

SINGING MACHINE CO INC  
Form 10-Q  
February 14, 2013

**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 December 31, 2012

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 5<sup>th</sup> 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  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:**

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 37,960,794 as of February 14, 2013

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

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

	December 31, 2012 (Unaudited)	March 31, 2012 (Audited)
Assets		
Current Assets		
Cash	\$ 3,547,860	\$ 267,465
Accounts receivable, net of allowances of \$259,871 and \$168,554, respectively	5,220,312	785,490
Due from Crestmark Bank	477,577	-
Due from related party - Starlight Consumer Electronics USA, Inc.	258,721	36,036
Due from related party - Starlight Electronics USA, Inc.	58,158	58,536
Due from related party - Cosmo Communications Canada, Ltd.	34,739	68,291
Inventories, net	4,794,887	4,008,392
Prepaid expenses and other current assets	52,430	53,233
Total Current Assets	14,444,684	5,277,443
Property and equipment, net	353,489	296,222
Other non-current assets	159,956	159,674
Total Assets	\$ 14,958,129	\$ 5,733,339
Liabilities and Shareholders' Equity (Deficit)		
Current Liabilities		
Accounts payable	\$ 3,518,257	\$ 1,303,395
Due to related party - Starlight Marketing Development, Ltd., current portion	1,107,678	1,924,431
Due to related party - Starlight Electronics Company, Ltd.	167,083	-
Due to related party - Ram Light Management, Ltd.	-	1,683,247
Due to related party - Starlight R&D, Ltd.	574,283	416,026
Due to related party - Cosmo Communications USA, Inc.	364,218	226,747
Due to related party - Starlight Consumer Electronics Co., Ltd.	2,093,643	103,545
Due to related parties - Other Starlight Group Companies	3,534	3,534
Accrued expenses	1,846,698	168,156
Obligations to clients for returns and allowances	114,310	242,379
Warranty provisions	869,866	219,760
Total Current Liabilities	10,659,570	6,291,220
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	13,159,570	6,291,220
Shareholders' Equity (Deficit)		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; no shares issued and outstanding	-	-

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Common stock, Class A, \$.01 par value; 100,000 shares authorized; no shares issued and outstanding	-	-
Common stock, \$.01 par value; 100,000,000 shares authorized; 37,960,794 and 37,960,794 shares issued and outstanding	379,607	379,607
Additional paid-in capital	19,146,019	19,141,098
Accumulated deficit	(17,727,067	) (20,078,586 )
Total Shareholders' Equity (Deficit)	1,798,559	(557,881 )
Total Liabilities and Shareholders' Equity (Deficit)	\$ 14,958,129	\$ 5,733,339

*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, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Net Sales	\$ 16,617,000	\$ 8,650,557	\$ 32,755,791	\$ 24,588,167
Cost of Goods Sold	12,594,626	6,854,398	24,818,560	19,169,982
Gross Profit	4,022,374	1,796,159	7,937,231	5,418,185
Operating Expenses				
Selling expenses	1,445,728	841,591	2,945,018	2,231,655
General and administrative expenses	1,123,998	760,198	2,509,824	1,970,802
Depreciation and amortization	24,145	55,159	90,996	116,550
Total Operating Expenses	2,593,871	1,656,948	5,545,838	4,319,007
Income from Operations	1,428,503	139,211	2,391,393	1,099,178
Other Expenses				
Interest expense	(31,433 )	(5,452 )	(39,875 )	(7,796 )
Income before provision for income taxes	1,397,070	133,759	2,351,518	1,091,382
Provision for income taxes	-	-	-	-
Net Income	\$ 1,397,070	\$ 133,759	\$ 2,351,518	\$ 1,091,382
Income per Common Share				
Basic	\$0.04	\$ 0.00	\$0.06	\$ 0.03
Diluted	\$0.04	\$ 0.00	\$0.06	\$ 0.03
Weighted Average Common and Common Equivalent Shares:				
Basic	37,960,794	37,877,002	37,960,794	37,849,479
Diluted	38,286,865	37,877,002	38,286,865	37,849,479

