Banking and Trust Company (“BB&T” or “Factor”). The agreement was comprised of three facilities including a maximum of \$7.0 million on 80% of qualified accounts receivable, a maximum letter of credit facility of \$4.0 million for accounts payable financing and a maximum of \$2.0 million for the negotiation of export bills under letter of credit.

Under the factor agreement, the Factor assumed credit risk on approved accounts (factor risk accounts). For non-approved accounts, the Company assumed the credit risk (client risk accounts). The factoring fees were .675% of the gross invoice for both client risk (recourse) and factor risk (non-recourse) accounts. As of June 30, 2010 there was a total of \$85,638 of open accounts receivable assigned to the Factor. The Company assumed credit risk (recourse) in the amount of \$24,301. Credit risk on the remaining factor assigned receivables in the amount of \$61,337 was assumed by the Factor (non-recourse). As of June 30, 2010 and March 31, 2010 there were outstanding amounts due from BB&T of \$20,881 and \$14,987 respectively. These amounts represent excess of customer payments received by BB&T that had yet to be transferred to DBS. As of June 30, 2010 and March 31, 2010 there were outstanding amounts due from DBS in the amount of \$126,546 and \$0 respectively. These amounts represent excess of customer payments received by DBS from non-assigned receivables that had yet to be transferred to the Company. As of June 30, 2010 and March 31, 2010 the outstanding amount under the factoring facility with DBS was \$0 and \$619,567 respectively. This amount represents advances made by DBS on non-recourse receivables and have been offset against accounts receivable in the accompanying consolidated balance sheet for March 31, 2010.

NOTE 6 - PROPERTY AND EQUIPMENT

A summary of property and equipment is as follows:

| | USEFUL LIFE | June 30 2010 (unaudited) | March 31, 2010 |
|--------------------------------|----------------|--------------------------------|-------------------|
| Computer and office equipment | 5 years | \$ 660,948 | \$ 660,948 |
| Furniture and fixtures | 5-7 years | 217,875 | 217,875 |
| Leasehold improvements | * | 151,503 | 151,503 |
| Warehouse equipment | 7 years | 101,521 | 101,521 |
| Molds and tooling | 3-5 years | 1,820,106 | 1,820,106 |
| | | 2,951,953 | 2,951,953 |
| Less: Accumulated depreciation | | (2,337,038) | (2,214,987) |
| | | \$ 614,915 | \$ 736,966 |

* Shorter of remaining term of lease or useful life

NOTE 7 - CUSTOMER CREDITS ON ACCOUNT

Customer credits on account represent customers that have received credits in excess of their accounts receivable balance. These balances were reclassified for financial statement purposes as current liabilities until paid or applied to future purchases.

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NOTE 8 – FINANCING

As of June 30, 2010 and March 31, 2010 the Company owed DBS \$280,533 and \$1,091,828 respectively pursuant to an accounts payable financing facility. The proceeds were used to pay China manufacturing vendors. The accounts payable facility loans are secured with corporate guarantees from the Company as well as a guarantee from Starlight and bear interest at 2.6%. The amounts are due to DBS as follows:

| Amount | Due Date | Interest Rate |
|-----------|-----------|---------------|
| \$232,225 | 24-Jun-10 | 2.60% |
| \$ 48,308 | 2-Aug-10 | 2.60% |
| \$280,533 | | |

This accounts payable financing facility is pursuant to the three-party Banking Facility agreement discussed in Note 5.

Interest on letter of credit facilities and discounting charges on accounts receivable advances will be charged at a rate of 1.5% per annum over LIBOR (London Interbank Offered Rate). The credit facility is secured with corporate guarantees from the Company as well as a \$2.0 million guarantee from Starlight International Holdings Limited, a related party. This agreement replaced a previous four-party agreement between the Company, Starlight Marketing Limited (a related party), Standard Chartered Bank (Hong Kong), Limited and CIT.

On June 8, 2010 the Company was notified by DBS that our credit and factoring facilities totaling \$13.0M were being withdrawn effective upon receipt of amounts due on both factoring and accounts payable financing facilities. As of issuing date of the financial statements, the Company did not have amounts due on this facility. Our parent company, The Starlight Group, has committed to providing bridge financing as the Company seeks replacement financing.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

LEGAL MATTERS

MGA ENTERTAINMENT, INC. v. THE SINGING MACHINE COMPANY, INC. (SUPERIOR COURT OF THE STATE OF CALIFORNIA COUNTY OF LOS ANGELES – CENTRAL, CASE NO. BC436007)

MGA Entertainment, Inc. (MGA) filed an action against the Company on April 16, 2010 alleging breach of contract, breach of implied covenant of good faith and fair dealing, and conversion claims relating to two licensing agreements between the parties entered into on May 10, 2006 and November 21, 2006. The two licensing agreements involved the manufacture, distribution and marketing of “Bratz” branded merchandise.

