

SINGING MACHINE CO INC  
Form 10-Q  
August 14, 2015

**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, 2015

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, Suite 2900, Fort Lauderdale FL 33309

(Address of principal executive offices)

(954) 596-1000

(Registrant's telephone number, including area code)

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

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

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

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

**APPLICABLE ONLY TO ISSUES INVOLVED IN BANKRUPTCY**

**PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

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

**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
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Common Stock, \$0.01 par value	38,117,517 as of August 14, 2015
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**THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARIES**

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

	<b>June 30, 2015</b>	<b>March 31, 2015</b>
	(Unaudited)	(Audited)
<b><u>Assets</u></b>		
<b>Current Assets</b>		
Cash	\$ 363,410	\$ 116,286
Accounts receivable, net of allowances of \$46,698 and \$174,131, respectively	1,673,628	1,466,168
Due from PNC Bank	-	137,415
Due from related party - Starlight Electronics Co., Ltd.	17,240	-
Due from related party - Cosmo Communications Canada, Ltd.	77,012	-
Inventories, net	8,110,348	7,448,167
Prepaid expenses and other current assets	90,695	92,609
Deferred financing costs	74,077	74,077
Deferred tax asset, net	761,599	449,274
<b>Total Current Assets</b>	<b>11,168,009</b>	<b>9,783,996</b>
<b>Property and equipment, net</b>	<b>471,395</b>	<b>466,571</b>
<b>Other non-current assets</b>	<b>11,394</b>	<b>11,394</b>
<b>Deferred financing costs, net of current portion</b>	<b>77,164</b>	<b>95,683</b>
<b>Deferred tax asset, net of current portion</b>	<b>1,856,281</b>	<b>1,856,281</b>
<b>Total Assets</b>	<b>\$ 13,584,243</b>	<b>\$ 12,213,925</b>
<b><u>Liabilities and Shareholders' Equity</u></b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 3,025,272	\$ 2,767,180
Note payable related party - Ram Light Management, Ltd.	551,177	496,496
Due to related party - Ram Light Management, Ltd.	583,247	583,247
Due to related party - Starlight R&D, Ltd.	582,072	554,031
Due to related party - Cosmo Communications Canada, Inc.	-	40,256
Due to related party - Starlight Consumer Electronics Co., Ltd.	256,343	208,672
Accrued expenses	617,901	452,651
Revolving line of credit	1,537,014	-
Current portion of capital lease	10,601	12,628
Customer deposits	287,110	-
Obligations to customers for returns and allowances	10,361	399,419
Warranty provisions	153,074	197,873
<b>Total Current Liabilities</b>	<b>7,614,172</b>	<b>5,712,453</b>
<b>Long-term capital lease, net of current portion</b>	<b>-</b>	<b>1,078</b>
<b>Note payable related party debt - Ram Light Management, Ltd. net of current portion</b>	<b>548,823</b>	<b>603,504</b>
<b>Accrued expenses, net of current portion</b>	<b>63,778</b>	<b>46,495</b>
<b>Subordinated related party debt - Starlight Marketing Development, Ltd.</b>	<b>1,924,431</b>	<b>1,924,431</b>

<b>Total Liabilities</b>	10,151,204	8,287,961
<b>Shareholders' Equity</b>		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, Class A, \$0.01 par value; 100,000 shares authorized; no shares issued and outstanding	-	-
Common stock, Class B, \$0.01 par value; 100,000,000 shares authorized; 38,117,517 shares issued and outstanding	381,175	381,175
Additional paid-in capital	19,309,967	19,307,966
Accumulated deficit	(16,258,103 )	(15,763,177 )
<b>Total Shareholders' Equity</b>	3,433,039	3,925,964
<b>Total Liabilities and Shareholders' Equity</b>	\$ 13,584,243	\$ 12,213,925

*See notes to the condensed consolidated financial statements.*

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

	<b>For Three Months Ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>
<b>Net Sales</b>	\$3,466,874	\$ 2,544,959
<b>Cost of Goods Sold</b>	2,608,453	2,029,068
<b>Gross Profit</b>	858,421	515,891
<b>Operating Expenses</b>		
Selling expenses	457,727	345,267
General and administrative expenses	1,101,981	928,871
Depreciation	37,333	29,331
<b>Total Operating Expenses</b>	1,597,041	1,303,469
<b>Loss from Operations</b>	(738,620 )	(787,578 )
<b>Other Expenses</b>		
Interest expense	(50,112 )	(1,842 )
Financing costs	(18,519 )	-
<b>Net Other Expenses</b>	(68,631 )	(1,842 )
<b>Loss before income tax benefit</b>	(807,251 )	(789,420 )
<b>Income tax benefit</b>	312,325	289,891
<b>Net Loss</b>	\$(494,926 )	\$(499,529 )
<b>Loss per Common Share</b>		
Basic and Diluted	\$(0.01 )	\$(0.01 )
<b>Weighted Average Common and Common Equivalent Shares:</b>		
Basic and Diluted	38,117,517	38,070,642