*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	December
	31, 2012	31, 2011
Cash flows from operating activities		
Net Income	\$2,351,518	\$1,091,382
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	90,996	116,550
Change in inventory reserve	(110,000 )	301,999
Change in allowance for bad debts	84,067	54,061
Disposal of property and equipment	-	31,028
Stock based compensation	4,921	24,380
Warranty provisions	650,106	344,770
Changes in operating assets and liabilities:		
(Increase) Decrease in:		
Accounts receivable	(4,518,889)	(2,142,824)
Due from Crestmark Bank	(477,577 )	-
Inventories	(676,495 )	(893,077 )
Prepaid expenses and other current assets	803	4,444
Other non-current assets	(282 )	5,003
Increase (Decrease) in:		
Accounts payable	2,214,862	75,119
Net due to related parties	2,264,154	1,711,226
Accrued expenses	1,678,542	560,272
Obligations to clients for returns and allowances	(128,069 )	(144,047 )
Net cash provided by operating activities	3,428,657	1,140,286
Cash flows from investing activities		
Purchase of property and equipment	(148,262 )	(87,216 )
Net cash used in investing activities	(148,262 )	(87,216 )
Cash flows from financing activities		
Net proceeds from short-term bank loan	-	253,750
Payments on long-term financing obligation	-	(4,547 )
Net cash provided by financing activities	-	249,203
Change in cash	3,280,395	1,302,273
Cash at beginning of period	267,465	674,712
Cash at end of period	\$3,547,860	\$1,976,985

Supplemental Disclosures of Cash Flow Information:

Cash paid for interest	\$39,875	\$7,796
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*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**December 31, 2012**

#### **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 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 months and nine months ended December 31, 2012 and 2011 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, 2012 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.

#### **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 condensed 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.

#### **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 in foreign financial institutions at December 31, 2012 and March 31, 2012 were \$2,894,884 and \$66,398, 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, 2012 total dilutive shares amounted to approximately 326,000 shares.

## **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 Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 718, Stock Compensation ("ASC 718"), which requires that all share-based payments to employees including grants of employee stock options be measured at fair value and expensed and reported as compensation cost over the service period (generally the vesting period). The Company continues to use the Black-Scholes option valuation model to value stock options. For the three and nine months ended December 31, 2012, stock option expense was \$1,640 and \$4,921, respectively. For the three and nine months ended December 31, 2011, stock option expense was \$2,696 and \$16,881, respectively. Employee stock option compensation expense in fiscal years 2012 and 2011 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 December 31, 2012, 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 nine months ended December 31, 2012: expected dividend yield 0%, risk-free interest rate of 0.19%, volatility 341.4% and expected term of three years.

For the nine months ended December 31, 2011: expected dividend yield 0%, risk-free interest rate of 0.22% to 0.30%, volatility 283.9% and expected term of three years.

## **ADVERTISING**

Costs incurred for producing, publishing and 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 clients' inventory purchases. 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 December 31, 2012 and 2011 was \$806,920 and \$396,159 respectively. Advertising expense for the nine months ended December 31, 2012 and 2011 was \$1,666,056 and \$1,005,122, 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, 2012 and 2011, these amounts totaled \$38,000 and \$41,162, respectively. For the nine months ended December 31, 2012 and 2011, these amounts totaled \$71,240 and \$65,996, respectively.

## **FAIR VALUE OF FINANCIAL INSTRUMENTS**

We have 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 customers 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 December 2011, the FASB issued ASU 2011-11, regarding disclosures about offsetting assets and liabilities. This update requires entities to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. Disclosures are required for derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. This update is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company does not expect the adoption of ASU 2011-11 to have any impact on its condensed consolidated financial statements.

## **NOTE 3- INCOME TAXES**

The Company follows FASB ASC 740-10, 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 December 31, 2012 the Company does not believe it has any tax positions that would result in any adjustment to the Company's provision for income taxes.