The Company has responded to the above captioned case and has removed the case to federal court, case no. CV 10-03761 DOC (RNBX). Based upon legal opinion from outside Counsel, the Company believes it has defenses to the claims raised by MGA. However, at the time of this filing, the case is still in early stages of litigation and the outcome is unknown. The Company is also contemplating pursuit of counter-claims against MGA.

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 Internal Revenue Service’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 (HK) 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 liability with regards to this issue.

LEASES

The Company has entered into various operating lease agreements for office and warehouse facilities in Coconut Creek, Florida and City of Industry, California. The leases expire at varying dates. Rent expense for the three months ended June 30, 2010 and 2009 was \$212,835 and \$225,557, respectively.

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

Future minimum lease payments under property and equipment leases with terms exceeding one year as of June 30, 2010 are as follows:

| | Property Leases | Equipment Leases |
|----------------------------|-----------------|------------------|
| For period ending June 30, | | |
| 2011 | \$ 555,326 | \$ 4,075 |
| 2012 | 675,460 | - |
| 2013 | 671,044 | - |
| 2014 | 57,384 | - |
| | \$ 1,959,214 | \$ 4,075 |

NOTE 10 - STOCKHOLDERS' EQUITY

COMMON STOCK ISSUANCES

During the three months ended June 30, 2010 and 2009, the Company did not issue any shares of its common stock.

EARNINGS PER SHARE

In accordance with FASB ASC 210, Earnings per Share, basic (loss) earnings per share are computed by dividing the net (loss) earnings for the year by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net earnings for the year by the weighted average number of common shares outstanding including the effect of common stock equivalents.

For the three months ended June 30, 2010 and 2009, common stock equivalents to purchase 2,016,710 and 2,986,920 shares of stock were not included in the computation of diluted earnings per share because the exercise prices were greater than the average market price of the Company's common stock for the period.

STOCK OPTIONS

On June 1, 2001, the Board of Directors approved the 2001 Stock Option Plan ("Plan"), which replaced the 1994 Stock Option Plan, as amended, (the "1994 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 June 30, 2010, 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 grant in any quarter. As of June 30, 2010 the Company granted 1,043,895 options under the Year 2001 Plan with 611,380 options still outstanding, leaving 906,105 options available to be granted. There were no additional stock options issued during the three months ended June 30, 2010.

STOCK WARRANTS

As of June 30 2010, the Company had a total of 1,250,000 stock purchase warrants outstanding. The exercise price of these warrants is \$0.35. The expiration date of these warrants was July 26, 2010. Subsequently these warrants were not exercised and have expired.

NOTE 11 - GEOGRAPHICAL INFORMATION

During the three months ended June 30, 2010 and June 30, 2009 total sales of \$2,091,627 and \$814,008 respectively were all made to North American customers. The geographic area of sales is based primarily on the location where the product is delivered.

NOTE 12 – DUE TO RELATED PARTIES, NET

As of June 30, 2010 and March 31, 2010 the Company had amounts due to related parties in the amounts of \$3,523,895 and \$3,033,801, respectively consisting primarily of non-interest bearing trade payables and expenses due to Starlight affiliates.

NOTE 13 – RELATED PARTY TRANSACTIONS

During the first quarter ended June 30, 2010 the Company sold approximately \$179,000 to Starlight Electronics at discounted pricing granted to major distributors. The average gross profit margin on sales to Starlight Electronics yielded 8% as compared to an overall gross profit margin of 27.5%. The product was drop shipped to Cosmo Communications of Canada (“Cosmo”), the Company’s primary distributor of its products to Canada. This amount was included as a component of cost of goods sold in the accompanying Consolidated Statements of Operations.

During the first quarter ended June 30, 2009 the Company sold approximately \$94,000 to Cosmo at discounted pricing granted to major distributors. The average gross profit margin on sales Cosmo yielded 12.4%.

The Company purchased products from Starlight Marketing Macao, a subsidiary of Starlight International Holding Ltd. The purchases from Starlight Marketing Macao for the three month period ended June 30, 2010 and 2009 were \$208,080 and \$0, respectively.