*See notes to the condensed consolidated financial statements.*



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

	<b>For Three Months Ended</b>	
	<b>June 30,</b>	<b>June 30, 2014</b>
	<b>2015</b>	
<b>Cash flows from operating activities:</b>		
Net Loss	\$ (494,926 )	\$ (499,529 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	37,333	29,331
Amortization of deferred financing costs	18,519	-
Change in inventory reserve	(37,560 )	-
Change in allowance for bad debts	(127,433 )	(23,757 )
Stock based compensation	2,001	32,398
Warranty provisions	(44,799 )	(78,348 )
Change in net deferred tax assets	(312,325 )	(289,891 )
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(80,027 )	(70,487 )
Due from PNC Bank	137,415	-
Inventories	(624,621 )	(5,701,055 )
Prepaid expenses and other current assets	1,914	(80,613 )
Other non-current assets	-	(659 )
Increase (decrease) in:		
Accounts payable	258,092	4,879,506
Net due to related parties	(58,796 )	642,540
Accrued expenses	182,533	97,275
Customer deposits	287,110	-
Obligations to customers for returns and allowances	(389,058 )	25,588
Net cash used in operating activities	(1,244,628 )	(1,037,701 )
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(42,157 )	(33,013 )
Net cash used in investing activities	(42,157 )	(33,013 )
<b>Cash flows from financing activities:</b>		
Net proceeds from revolving line of credit	1,537,014	84,414
Payments on long-term capital lease	(3,105 )	(2,969 )
Net cash provided by financing activities	1,533,909	81,445
<b>Net change in cash</b>	<b>247,124</b>	<b>(989,269 )</b>
<b>Cash at beginning of period</b>	<b>116,286</b>	<b>1,354,099</b>
<b>Cash at end of the period</b>	<b>\$ 363,410</b>	<b>\$ 364,830</b>

**Supplemental Disclosures of Cash Flow Information:**

Cash paid for interest	\$9,665	\$ 1,842
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*See notes to the condensed consolidated financial statements.*

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

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

**June 30, 2015**

#### **NOTE 1 – BASIS OF PRESENTATION**

##### **OVERVIEW**

The Singing Machine Company, Inc., a Delaware corporation (the “Company”, “SMC”, “The Singing Machine”) and its three wholly-owned subsidiaries SMC (Comercial Offshore De Macau) Limitada (“Macau Subsidiary”), SMC Logistics, Inc. (“SMC-L”) and SMC-Music, Inc. (“SMC-M”) are primarily engaged in the development, marketing, and sale of consumer karaoke audio systems, accessories, musical instruments and musical recordings. The products are sold by SMC to retailers and distributors for resale to consumers.

#### **NOTE 2-SUMMARY OF ACCOUNTING POLICIES**

##### **PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION**

The condensed consolidated financial statements include the accounts of the Company and all of its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in the condensed consolidated financial statements. The accompanying unaudited financial statements for the three months ended June 30, 2015 and 2014 have been prepared in accordance with generally accepted accounting principles applicable to interim financial information and the requirements of Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete consolidated financial statements. 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, 2015 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, warranty reserves, inventory 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. Future events and their effects cannot be determined with absolute certainty; therefore, the determination of estimates requires the exercise of judgment. 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 in 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. The financial statements of the subsidiaries are translated to U.S. dollars using period-end rates of exchange for assets and liabilities, and average rates of exchange for the period for revenues, costs, and expenses. Net gains and losses resulting from foreign exchange transactions and translations were not material during the periods presented.

### **Concentration of Credit Risk**

At times, the Company maintains cash in United States bank accounts that are in excess of the Federal Deposit Insurance Corporation ("FDIC") insured amounts of up to \$250,000. As of June 30, 2015 and March 31, 2015, the Company had no cash deposits that exceeded the FDIC insurance limit. The Company maintains cash balances in foreign financial institutions. The amounts in foreign financial institutions at June 30, 2015 and March 31, 2015 were \$329,731 and \$23,794, respectively.

### **INVENTORY**

Inventories are comprised primarily of electronic karaoke equipment, microphones and accessories, 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**

Loss per common share is computed by dividing net loss 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 June 30, 2015 and 2014 total potential dilutive shares amounted to approximately 880,000 and 74,000 shares, respectively, however these shares were not included in the computation of diluted earnings per share for the three months ended June 30, 2015 and June 30, 2014 because their effect was anti-dilutive.

## **REVENUE RECOGNITION**

Revenue from the sale of equipment, accessories, musical recordings and subscriptions and third –party logistics services are recognized upon the later of: (a) the time of shipment or (b) when title passes to the customers and all significant contractual obligations and services have been satisfied and collection of the resulting receivable is reasonably assured. Net sales are comprised of gross sales net of actual and estimated future returns, discounts and volume rebates.

## **STOCK BASED COMPENSATION**

The Company follows the provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 718-20, “Compensation – Stock Compensation Awards Classified as Equity”. 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 condensed consolidated statements of operations over the service period (generally the vesting period). The Company uses the Black-Scholes option valuation model to value stock options. Employee stock option compensation expense for the three months ended June 30, 2015 and 2014 includes the estimated fair value of options granted, amortized on a straight-line basis over the requisite service period for the entire portion of the award. For the three months ended June 30, 2015 and 2014, the stock option expense was \$2,001 and \$32,398, respectively.

## **ADVERTISING**

Costs incurred for producing and publishing advertising of the Company are charged to operations the first time the advertising takes place. The Company has entered into cooperative advertising agreements with its major customers that specifically indicated that the customer has to spend the cooperative advertising fund upon the occurrence of mutually agreed events. The percentage of the cooperative advertising allowance ranges from 2% to 9% of the purchase. The customers have to advertise the Company's products in the customer's catalog, local newspaper and other advertising media. The customer must submit the proof of the performance (such as a copy of the advertising showing the Company's products) to the Company to request for the allowance. The customer does not have the ability to spend the allowance at their discretion. The Company believes that the identifiable benefit from the cooperative advertising program and the fair value of the advertising benefit is equal or greater than the cooperative advertising expense. Advertising expense for the three months ended June 30, 2015 and 2014 was \$279,356 and \$199,720, respectively.