As of December 31, 2012 and March 31, 2012, The Singing Machine had gross deferred tax assets of approximately \$3.1 million and \$3.9 million, respectively, against which the Company recorded valuation allowances totaling



approximately \$3.1 million and \$3.9 million, respectively. Valuation allowances are recorded against deferred tax assets because it is more likely than not that the tax benefits from the deferred tax assets will not be realized. The Company's effective tax rate is lower than what would be expected if the federal statutory rate was applied to net income before provision for income taxes primarily because of net operating loss carryforwards that are more than sufficient to offset net income for the three and nine months ended December 31, 2012.

As of December 31, 2012 the Company is subject to U.S. Federal income tax examinations for the tax years ended March 31, 2009 through March 31, 2012.

**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 8 – LINE OF CREDIT). As of December 31, 2012 Crestmark owed the Company \$477,577, 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, 2012 (unaudited)	March 31, 2012
Finished Goods	\$ 5,099,192	\$4,224,395
Inventory in Transit	248,695	446,997
Less: Inventory Reserve	(553,000 )	(663,000 )
Inventories, net	\$ 4,794,887	\$4,008,392

Inventory consigned to customers at December 31, 2012 and March 31, 2012 were \$770,383 and \$353,201, respectively.

**NOTE 6 - PROPERTY AND EQUIPMENT**

A summary of property and equipment is as follows:

	USEFUL LIFE	December 31, 2012 (unaudited)	March 31, 2012
Computer and office equipment	5 years	\$ 277,994	\$276,332
Leasehold improvements	*	5,500	5,500
Warehouse equipment	7 years	101,521	101,521
Molds and tooling	3-5 years	2,071,245	1,924,645
		2,456,260	2,307,998
Less: Accumulated depreciation		(2,102,771 )	(2,011,776)
Property and equipment, net		\$ 353,489	\$296,222

\* Shorter of remaining term of lease or useful life

Depreciation and amortization expense for the three month periods ended December 31, 2012 and December 31, 2011 were \$24,145 and \$55,159, respectively. Depreciation and amortization expense for the nine month periods ended December 31, 2012 and December 31, 2011 were \$90,996 and \$116,550, respectively.

**NOTE 7 - 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 sheets. 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, 2012 and March 31, 2012, obligations to clients for returns and allowances reclassified from accounts receivable were \$374,401 and \$242,379, respectively. There was one major client requesting a credit amount refund of \$260,091 as of December 31, 2012 and this amount was afterwards appropriately reclassified from obligations to clients for returns and allowances to accounts payable. There were no credit amounts requested by clients to be paid as of March 31, 2012 and as such no amounts were reclassified from obligations to clients for returns and allowances to accounts payable as of this date.

**NOTE 8 - LINE OF CREDIT**

On October 19, 2012, the Company executed a two-year Accounts Receivable Ledged 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 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. 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. The factoring fees are 1% of the gross invoice for all domestic accounts receivable assigned. There were no amounts outstanding on the line of credit as of the period ended December 31, 2012.

**NOTE 9 - 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 has entered into various operating lease agreements for office and warehouse facilities in Fort Lauderdale, Florida and City of Industry, California. The leases expire at varying dates through 2016. Rent expense for the three and nine months ended December 31, 2012 was \$170,375 and \$547,984, respectively. Rent expense for the three and nine months ended December 31, 2011 was \$199,423 and \$605,687, respectively.

Future minimum lease payments under property and equipment leases with terms exceeding one year as of December 31, 2012 are as follows:

	Property Leases
For period ending December, 31	
2013	\$ 295,920
2014	63,485
2015	61,128

2016                    62,656  
                           \$ 483,189

## NOTE 10 - SHAREHOLDERS' EQUITY

### COMMON STOCK ISSUANCES

During the three and nine months ended December 31, 2012 the Company did not issue any shares of its common stock.

On December 2, 2011 the Company issued 125,001 shares of its common stock to our Board of Directors at \$0.06 per share, pursuant to our annual director compensation plan.

### 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. The Plan was 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 December 31, 2012, the Company had granted 1,683,895 options under the Year 2001 Plan with 1,251,380 options still outstanding. There were no additional stock options issued during the three and nine months ended December 31, 2012 and as of December 31, 2012 the Plan had expired and no further options can be issued under the Plan.

