

SINGING MACHINE CO INC  
Form 10-Q  
August 14, 2017

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, 2017

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  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	38,259,303 as of August 14, 2017

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

INDEX

	<b>Page No.</b>
 <u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets – June 30, 2017 (Unaudited) and March 31, 2017</u>	3
<u>Condensed Consolidated Statements of Operations – Three months ended June 30, 2017 and 2016 (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows - Three months ended June 30, 2017 and 2016 (Unaudited)</u>	5
<u>Notes to Condensed Consolidated Financial Statements - June 30, 2017 (Unaudited)</u>	6
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	16
Item 4. <u>Controls and Procedures</u>	16
 <u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	17
Item 1A. <u>Risk Factors</u>	17
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	17
Item 3. <u>Defaults Upon Senior Securities</u>	17
Item 4. <u>Mine Safety Disclosures</u>	17
Item 5. <u>Other Information</u>	17
Item 6. <u>Exhibits</u>	17

SIGNATURES

18

2

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## The Singing Machine Company, Inc. and Subsidiaries

## CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2017 (Unaudited)	March 31, 2017
Assets		
Current Assets		
Cash	\$430,944	\$2,305,439
Accounts receivable, net of allowances of \$126,555 and \$132,583, respectively	2,762,249	1,655,518
Due from PNC Bank	-	242,859
Accounts receivable related party - Cosmo Communications Canada, Ltd	241,128	-
Accounts receivable related party - Winglight Pacific, Ltd	310,772	-
Accounts receivable related party - other	5,747	-
Inventories, net	8,661,876	5,426,346
Prepaid expenses and other current assets	397,621	81,278
Deferred financing costs	13,333	21,606
Total Current Assets	12,823,670	9,733,046
Property and equipment, net	554,928	412,805
Other non-current assets	11,523	11,523
Deferred financing costs, net of current portion	26,667	-
Deferred tax asset	1,762,335	1,479,209
Total Assets	\$15,179,123	\$11,636,583
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	\$4,522,450	\$1,381,870
Current portion of bank term note payable	500,000	-
Due to related party - Starlight Electronics Co., Ltd	79,824	-
Due to related party - Merrygain Holding Co.,Ltd	38,487	-
Due to related party - Starlight Consumer Electronics Co., Ltd.	31,476	-
Accrued expenses	726,287	626,331
Revolving line of credit	683,986	-
Obligations to customers for returns and allowances	108,175	38,460
Warranty provisions	93,989	223,700
	446,221	1,924,431

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Current portion of subordinated related party debt - Starlight Marketing Development, Ltd.		
Total Current Liabilities	7,230,895	4,194,792
Bank term note payable, net of current portion	500,000	-
Subordinated related party debt - Starlight Marketing Development, Ltd., net of current portion	478,210	-
Total Liabilities	8,209,105	4,194,792
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, Class A, \$0.01 par value; 100,000 shares authorized; no shares issued and outstanding	-	-
Common stock, Class B, \$0.01 par value; 100,000,000 shares authorized; 38,259,303 shares issued and outstanding	382,593	382,593
Additional paid-in capital	19,468,024	19,412,787
Accumulated deficit	(12,880,599)	(12,353,589)
Total Shareholders' Equity	6,970,018	7,441,791
Total Liabilities and Shareholders' Equity	\$15,179,123	\$11,636,583

*See notes to the condensed consolidated financial statements.*

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

	For Three Months Ended	
	June 30, 2017	June 30, 2016
Net Sales	\$3,939,733	\$4,859,392
Cost of Goods Sold	2,860,584	3,715,709
Gross Profit	1,079,149	1,143,683
Operating Expenses		
Selling expenses	463,747	424,878
General and administrative expenses	1,359,231	1,246,851
Depreciation	43,213	43,795
Total Operating Expenses	1,866,191	1,715,524
Loss from Operations	(787,042 )	(571,841 )
Other Expenses		
Interest expense	(283 )	(16,027 )
Financing costs	(21,606 )	(18,519 )
Total Other Expenses	(21,889 )	(34,546 )
Loss Before Income Tax Benefit	(808,931 )	(606,387 )
Income Tax Benefit	281,921	169,314
Net Loss	\$(527,010 )	\$(437,073 )
Loss per Common Share		
Basic and Diluted	\$(0.01 )	\$(0.01 )
Weighted Average Common and Common Equivalent Shares:		
Basic and Diluted	38,259,303	38,181,635