## **RESEARCH AND DEVELOPMENT COSTS**

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 June 30, 2015 and 2014, these amounts totaled \$32,120 and \$28,200 respectively.

## **FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company 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, 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.

## **INCOME TAXES**

The Company follows the provisions of FASB ASC 740 "Accounting for Income Taxes." Under the asset and liability method of ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If it is more likely than not that some portion of a deferred tax asset will not be realized, a valuation allowance is recognized.

The Company analyzes its deferred tax assets and liabilities at the end of each interim period and, based on management's best estimate of its full year effective tax rate, recognizes cumulative adjustments to its deferred tax assets and liabilities. The Company's effective tax rate for the fiscal year ending March 31, 2016 is estimated to be approximately 39%. The effective tax rate for the full year ended March 31, 2015 was approximately 35%.

As of June 30, 2015 and March 31, 2015, The Singing Machine had gross deferred tax assets of approximately \$3.3 million and \$3.0 million, respectively, against which the Company recorded valuation allowances totaling approximately \$0.7 million. A valuation allowance was recorded against deferred tax assets because it is more likely than not that a portion of the tax benefits from the gross deferred tax assets will not be realized. For the three month period ended June 30, 2015, the Company recorded a loss before income tax benefit of approximately \$807,000 which generated an additional current deferred tax asset and income tax benefit of approximately \$312,000. Due to the seasonality of the business, the Company is expected to reverse this increase in deferred tax asset during the remainder of fiscal year ending March 31, 2016.



The Company recognizes a liability for uncertain tax positions. An uncertain tax position is defined as a position in a previously filed tax return or a position expected to be taken in a future tax return that is not based on clear and unambiguous tax law and which is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company measures the tax benefits recognized based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. As of June 30, 2015, there were no uncertain tax positions that resulted in any adjustment to the Company's provision for income taxes. The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. The Company currently has no liabilities recorded for accrued interest or penalties related to uncertain tax provisions.

As of June 30, 2015, the Company is subject to U.S. Federal income tax examinations for the tax years ended March 31, 2012 through March 31, 2015.

#### **LONG-LIVED ASSETS**

The Company reviews long-lived assets for impairment whenever circumstances and situations change such that there is an indication that the carrying amounts may not be recoverable. If the undiscounted future cash flows attributable to the related assets are less than the carrying amount, the carrying amounts are reduced to fair value and an impairment loss is recognized in accordance with FASB ASC 360-10-05, "Accounting for the Impairment or Disposal of Long-Lived Assets."

#### **PROPERTY AND EQUIPMENT**

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

#### **SHIPPING AND HANDLING COSTS**

Shipping and handling costs are classified as a component of selling expenses and those billed to customers are recorded as a reduction of expense in the consolidated statements of income.

#### **RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2014-09 which outlines a single comprehensive model for companies to use when accounting for revenue arising from contracts with customers. The core principle of the revenue recognition model is that an entity recognizes revenue to depict the



transfer of goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In order to achieve this core principle a company must apply the following steps in determining revenue recognition:

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to the performance obligations in the contract.
- Recognize revenue when (or as) the entity satisfies a performance obligation.

The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017 including interim periods within that reporting period with early application allowed beginning with reporting periods after December 15, 2016. Management is currently assessing whether the implementation of ASU 2014-09 will have any material effect on the company's consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. The ASU clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. An entity would not record compensation expense (measured as of the grant date without taking into account the effect of the performance target) related to an award for which transfer to the employee is contingent on the entity's satisfaction of a performance target until it becomes probable that the performance target will be met. The ASU is effective for all entities for reporting periods beginning after December 15, 2015. The implementation of ASU 2014-12 is not expected to have any material effect on the company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The ASU requires that at every interim and annual period, management determine whether conditions or events exist which raise substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued. If management's initial consideration of the relevant conditions and events indicates that it is probable the entity will not be able to meet its obligations as they become due within the assessment period, then management must evaluate whether it is probable that plans to mitigate these factors will alleviate that substantial doubt. The mitigating effect is considered only if it is probable that the plan will be effectively implemented and probable that the plans will mitigate the conditions or events that raised the substantial doubt. If management's plans will alleviate the substantial doubt, an entity must disclose in the notes to the financial statements the conditions or events that raised substantial doubt and management's plans that alleviated those concerns. If management's plans will not alleviate the substantial doubt, an entity must disclose in the notes to the financial statements the same conditions and events along with management's plans that did not alleviate the substantial doubt, in addition to a statement that indicates there is substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016 and for interim periods within annual periods beginning after December 15, 2016. Management is currently assessing whether the implementation of ASU 2014-15 will have any material effect on the company's consolidated financial statement disclosures.