## NOTE 11 - GEOGRAPHICAL INFORMATION

The majority of sales to customers outside of the United States for the three and nine months ended December 31, 2012 and 2011 were made by the Macau Subsidiary. Sales by geographic region for the periods presented are as follows:

	FOR THE THREE MONTHS ENDED		FOR THE NINE MONTHS ENDED	
	December 31,		December 31,	
	2012	2011	2012	2011
North America	\$ 16,617,000	\$ 8,679,579	\$ 32,363,355	\$ 23,919,267
Europe	-	(29,022	) 392,436	668,900
	\$ 16,617,000	\$ 8,650,557	\$ 32,755,791	\$ 24,588,167



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

#### **NOTE 12 – DUE TO / FROM RELATED PARTIES**

As of December 31, 2012 and March 31, 2012 the Company had amounts due to related parties in the amounts of \$6,810,439 and \$4,357,530 respectively, consisting primarily of trade payables due to Starlight affiliates. As of December 31, 2012 and March 31, 2012 the Company had amounts due from related parties in the amounts of \$351,618 and \$162,863 respectively, consisting primarily of trade receivables due from Starlight affiliates. As of April 1, 2012 Starlight Electronics Company, Ltd (related-party company) began charging interest on the current year intercompany trade payables that are past due at a rate of 4.5% per annum. For the three and nine months ended December 31, 2012 and December 31, 2011, the Company incurred interest expense in the amounts of \$5,575 and \$0, respectively.

#### **NOTE 13 – RELATED PARTY TRANSACTIONS**

During the three months ended December 31, 2012 and December 31, 2011 the Company sold approximately \$647,000 and \$0 respectively to Starlight Electronics Company, Ltd. During the nine months ended December 31, 2012 and December 31, 2011 the Company sold approximately \$1,813,000 and \$1,541,000 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, 2012 and December 31, 2011 was 12.4% and 0%, respectively. The average gross profit margin on sales to Starlight Electronics for the nine months ended December 31, 2012 and December 31, 2011 was 12.6% and 7.6%, 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, 2012 and December 31, 2011 we sold an additional \$36,150 and \$50,000 respectively of product to Cosmo from our California warehouse facility. During the nine months ended December 31, 2012 and December 31, 2011 we sold an additional \$361,824 and \$50,000 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, 2012 and 2011 were \$2,346,387 and \$4,217,766, respectively. The purchases from SCE for the nine month period ended December 31, 2012 and 2011 were \$7,306,460 and \$7,231,641, respectively.

During the three month period ended December 31, 2012 and December 31, 2011 the Company purchased products from Cosmo Communications USA, Inc. (“Cosmo USA”) in the amount of \$0 and \$33,500, respectively. During the nine month period ended December 31, 2012 and December 31, 2011 the Company purchased products from Cosmo Communications USA, Inc. (“Cosmo USA”) in the amount of \$0 and \$171,551, respectively.

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 have agreed to pay the Company annual service fees totaling approximately \$435,000 payable monthly beginning July 1, 2012. The Company received \$133,219 and \$0 in service fees from these affiliates during the three months ended December 31, 2012 and December 31, 2011, respectively. The Company received \$266,238 and \$0 in service fees from these affiliates during the nine months ended December 31, 2012 and December 31, 2011, respectively. This agreement terminates on April 30, 2013 at which time another annual agreement is expected to be signed for approximately the same amount.

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 three months ended December 31, 2012 and December 31, 2011, respectively. The Company received \$249,999 and \$749,997 in service fees from these affiliates during the nine months ended December 31, 2012 and December 31, 2011, respectively. For the three months ended December 31, 2012 and 2011, the Company additionally received reimbursements from these affiliates in the amount of \$0 and \$6,215, respectively for expenses and salaries incurred by SMC-L on their behalf. For the nine months ended December 31, 2012 and 2011, the Company additionally received reimbursements from these affiliates in the amount of \$0 and \$21,585, respectively for expenses and salaries incurred by SMC-L on their behalf. This agreement terminated on June 30, 2012.