NOTE 14 – SUBSEQUENT EVENTS

We evaluated the effects of all subsequent events from June 30, 2010 through August 23, 2010, the date we filed our financial statements with the U.S. Securities and Exchange Commission (“SEC”). There were no events to report during this evaluation period.

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 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" or "ours") and 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) and Motown trademarks.

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, Kohl's, J.C. Penney, Toys R Us, 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 consolidated statements of operations as a percentage of net sales for the three months ended June 30, 2010 and 2009.

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

For three months ended
June 30, 2010 June 30, 2009

| | | |
|-------------------------------------|--------|---------|
| Net Sales | 100.0% | 100.0% |
| Cost of Goods Sold | 72.5% | 135.1% |
| Gross Profit | 27.5% | -35.1% |
| Operating Expenses | | |
| Selling expenses | 11.9% | 37.4% |
| General and administrative expenses | 32.3% | 105.7% |
| Depreciation and amortization | 5.8% | 12.3% |
| Total Operating Expenses | 50.0% | 155.3% |
| Income from Operations | -22.6% | -190.4% |
| Other Income (Expenses) | | |
| Interest expense | -0.4% | -0.4% |
| Net Other Expenses (Income) | -0.4% | -0.4% |
| Net Income | -22.9% | -190.8% |

QUARTER ENDED JUNE 30, 2010 COMPARED TO THE QUARTER ENDED JUNE 30, 2009

NET SALES

Net sales for the quarter ended June 30, 2010 increased to \$2,091,627 from \$814,008, an increase of \$1,277,619 as compared to the same period ended June 30, 2010. This increase in sales is primarily due to increased product demand from Toys 'R' US and WalMart which accounted for 70% of the increase. The remaining increase was primarily due to other domestic retail account committing to earlier deliveries than in the previous year.

GROSS PROFIT

Our gross profit for the quarter ended June 30, 2010 increased to \$575,893 from \$(285,622), representing an increase of \$861,515 as compared to the same period in the prior year. We did not have any one-time pricing allowances

during the quarter ended June 30, 2010 as compared to one-time pricing allowances of \$235,440 for defective product granted during the same quarter ended June 30, 2009. In addition, we did not recognize any significant inventory adjustments during the quarter ended June 30, 2010 compared to the same period in the prior year where we recognized a \$181,142 one-time charge to adjust certain Bratz licensed products and musical instruments to lower of cost or market. The remainder of the increase was due to the increase in sales volume from the first quarter ended June 30, 2010 compared to the first quarter ended June 30, 2009. As a percentage of revenues, our gross profit for the three months ended June 30, 2010 increased to 27.5% from (35.1%) for the same period in 2010. The increase in gross profit as a percentage of revenues was primarily due to sales price increases in excess of product cost increases, lack of international business that normally yields lower margins than domestic sales and the absence of one-time charges of \$416,582 that were recognized during the same period of the prior year.

OPERATING EXPENSES

For the quarter ended June 30, 2010, total operating expenses decreased to \$1,046,717. This represents a decrease of \$217,430 from the same period's quarter ended total operating expenses of \$1,264,147. This decrease was primarily due our continued efforts to reduce administrative overhead and decrease selling expenses especially in the area of outbound freight costs.

Factors contributing to the decrease in operating expenses are as follows:

- 1) Selling expenses decreased \$55,042 which was primarily due to a decrease in inbound defective return freight as well as a decrease in outbound freight as a major customer has contractually agreed to pay for delivery freight.
- 2) General and administrative expenses decreased \$184,678 which was primarily due a decrease of approximately \$144,000 in compensation expenses from reductions in the workforce, reduced travel of approximately \$24,000 and a reduction in related party service charges of \$45,000. These expense reductions were somewhat offset by an increase of \$22,300 in depreciation expense primarily related to molds and tooling purchased in the prior year.

LOSS FROM OPERATIONS

Loss from operations decreased \$1,078,945 this quarter, to \$470,824 for the three months ended June 30, 2010 compared to net loss from operations of \$1,549,769 for the same period ended June 30, 2009. The decrease was due to a combination of increased sales, strong domestic sales mix, absence of one-time charges and reduction of operating expenses discussed above.

OTHER INCOME/EXPENSES

Our net other expenses (interest expense) increased to \$8,636 from \$3,268 for the same period a year ago. The increase in interest expense was due to the increase in the DBS Bank accounts payable financing facility utilized compared to the same period in the prior year.