In January 2015, the FASB issued ASU 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. To be considered an extraordinary item under existing Generally Accepted Accounting Principles, an event or transaction that is identified as both unusual in nature and occurs infrequently must be segregated as an extraordinary item from results or ordinary operations, separately presented as an extraordinary item on an entity's income statement, net of tax, after income from continuing operations and an entity must disclose income taxes and earnings per share data applicable to the extraordinary item. While the ASU eliminates the requirement to segregate and separately report an event that is identified as an extraordinary item it does not affect the reporting and disclosure requirements for an extraordinary item. ASU 2015-01 is effective for periods beginning after December 15, 2015 and interim periods within those annual periods. The implementation of ASU 2015-01 is not expected to have any material effect on the company's consolidated financial statement disclosures.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The ASU changes the presentation of debt issuance costs in financial statements. Under the ASU, an entity presents these costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. The ASU specifies that "issue costs shall be reported in the balance sheet as a direct deduction from the face amount of the note" and that "amortization of debt issue costs shall also be reported as interest expense". Any debt issuance costs incurred before the associated funding is received should be reported on the balance sheet as deferred charges until the debt liability amount is recorded. The guidance in ASU 2015-03 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2015. Early adoption is allowed for financial statements that have not been previously issued with the new guidance to be applied retrospectively to all prior periods. Management is currently assessing whether the implementation of ASU 2015-03 will have any material effect on the company's consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory*. The ASU requires that inventory be measured at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Inventory measured using last-in, first-out (LIFO) and the retail inventory method (RIM) are not impacted by the new guidance. The guidance in ASU 2015-11 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. The new guidance should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. Management is currently assessing whether the implementation of ASU 2015-11 will have any material effect on the company's consolidated financial statements.

### **NOTE 3 – DUE FROM PNC BANK**

In connection with the Company's revolving credit facility with PNC Bank, cash collected by PNC Bank on trade accounts receivable may exceed amounts borrowed on the revolving credit facility from time to time (See Note 6 – LINE of CREDIT). As of June 30, 2015 and March 31, 2015, PNC Bank owed the Company \$0 and \$137,415, respectively, which represented cash received by PNC Bank on accounts receivable in excess of amounts borrowed against the revolving credit facility.

**NOTE 4- INVENTORIES, NET**

Inventories are comprised of the following components:

	June 30, 2015 (unaudited)	March 31, 2015 (audited)
Finished Goods	\$7,893,750	\$7,869,167
Inventory in Transit	600,038	-
Inventory Reserve	(383,440 )	(421,000 )
Inventories, net	\$8,110,348	\$7,448,167

**NOTE 5 - PROPERTY AND EQUIPMENT**

A summary of property and equipment is as follows:

	USEFUL LIFE	June 30, 2015 (unaudited)	March 31, 2015 (audited)
Computer and office equipment	5 years	\$285,650	\$285,650
Furniture and fixtures	5-7 years	4,312	4,312
Warehouse equipment	7 years	224,106	224,106
Molds and tooling	3-5 years	2,399,290	2,357,133
		2,913,358	2,871,201
Accumulated depreciation		2,441,963	2,404,630
		\$471,395	\$466,571

Depreciation expense for the three months ended June 30, 2015 and June 30, 2014 was \$37,333 and \$29,331, respectively.

**NOTE 6 – LINE OF CREDIT****CRESTMARK BANK**

On October 19, 2012, the Company executed a two-year Accounts Receivable Ledgered Line of Credit Facility (“line of credit”) with Crestmark Bank (“Crestmark”) of Troy, Michigan which was terminated by SMC on July 15, 2014 and replaced by a revolving credit facility from PNC Bank National Association.

Interest on the line of credit and discounting charges on accounts receivable advances was accrued at a rate of 2% per annum over the prime rate as published by the Wall Street Journal and at no time was the effective rate less than 5.25% per annum. During the three month period ended June 30, 2015 and 2014 the Company incurred interest expense of \$0 and \$1,576, respectively on amounts borrowed against the line of credit. The credit facility was secured with all assets of the Company as well as related-party debt subordination agreements totaling \$2,500,000 from Ram Light Management, Ltd. in the amount of \$1,683,247 and Starlight Marketing Development, Ltd. in the amount of \$816,753. There was a 1% commission fee of the gross invoice amount on all domestic accounts receivable pledged. For the three month period ended June 30, 2015 and 2014 the Company incurred commission fees on pledged receivables in the amount of \$0 and \$14,506, respectively. There were no amounts outstanding on the line of credit as of June 30, 2015 and March 31, 2015.

## **PNC BANK NATIONAL ASSOCIATION**

On July 14, 2014, the Company executed a three-year revolving credit facility (the “Revolving Credit Facility”) with PNC Bank, National Association (“PNC”) that replaced the existing line of credit agreement with Crestmark. The Revolving Credit Facility has a three year term expiring on July 14, 2017. The outstanding loan balance cannot exceed \$15,000,000 during peak selling season between August 1 and December 31 and is reduced to a maximum of \$7,500,000 between January 1 and July 31. Usage under the Revolving Credit Facility shall not exceed the sum of the following (the “Borrowing Base”):

Up to 85% of the company’s eligible domestic and Canadian accounts receivable aged less than 60 days past due (not to exceed 90 days from invoice date, cross aged on the basis of 50% or more past due with certain specific accounts qualifying for up to 120 days from invoice date not to exceed 30 days from the due date); plus

Up to the lesser of (a) 50% of the cost of eligible inventory or (b) 75% of net orderly liquidation value percentage of eligible inventory (annual inventory appraisals required); minus

An all-time \$500,000 block; minus

Applicable reserves including a dilution reserve equal to 125% of the Company’s advertising and return accrual reserves. Dilution reserve not to exceed availability generated from eligible accounts receivable.

The Revolving Credit Facility includes the following sub-limits:

Letters of Credit to be issued limited to \$3,000,000.

Inventory availability limited to \$4,000,000.

Mandatory pay-down to \$1,000,000 (excluding letters of credit) for any 30 consecutive days between February 1 and April 30.

The Revolving Credit Facility must comply with the following quarterly financial covenants to avoid default:

Fixed charge coverage ratio test of 1.1:1 times measured on a rolling four quarter basis, defined as EBITDA less non-financed capital expenditures, cash dividends and distributions paid and cash taxes paid divided by the sum of interest and principal on all indebtedness.

Capital expenditures limited to \$150,000 per year.