#### **NOTE 14 – 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,	December 31,	December 31,	December 31,
	2012	2011	2012	2011
Estimated return and allowance liabilities at beginning of period	\$462,387	\$ 438,368	\$219,760	\$ 144,021
Costs accrued for new estimated returns and allowances	559,551	276,152	1,097,615	737,046
Return and allowance obligations honored	(152,072)	(225,728)	(447,509)	(392,275)
Estimated return and allowance liabilities at end of period	\$869,866	\$ 488,792	\$869,866	\$ 488,792

#### **NOTE 15 – SUBORDINATED RELATED PARTY DEBT**

In connection with the line of credit with Crestmark Bank the Company was required to subordinate related party debt from Ram Light Management, Ltd. in the amount of \$1,683,247 and Starlight Marketing Development, Ltd. in the amount of \$816,753. Since the subordination agreements are in effect throughout the term of the agreement, the amounts due are not payable until the agreement has been terminated.

#### **NOTE 16 – SUBSEQUENT EVENTS**

We evaluated the effects of all subsequent events from the end of the third quarter ended December 31, 2012 through the date we filed our financial statements with the U.S. Securities and Exchange Commission. 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 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”) 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, 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, 2012 and 2011.

	For Three Months Ended				For Nine Months Ended			
	December 31, 2012		December 31, 2011		December 31, 2012		December 31, 2011	
Net Sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of Goods Sold	75.8	%	79.2	%	75.8	%	78.0	%
Gross Profit	24.2	%	20.8	%	24.2	%	22.0	%
Operating Expenses								
Selling expenses	8.7	%	9.8	%	8.9	%	9.1	%
General and administrative expenses	6.8	%	8.8	%	7.7	%	8.0	%
Depreciation and amortization	0.1	%	0.6	%	0.3	%	0.5	%
Total Operating Expenses	15.6	%	19.2	%	16.9	%	17.6	%
Income from Operations	8.6	%	1.6	%	7.3	%	4.4	%
Other Income (Expenses)								
Interest expense	-0.2	%	-0.1	%	-0.1	%	0.0	%
Provision for income taxes	0.0	%	0.0	%	0.0	%	0.0	%

Net Income	8.4	%	1.5	%	7.2	%	4.4	%
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QUARTER ENDED DECEMBER 31, 2012 COMPARED TO THE QUARTER ENDED DECEMBER 31, 2011

## NET SALES

Net sales for the quarter ended December 31, 2012 increased to \$16,617,000 from \$8,650,557, an increase of \$7,966,443 as compared to the same period ended December 31, 2011. The increase in net sales is attributable to an approximate \$4,893,000 increase in direct import shipments primarily due to one major retail customer who chose the Company as its sole provider of karaoke products for their current year's business and accounting for 61% of the increase. There was an increase of approximately \$1,900,000 in net sales from continued expansion of our drop-ship program with several major retailers which accounted for an additional 24% of the increase in net sales. The remaining increase was due to the addition of new smaller retail stores.

## GROSS PROFIT

Our gross profit for the quarter ended December 31, 2012 increased to \$4,022,374 from \$1,796,159 an increase of \$2,226,215 as compared to the same period in the prior year. This increase is primarily due to the increase in net sales and gross profit margin in the quarter as compared to the same quarter in the prior year.

Gross profit margin for the three month period ended December 31, 2012 was 24.2% compared to 20.8% for the three month period ended December 31, 2011. There was no increase in inventory reserves for slow moving inventory for the three month period ended December 31, 2012 as compared to approximately \$186,000 of inventory reserve recorded for the three months ended December 31, 2011 which accounted for 1.1% of the margin increase. The remaining 2.3% increase in gross profit margin was due an increase in the favorable mix of products sold by direct import to one major retail customer during the quarter ended December 31, 2012.

## **OPERATING EXPENSES**

For the quarter ended December 31, 2012, total operating expenses increased to \$2,593,871. This represents an increase of \$936,923 from the same period's quarter ended total operating expenses of \$1,656,948. This increase was primarily due to an increase in variable selling expenses associated with the increase in net sales.