INCOME TAXES

For the three months ended June 30, 2010 and June 30, 2009 the Company did not record a tax provision because it expects current year-to-date losses and sufficient future net losses to offset the income for these periods.

NET LOSS

For the three months ended June 30, 2010 net loss decreased to \$479,460 compared to net loss of \$1,553,037 for the same period a year ago. The decrease of net loss was a combination of increased sales, strong domestic sales mix, absence of one-time charges and reduction of operating expenses compared to the same period in the prior year.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2010, Singing Machine had cash on hand of \$282,060 as compared to cash on hand of \$616,865 as of June 30, 2009. We had working capital deficit of \$1,704,704 as of June 30, 2010.

Net cash provided by operating activities was \$671,226 for the three months ended June 30, 2010, as compared to \$1,478,149 used in operating activities the same period a year ago. The increase in net cash provided was primarily a result of the increase in trade and related party accounts payable for inventory shipments commencing earlier than the

prior year and increased reliance on vendor credit to pay the outstanding balances due on the DBS financing facilities that were withdrawn.

Net cash provided by investing activities for the three months ended June 30, 2010 was \$0 as compared to \$35,377 used by investing activities for the same period ended a year ago. This decrease was caused primarily by limiting the amounts of capital expenditures for the current fiscal year.

Net cash used by financing activities was \$1,254,943 for the three months ended June 30, 2010, as compared to \$1,173,228 provided by financing activities for the same period ended a year ago. The increase in cash used by financing activities primarily relates to the notification from DBS Bank that our financing facilities were to be withdrawn upon receipt of all amounts due on the facility. The Company relied on vendor and related party trade payable financing to pay down the amounts due on the financing facility until a new financing facility is arranged. As of the date of filing of these financial statements there were no amounts remaining due to DBS Bank.

As of June 30, 2010, our unrestricted cash on hand was \$282,060. Our average monthly general and administrative expenses are approximately \$250,000. We expect that we will require approximately \$1.5 million 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 factoring bank;
- Short term loans 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.

On June 8, 2010 the Company was notified by DBS Bank that our credit and factoring facilities totaling \$13.0M were being withdrawn effective upon receipt of amounts due on both factoring and accounts payable financing facilities. The Company is actively pursuing replacement financing facilities and is in negotiations for an accounts receivable factoring facility with several US based factoring companies. Our parent company, The Starlight Group, has committed to provide bridge financing until new facilities have been found.

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 89.0% and 92.0% of net sales in fiscal 2010 and 2009 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 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 and our Macau income tax exemption.

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 4T. 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.** We reported certain material weaknesses in our internal controls over financial reporting in our annual report on Form 10-K for the year ended March 31, 2010. The Company is still in the process of addressing these material weaknesses and will continue to update the Exchange as to our remediation progress.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

MGA ENTERTAINMENT, INC. v. THE SINGING MACHINE COMPANY, INC. (SUPERIOR COURT OF THE STATE OF CALIFORNIA COUNTY OF LOS ANGELES – CENTRAL, CASE NO. BC436007)

MGA Entertainment, Inc. (MGA) filed an action against the Company on April 16, 2010 alleging breach of contract, breach of implied covenant of good faith and fair dealing, and conversion claims relating to two licensing agreements between the parties entered into on May 10, 2006 and November 21, 2006. The two licensing agreements involved the manufacture, distribution and marketing of "Bratz" branded merchandise.

The Company has responded to the above captioned case and has removed the case to federal court, case no. CV 10-03761 DOC (RNBX). Based upon legal opinion from outside Counsel, the Company believes it has defenses to the claims raised by MGA. However, at the time of this filing, the case is still in early stages of litigation and the outcome is unknown. The Company is also contemplating pursuit of counter-claims against MGA.

ITEM 1A. RISK FACTORS

RISKS ASSOCIATED WITH OUR BUSINESS

CURRENT LEVELS OF SECURITIES AND FINANCIAL MARKET VOLATILITY ARE UNPRECEDENTED.

The capital and credit markets have been experiencing volatility and disruption for more than 12 months. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers. We believe these credit market disruptions have likely decreased our ability to access debt and equity financing. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

RISKS ASSOCIATED WITH OUR CAPITAL STRUCTURE

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

We are not currently in default upon any of our senior securities.

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

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 Carol Lau, Interim 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: August 23, 2010

By: /s/ Gary Atkinson
Gary Atkinson
Interim Chief Executive Officer

/s/ Carol Lau
Carol Lau
Interim Chief Financial Officer