Interest on the Revolving Line of Credit accrues at 2% per annum over PNC’s announced prime rate with an option for the Company to elect the 1, 2 or 3 month fully absorbed PNC LIBOR Rate plus 3.5% per annum with a default rate of 2% over the applicable rate. There is an unused facility fee equal to .375% per annum on the unused portion of the Revolving Credit Facility which is calculated on the basis of a 360 day year for the actual number of days elapsed and is payable quarterly in arrears. During the three month periods ended June 30, 2015 and 2014 the Company incurred interest expense of \$9,665 and \$0, respectively on amounts borrowed against the line of credit. During the three month periods ended June 30, 2015 and 2014 the Company incurred an unused facility fee of \$6,142 and \$0, respectively on the unused portion of the Revolving Credit Facility.



The Revolving Line of Credit is secured by first priority security interests in all of the named borrowers' tangible and intangible assets as well as first priority security interests of 100% of member or ownership interests of any of its domestic existing or newly formed subsidiaries and first priority lien on up to 65% of the borrowers' domestic subsidiary's existing or subsequently formed or acquired foreign subsidiaries. The Revolving Credit Facility is also secured by a related-party debt subordination agreement with Starlight Marketing Development, Ltd. in the amount of \$2,500,000. Costs associated with securing the Revolving Credit Facility of approximately \$222,000 were deferred and amortized over the term of the agreement. Amortization of deferred financing costs for the three months ended June 30, 2015 and 2014 was \$18,519 and \$0, respectively.

As a condition of the Revolving Credit Facility, a portion of the Company's related-party debt with Ram Light Management, Ltd. in the amount of \$1,100,000 was converted to a note payable with Ram Light Management, Ltd. ("Ram Light Note"). The Ram Light Note bears interest at 6% per annum with quarterly payments of \$150,000 (including principal and interest) payable beginning December 31, 2014. Scheduled principal and interest payment of \$150,000 will only be permitted upon receipt of the Company's current quarterly compliance certificate; the Company having met the mandatory pay-down of the Revolving Credit Facility to \$1,000,000 and average excess availability for the prior 30 days (after subtraction of third party trade payables 30 days or more past due) of no less than \$1,000,000 after giving effect to the payment. The Company has not met the above requirements for the first three scheduled payments and as a result has not made any scheduled payments on the note as of June 30, 2015. For the three months ended June 30, 2015 and 2014 the company accrued interest expense on the Ram Light Note in the amount of \$17,283 and \$0, respectively.

#### **NOTE 7 – LONG-TERM CAPITAL LEASE**

On April 13, 2013, the company entered into a long-term capital leasing arrangement with Wells Fargo Equipment Finance ("Wells Fargo") to finance the lease of two used forklift vehicles in the amount of \$36,388. The lease requires monthly payments in the amount of \$1,082 per month over a total lease term of 36 months which commenced on May 19, 2013. The agreement has an effective interest rate of 4.5% and the company has the option to purchase the equipment at the end of the lease term for one dollar. As of June 30, 2015 and March 31, 2015, the outstanding amount due to Wells Fargo was \$10,601 and \$13,706 respectively.

As of June 30, 2015 and March 31, 2015, the Company had obligations under the capital lease repayable as follows:

	June 30, 2015	March 31, 2015
Total minimum lease payments Within one year	\$ 10,820	\$ 12,984
After one year but within three years	-	1,078
	10,820	14,062
Interest payments relating to future periods	(219 )	(356 )



Present Value of minimum lease payments	\$ 10,601	\$ 13,706
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For the three month periods ended June 30, 2015 and June 30, 2014 the amount of interest related to the capital lease was \$142 and \$277, respectively.

#### **NOTE 8 – CUSTOMER DEPOSITS**

Normal credit terms to foreign customers shipped direct import from our Macau subsidiary are 50% of invoice price prior to shipment with the remaining 50% of invoice price due at time of shipment. As of June 30, 2015 and March 31, 2015 there was a total of \$287,110 and \$0, respectively on deposit with the company for future period shipments.

#### **NOTE 9 - OBLIGATIONS TO CUSTOMERS FOR RETURNS AND ALLOWANCES**

Due to the seasonality of the business and length of time customers are given to return defective product, it is not uncommon for customers 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 customers' accounts receivable are reclassified to "obligations to customers 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 customers 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 June 30, 2015 and March 31, 2015 obligations to customers for returns and allowances reclassified from accounts receivable were \$10,361 and \$399,419, respectively. As of June 30, 2015 and March 31, 2015, there were no customers requesting payment of their credit balance and as such there were no amounts reclassified from obligations to customers for returns and allowances to accounts payable.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

**LEGAL MATTERS**

Management is currently not aware of any legal proceedings.

**OPERATING LEASES**

The Company has entered into various operating lease agreements for office and warehouse facilities in Fort Lauderdale, Florida, Ontario, California and Macau expiring at varying dates. Rent expense for the three month periods ended June 30, 2015 and 2014 was \$155,221 and \$163,470 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, 2015 are as follows:

For period ending June 30,	Operating Leases
2015	\$547,316
2016	535,626
2017	487,671
2018	518,171
2019	524,272
2020 and beyond	218,447
	\$2,831,503

**NOTE 11 - SHAREHOLDERS' EQUITY**

**COMMON STOCK ISSUANCES**

During the three months ended June 30, 2015 and 2014, the Company did not issue any shares of its common stock.