Selling expenses increased approximately \$604,000 for the three months ended December 31, 2012 compared to the three months ended December 31, 2011. Advertising allowance expenses increased by approximately \$373,000 and commission expense increased by approximately \$130,000 during the three month period ended December 31, 2012 compared to the three month period ended December 31, 2011 accounting for 62% and 22% of the increase, respectively. Other variable selling expenses increased commensurate with the increase in net sales by \$101,000 during the three month period ended December 31, 2012 compared to the three month period ended December 31, 2011 accounting for 16% of the variance.

General and administrative expenses increased approximately \$364,000 for the nine months ended December 31, 2012 compared to the same period ended December 31, 2011. This was primarily due to a decrease in reimbursement for logistics services provided to the Starlight Group of approximately \$117,000, and increase in financing fees of approximately \$110,000 for the servicing of the line of credit facility and an increase of approximately \$70,000 in wages and salaries primarily due to payment of bonuses at the end of the quarter ended December 31, 2012 which accounted for 30%, 30%, and 19% respectively of the total increase in general and administrative expenses for the three month period ended December 31, 2012 compared to the three month period ended December 31, 2011.

## **INCOME FROM OPERATIONS**

Income from operations increased \$1,289,292 this quarter, to \$1,428,503 for the three months ended December 31, 2012 compared to net income from operations of \$139,211 for the same period ended December 31, 2011. Increased sales and gross profit offset by increased variable selling and administrative expenses accounted for the increase in income from operations.

## **OTHER EXPENSES**

Our other expenses (interest expense) increased to \$31,433 from \$5,452 for the same period a year ago primarily related to interest expense on borrowings against our line of credit facility during the three month period ended December 31, 2012

## **INCOME TAXES**

For the three months ended December 31, 2012 and 2011, the Company did not record a tax provision as it had sufficient net operating losses from previous periods to offset the income for the three months ended December 31, 2012.

## **NET INCOME**

For the three months ended December 31, 2012 net income increased to \$1,397,070 compared to net income of \$133,759 for the same period a year ago. The increase in net income was primarily due to increased revenue which resulted in higher gross profit. This was somewhat offset by an increase in variable selling and administrative expenses associated with net sales increase.

## **NINE MONTHS ENDED DECEMBER 31, 2012 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2011**

### **NET SALES**

Net sales for the nine months ended December 31, 2012 increased to \$32,755,791 from \$24,588,167, an increase of \$8,167,624 as compared to the same period ended December 31, 2011. This increase in sales is primarily due to the addition of a former major retail customer accounting for approximately \$3,200,000 or 39% of the increase, an increase of approximately \$3,100,000 from another major retail customer who chose the Company as its sole provider of karaoke products for their current year's business accounting for another 38% of the increase. The remaining increase is primarily due to continued expansion of our drop-ship program with several major retailers.

### **GROSS PROFIT**

Our gross profit for the nine months ended December 31, 2012 increased to \$7,937,231 from \$5,418,185, an increase of \$2,519,046 as compared to the same period in the prior year primarily due to the increase in net sales and gross profit margin for the comparable periods.

Gross profit margin for the nine month period ended December 31, 2012 was 24.2% compared to 22.0% for the nine month period ended December 31, 2011. There was a decrease in excess and slow-moving inventory reserves expense of approximately \$462,000 during the nine month period ended December 31, 2012 compared to the nine month period ended December 31, 2011 which accounted for 5.8% of the gross margin increase. This increase to the gross profit margin was offset by increased other cost of goods sold expense items of approximately \$159,000 associated with the increase in the amount of inventory received which accounted for 2.0% of the offset. The remaining offset is primarily due to the mix of products sold during the comparable periods.

### **OPERATING EXPENSES**

For the nine months ended December 31, 2012, total operating expenses increased to \$5,545,838 from \$4,319,007 for the nine months ended December 31, 2011, an increase of \$1,226,831. This increase was primarily due to variable selling expenses associated with the increase in net sales and general and administrative expenses due to decreased reimbursement for logistics services performed for the Starlight Group and an increase in financing fees related to servicing our line of credit.

Selling expenses increased approximately \$713,000 for the nine months ended December 31, 2012 compared to the nine months ended December 31, 2011. This increase was primarily due to variable expenses associated with the 33% increase in net sales from the same nine month period ended December 31, 2011. Advertising and advertising allowance increased approximately \$507,000 accounting for 71% of the increase. Sales commissions increased approximately \$167,000 which yielded 23% of the increase with the remaining 6% due to other variable selling expenses.