**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 Plan was developed to provide a means whereby directors and selected employees, officers, consultants, and advisors of the Company were granted incentive or non-qualified stock options to purchase common stock of the Company. As of June 30, 2015, the Plan had expired and no shares were available to be issued. As of June 30, 2015, there were 1,102,000 options still outstanding and exercisable under the Plan. This does not include an additional 760,000 options issued after the expiration date of the Plan to directors and key employees as compensation that were not issued from the Plan.

There were no stock options issued during the three months ended June 30, 2015.

**NOTE 12 - GEOGRAPHICAL INFORMATION**

All sales to customers outside of the United States for the three months ended June 30, 2015 were made by the Macau Subsidiary. Sales by geographic region for the periods presented are as follows:

	2015	2014
North America	\$3,073,577	\$2,290,253
Europe	237,507	254,706
South Africa	155,790	-
	\$3,466,874	\$2,544,959

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

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

During the fiscal year ended March 31, 2015, our parent company, Starlight International Holdings Limited, was renamed to Shihua Development Company Limited ("Shihua"), due to a corporate restructuring transaction. As a result of the transaction, Shihua now holds 100% of the common stock of koncepts International Limited ("koncepts"). Koncepts is a major stockholder of the Company, owning approximately 49% of our shares of common stock outstanding on a fully diluted basis as of June 30, 2015.

As of June 30, 2015 and March 31, 2015 the Company had amounts due to related parties in the amounts of \$4,446,093 and \$4,410,637, respectively, consisting of an interest-bearing note payable to Ram Light Management Ltd of \$1,100,000 and \$0, respectively, (See Note 6) and trade payables due primarily to Shihua affiliates in the amount of \$3,346,093 and \$4,925,982, respectively. Current fiscal year trade payables that are past due bear interest at a rate of 6% per annum and calculated on the number of days the current fiscal year trade payables are past due. Accrued interest on past due trade payables to Starlight affiliates was \$15,842 and \$2,357 for the three months ended June 30, 2015 and 2014, respectively. As of June 30, 2015 and March 31, 2015 the Company had amounts due from related parties in the amounts of \$94,252 and \$0, respectively, consisting primarily of non-interest bearing trade receivables due from Shihua affiliates.

#### **NOTE 14 – RELATED PARTY TRANSACTIONS**

During the three months ended June 30, 2015 and June 30, 2014 the Company sold \$64,903 and \$316,594, respectively to Starlight Electronics Company, Ltd (“SLE”), a related party, 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 SLE for the three months ended June 30, 2015 and June 30, 2014 was 14.7% and 16.6%, 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 June 30, 2015 and June 30, 2014 the Company sold an additional \$113,962 and \$101,161, respectively of product to Cosmo from its 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 and services from Starlight R&D, Ltd, (“SLRD”) a related party. The purchases from SLRD for the three month periods ended June 30, 2015 and 2014 were \$32,857 and \$24,769, respectively. The Company purchased products from Starlight Consumer Electronics USA, Inc., (“SCE”) a related party. The purchases from SCE for the three month periods ended June 30, 2015 and 2014 were \$165,893 and \$1,598,200, respectively. These amounts were included as a component of cost of goods sold in the accompanying condensed consolidated statements of operations.

Effective April 1 2015, SMC-L entered into a service and logistics agreement with SCE, Cosmo and SLE, to provide logistics, fulfillment, and warehousing services for Shihua affiliated companies SCE, Cosmo and SLE’s domestic sales. For these services, Starlight USA, Cosmo and SLE have agreed to reimburse the Company for actual warehouse space occupied by these companies at \$0.096 per cubic foot and for logistics services performed based on an agreed to fee schedule specified in the agreement. For the three months ended June 30, 2015 and 2014, the company received approximately \$19,885 and \$0, respectively. The Company estimates it will receive approximately \$100,000 in expense reimbursements for the fiscal year ending March 31, 2016 related to this agreement.

Effective April 1 2014, SMC-L entered into a service and logistics agreement with SCE, Cosmo and SLE, to provide logistics, fulfillment, and warehousing services for Shihua affiliated companies SCE, Cosmo and SLE’s domestic

sales. For these services, Starlight USA, Cosmo and SLE agreed to reimburse the Company for actual warehouse space occupied by these companies at \$8 per pallet and for logistics services performed based on an agreed to fee schedule specified in the agreement. For the three months ended June 30, 2015 and 2014 the Company received \$0 and \$43,285, respectively. These amounts were included as a component of general and administrative expenses in the accompanying condensed consolidated statements of operations. This agreement expired on March 31, 2015.

#### **NOTE 15 – WARRANTY PROVISIONS**

A return program for defective goods is negotiated with each of our wholesale customers on a year-to-year basis. Customers are either allowed to return defective goods within a specified period of time after shipment (between 6 and 9 months) or granted a “defective allowance” consisting of a fixed percentage (between 1% and 5%) off of 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	
	June 30, 2015	June 30, 2014
Estimated return and allowance liabilities at beginning of period	\$197,873	\$235,172
Costs accrued for new estimated returns and allowances	87,235	54,002
Return and allowance obligations honored	(132,034)	(132,350)
Estimated return and allowance liabilities at end of period	\$153,074	\$156,824

#### **NOTE 13 - EMPLOYEE BENEFIT PLANS**

The Company has a 401(k) plan for its employees to which the Company makes contributions at rates dependent on the level of each employee’s contributions. Contributions made by the Company are limited to the maximum allowable for federal income tax purposes. The amounts charged to operations for contributions to this plan and administrative costs during the three month periods ended June 30, 2015 and 2014 totaled \$9,258 and \$6,720, respectively. The amounts are included as a component of general and administrative expense in the accompanying Consolidated Statements of Income. The Company does not provide any post-employment benefits to retirees.