General and administrative expenses increased approximately \$539,000 for the nine months ended December 31, 2012 compared to the same period ended December 31, 2011. This increase was primarily due to a decrease in reimbursement for logistics services provided to the Starlight Group of approximately \$234,000, and increase in financing fees of approximately \$115,000 associated with servicing of the line of credit facility and an increase of approximately \$115,000 in wages and salaries primarily due to salary increases and payment of bonuses at the end of the quarter ended December 31, 2012 which accounted for 44%, 21%, and 21% respectively of the total increase in operating expenses for the nine month period ended December 31, 2012 compared to the nine month period ended December 31, 2011. The remaining increase in general and administrative expenses is due to increased travel expenses of approximately \$28,000 associated with continued growth, an increase of approximately \$38,000 in temporary warehouse labor associated with the increase in our drop-shipment program and other general expenses.

#### **OTHER EXPENSES**

Our other expenses (interest expense) increased to \$39,875 from \$7,796 for the same period a year ago. The increase in interest expense was primarily due to interest expense associated with borrowings against our line of credit facility.

#### **INCOME TAXES**

For the nine months ended December 31, 2012 and 2011, the Company did not record a tax provision as it had sufficient net operating losses from previous periods to offset the income for the nine months ended December 31, 2012.

#### **NET INCOME**

We earned net income of \$2,351,518 for the nine months ended December 31, 2012 compared to net income of \$1,091,382 for the same period a year ago. The \$1,260,136 increase in net income was primarily due to increased revenue resulting in gross profit increase of approximately \$2,519,046 offset by an increase in operating expenses of approximately \$1,292,215 due to variable selling expense increases commensurate with net sales increases and increased general and administrative and interest expenses as explained above.

#### **LIQUIDITY AND CAPITAL RESOURCES**

As of December 31, 2012, Singing Machine had cash on hand of \$3,547,860 as compared to cash on hand of \$1,976,985 as of December 31, 2011. We had working capital of \$3,785,114 as of December 31, 2012.



Net cash provided by operating activities was \$3,428,657 for the nine months ended December 31, 2012, as compared to \$1,140,286 provided by operating activities the same period a year ago. The increase in net cash provided was primarily a result of an increase in trade accounts payable due to the increase in inventory purchased to fulfill increased sales during the nine month period ended December 31, 2012

Net cash used by investing activities for the nine months ended December 31, 2012 was \$148,262 as compared to \$87,216 used by investing activities for the same period ended a year ago. This increase was caused by capital expenditures for molds, tooling and technology related to our next generation karaoke system during current fiscal year.

Net cash provided by financing activities was \$0 for the nine months ended December 31, 2012, as compared to cash provided by financing activities of \$249,203 for the same period ended a year ago. We obtained short term financing from financial institutions of approximately \$254,000 during the nine months ended December 31, 2011 by discounting Letters of Credit provided as payment for direct import shipments from two major customers.

Our parent company, the Starlight Group (“Group”), has expressed their willingness and ability to provide bridge financing and advance funds to us for key vendor payments as well as extending longer payment terms for goods they manufacture for us. For the nine month period ended December 31, 2012 the Group provided \$2,264,154 of financing primarily through trade payables with the Group. Since we have a line of credit facility with Crestmark, we do not estimate any necessary additional financing requirements from the Group for the year ending March 31, 2013. Taking into account the internally generated funds and credit facilities available to the Group we have concluded that our parent will have sufficient working capital to provide additional financing to us for at least the next 12 months if required.

As of December 31, 2012, our unrestricted cash on hand was \$3,547,860. Our average monthly general and administrative expenses are approximately \$325,000. We expect that we will require approximately \$1 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 line of credit with Crestmark Bank;  
Extended trade payable 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 87.9% and 79.8% of net sales in fiscal 2012 and 2011, 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**

There were no pending proceedings as of the period ended December 31, 2012.

### **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, 2013 *By: /s/ Gary Atkinson*  
Gary Atkinson  
Chief Executive Officer

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