## **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 “Company”, “SMC”, “The Singing Machine”) and its three wholly-owned subsidiaries SMC (Comercial Offshore De Macau) Limitada (“Macau Subsidiary”), SMC Logistics, Inc. (“SMC-L”) and SMC-Music, Inc. (“SMC-M”) are primarily engaged in the development, marketing, and sale of consumer karaoke audio systems, accessories, musical instruments and musical recordings. The products are sold by SMC to retailers and distributors for resale to consumers.

Our products are sold throughout North America, Europe, Australia and South Africa primarily through major mass merchandisers and warehouse clubs, on-line retailers and to a lesser extent department stores, lifestyle merchants, direct mail catalogs and showrooms, music and record stores, and specialty stores.

Representative customers include Amazon, BJ’s Wholesale, Costco, Sam’s Club, Target, Toys R Us, and Wal-Mart. Our business has historically been subject to seasonal fluctuations causing our revenues to vary from quarter to quarter and between the same periods in different fiscal years. Our products are manufactured for the most part based on the purchase indications of our customers. We are uncertain of how significantly our business would be harmed by a prolonged economic recession, but we anticipate that continued contraction of consumer spending would 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, 2015 and 2014.

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

	<b>For Three Months Ended</b>	
	<b>June 30, 2015</b>	<b>June 30, 2014</b>
<b>Net Sales</b>	100.0%	100.0%
<b>Cost of Goods Sold</b>	75.2 %	79.7 %
<b>Gross Profit</b>	24.8 %	20.3 %
<b>Operating Expenses</b>		
Selling expenses	13.2 %	13.6 %
General and administrative expenses	31.8 %	36.4 %
Depreciation	1.1 %	1.2 %
<b>Total Operating Expenses</b>	46.1 %	51.2 %
<b>Loss from Operations</b>	-21.3 %	-30.9 %
<b>Other Expenses</b>		
Interest expense	-1.5 %	-0.1 %
Finance Costs	-0.5 %	0.0 %
<b>Total Other Expenses</b>	-2.0 %	-0.1 %
<b>Loss before income tax benefit</b>	-23.3 %	-31.0 %
<b>Income tax benefit</b>	9.0 %	11.4 %
<b>Net Income</b>	-14.3 %	-19.6 %

QUARTER ENDED JUNE 30, 2015 COMPARED TO THE QUARTER ENDED JUNE 30, 2014

**NET SALES**



Net sales for the quarter ended June 30, 2015 increased to \$3,466,874 from \$2,544,959, an increase of \$921,915 as compared to the same period ended June 30, 2014. This increase was primarily due to an increase in sales to two major retail customers of approximately \$1,310,000 due from replenishment to meet expected spring and summer sales expectations. There was also an increase of approximately \$160,000 in direct import sales to a new distributor in South Africa. This sales increase was offset by a reduction in sales to a related party of approximately \$210,000 and a reduction of approximately \$260,000 to a major retailer that opted not to run the same spring promotion program they ran in the previous year. The remaining sales reduction of approximately \$80,000 came from overall reduced restocking requirements of other customers.

## **GROSS PROFIT**

Gross profit for the quarter ended June 30, 2015 increased to \$858,421 from \$515,891 an increase of \$342,530 as compared to the same period in the prior year. Approximately 65% of the gross profit increase was commensurate with the increase in net sales as explained above with the remaining 35% increase due to increased gross profit margin percentage on net sales as explained below.

As a percentage of revenues, gross profit margin for the three months ended June 30, 2015 was 24.8% compared to 20.3% for the three months ended June 30, 2014. This 4.5% increase in gross profit margin points was primarily due to the increased sales of higher margin products to major domestic retail customers for the three months ended June 30, 2015 which accounted for approximately 2.1% of the margin increase with the remaining increase due primarily to favorable product mix to other customers and reductions in product cost from the same period in the prior year.

## **OPERATING EXPENSES**

For the quarter ended June 30, 2015, total operating expenses increased to \$1,597,041 compared to \$1,303,469 from the same period in the prior year. This represents an increase in total operating expenses of \$293,572 from the quarter ended June 30, 2014. Selling expenses increased by approximately \$112,000 primarily due to an increase in advertising allowance expense associated with the increase in net sales to one major retail customer and an additional investment in co-op advertising programs with this same customer.

General and administrative expenses increased by approximately \$173,110 to \$1,101,981 for the three months ended June 30, 2015 compared to \$928,871 for the same period ended June 30, 2014. Legal and professional services increased by approximately \$20,000 due to field audit and appraisal services provided by PNC Bank as required by our revolving credit facility, an increase of approximately \$90,000 in product repair fees from vendors partially due to the timing of returns of repaired goods, an increase of approximately \$29,000 in temporary warehouse labor and an increase in payroll expenses of approximately \$20,000 due to sales incentives for the net sales increase as well as the hiring of a sales/inventory control analyst. The remaining increase in general and administrative expenses was primarily due to various other variable expenses and was commensurate with the increase in net sales.

## **LOSS FROM OPERATIONS**

Loss from operations decreased \$48,958 this quarter to \$738,620 for the three months ended June 30, 2015 compared to a loss from operations of \$787,578 for the same period ended June 30, 2014. An increase in gross profit margin contributed approximately \$343,000 to the decreased loss due to increased sales as explained in Net Sales and Gross Profit above and was offset by an increase in selling, general and administrative expenses of approximately \$294,000 as discussed in Operating Expenses above.

## **INCOME TAXES**

The Company recorded an income tax benefit of approximately \$312,000 due to the loss from operations during the three months ended June 30, 2015 which generated an additional current deferred tax asset of approximately \$312,000 as of June 30, 2015. The income tax benefit was based on management's best estimate of the Company's full year effective tax rate of approximately 39%. Due to the seasonality of the business, the Company is expected to fully reverse this increase in deferred tax asset during the fiscal year ending March 31, 2016. For the three months ended June 30, 2014, the Company recorded an income tax benefit of approximately \$290,000 due to the loss from operations which generated an additional current deferred tax asset of approximately \$290,000 as of June 30, 2014.

## **NET LOSS**

For the three months ended June 30, 2015 net loss decreased to \$494,926 compared to a net loss of \$499,529 for the same period a year ago. The decrease in net loss was primarily due to the same reasons discussed in loss from operations and income taxes.

## **LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2015, Singing Machine had cash on hand of \$363,410 with no restrictions as compared to cash on hand of \$502,872 of which \$138,042 was restricted as collateral for a stand-by letter of credit on June 30, 2014. We had working capital of \$3,553,837 as of June 30, 2015.

Net cash used in operating activities was \$1,244,628 for the three months ended June 30, 2015, as compared to \$1,037,701 used in operating activities the same period a year ago. During the three month period ending June 30, 2015 there was a loss before income tax benefit of approximately \$807,000 due primarily to increased gross profit margin offset by increased selling and administrative expenses as explained in Net Sales, Gross Profit and Operating Expenses above. Inventory increased approximately \$625,000 due to seasonal returns and purchases for sales in the upcoming quarter. This inventory increase was offset by an increase in accrued expenses of approximately \$183,000 during the three month period ended June 30, 2015 primarily due to an increase in accrued advertising allowance associated with incremental sales.

Net cash used in operating activities was \$1,037,701 for the three months ended June 30, 2014. During the three month period ending June 30, 2014 there was a loss before income tax benefit of approximately \$790,000 due primarily to increased gross profit margin offset by increased selling and administrative expenses as explained in Net Sales, Gross Profit and Operating Expenses above. The Company also increased its accounts payable and net due to related parties by approximately \$5,500,000 which was offset by an increase in inventory of approximately \$5,700,000 during the three month period ended June 30, 2014 in anticipation of upcoming seasonal customer sales.

Net cash used by investing activities for the three months ended June 30, 2015 was \$42,157 as compared to \$33,013 used by investing activities for the same period ended a year ago. This increase in investment activity was due to an increase in investment of tooling and molds for new products during the three month period ended June 30, 2015 as compared to the three months ended June 30, 2014.

Net cash provided by financing activities for the three month period ended June 30, 2015 was \$1,533,909 compared to cash provided by financing activities of \$81,445 for the same period ended a year ago. Financing activities for the three month period ended June 30, 2015 were primarily from borrowings on the revolving line of credit which allowed advances against inventory as compared to previous line of credit in place for the period ended June 30, 2014 which

did not allow for advances on inventory.

Forward-looking liquidity and capital resources: As previously announced, SMC on July 14, 2014 entered into a 3-year Revolving Credit Facility with PNC Bank which provides for a near-tripling of our credit availability and at more attractive pricing than the previous factoring arrangement with Crestmark Bank. In addition to our current bank financing, the Shihua Group has expressed their willingness and ability to provide extended payment terms to us for key vendor payments primarily by extending longer payment terms for goods they manufacture for us. We do not believe we will require any bridge financing from the Shihua Group for the fiscal year ending March 31, 2016, however we will continue to take advantage of extended terms for trade payables with the Shihua Group throughout the year. During the three months ended June 30, 2015, our related party debt decreased by approximately \$59,000 primarily due to increases in related-party inventory repair invoices. Taking into account internally generated funds and credit facilities available to Shihua we have concluded that our parent will have sufficient working capital to provide extended trade payable terms to us for at least the next 12 months.

Our average monthly general and administrative expenses are approximately \$370,000. We expect that we will require approximately \$1,100,000 for working capital during the next three-month period.

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

- Collecting our existing accounts receivable;
- Selling existing inventory;
- Vendor financing;
- Borrowing from the Revolving Credit facility;
- Extended payment terms from our majority shareholder;
- Fees for fulfillment, delivery and returns services from related and non-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. As of June 30, 2015, we continued to borrow from our asset based lending facility with PNC Bank N.A. which provides for a maximum loan amount of \$15,000,000 during peak selling season and reduces to \$7,500,000 during the off-peak season. We believe this credit facility will be adequate to maintain and grow our business during the three-year term of the agreement. If we are unable to comply with the financial covenants defined in the financing agreement and default on the credit facility, 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 defective returns and maintain the appropriate level of inventory. We believe that our warranty provision reflects the proper amount of reserves to cover potential defective sales 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 systems 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% and 88% of net sales in fiscal 2015 and 2014, 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 condensed consolidated 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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not required for small reporting companies.

### **ITEM 4. CONTROLS AND PROCEDURES**



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

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

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Management is currently not aware of any legal proceedings.

**ITEM 1A. RISK FACTORS**

Not applicable for smaller reporting companies

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

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

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

**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.\*

101.INSXBRL Instance Document \*

101.SCHXBRL Taxonomy Extension Schema Document \*

101.CALXBRL Taxonomy Extension Calculation Linkbase Document \*

101.DEF XBRL Taxonomy Extension Definition Linkbase Document \*

101.LABXBRL Taxonomy Extension Label Linkbase Document \*

101.PREXBRL Taxonomy Extension Presentation Linkbase Document \*

\* 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 14, 2015

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

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