*See notes to the condensed consolidated financial statements.*





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

	For Three Months Ended	
	June 30, 2017	June 30, 2016
Cash flows from operating activities:		
Net Loss	\$(527,010 )	\$(437,073 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	43,213	43,795
Amortization of deferred financing costs	21,606	18,519
Change in inventory reserve	(375,000 )	66,000
Change in allowance for bad debts	(6,028 )	23,319
Stock based compensation	55,237	9,329
Change in net deferred tax asset	(283,126 )	(198,588 )
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(1,100,703 )	(2,092,830 )
Due from PNC Bank	242,859	183,531
Accounts receivable - related parties	(557,647 )	(325,333 )
Inventories	(2,860,530 )	(4,742,982 )
Prepaid expenses and other current assets	(316,343 )	(33,205 )
Other non-current assets	-	(129 )
Increase (decrease) in:		
Accounts payable	3,140,580	5,604,524
Due to related parties	149,787	521,648
Accrued expenses	99,956	84,161
Obligations to clients for returns and allowances	69,715	(98,678 )
Warranty provisions	(129,711 )	(99,237 )
Net cash used in operating activities	(2,333,145 )	(1,473,229 )
Cash flows from investing activities:		
Purchase of property and equipment	(185,336 )	(65,531 )
Net cash used in investing activities	(185,336 )	(65,531 )
Cash flows from financing activities:		
Net proceeds from revolving line of credit	683,986	-
Proceeds from bank term note	1,000,000	-
Proceeds from exercise of stock options	-	6,400
Payment of deferred financing costs	(40,000 )	-
Payment on note payable related party - Ram Light Management, Ltd.	-	(138,537 )
Payment on subordinated debt - related party	(1,000,000 )	-
Payments on capital lease	-	(1,078 )
Net cash provided by (used in) financing activities	643,986	(133,215 )

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Net change in cash	(1,874,495)	(1,671,975)
Cash at beginning of period	2,305,439	2,116,490
Cash at end of period	\$430,944	\$444,515
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$283	\$15,027
Cash paid for income taxes	\$30,000	\$-

*See notes to the condensed consolidated financial statements.*

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

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

**June 30, 2017**

**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, 2017 and 2016 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 Securities and Exchange Commission. 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, 2017 was derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended March 31, 2017. 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, the allowance for doubtful accounts 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. The Company is subject to chargebacks from customers for cooperative marketing programs, defective returns, return freight and handling charges that are deducted from open invoices and reduce collectability of open invoices. 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 year-end rates of exchange for assets and liabilities, and average rates of exchange for the year for revenues, costs, and expenses. Net gains and losses resulting from foreign exchange transactions and translations were not material during the periods presented.

## **Concentration of Credit Risk**

At times, the Company maintains cash in United States bank accounts that are in excess of the Federal Deposit Insurance Corporation insured amounts. The Company maintains cash balances in foreign financial institutions. The amounts at foreign financial institutions at June 30, 2017 and March 31, 2017 are \$180,371 and \$150,665, respectively.

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist of accounts receivable.

## **INVENTORY**

Inventories are comprised primarily of electronic karaoke equipment, microphones and accessories, and are stated at the lower of cost or net realizable value 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. As of June 30, 2017 and March 31, 2017, the Company had inventory reserves of \$325,000 and \$700,000, respectively, for estimated excess and obsolete inventory.

## **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 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. 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.

## **FAIR VALUE OF FINANCIAL INSTRUMENTS**

We follow Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("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, accrued expenses, obligations to clients for returns and allowances, and due to/from related parties approximates fair value due to the relatively short period to maturity for these instruments. The carrying amounts on the bank term note payable and the subordinated debt to Starlight Marketing Development, Ltd. (related party) approximate fair value due to the relatively short period to maturity and related interest accrued at a rate similar to market rates. The carrying amounts on the revolving line of credit approximates fair value due the relatively short period to maturity and related interest accrued at market rates.

## **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.

## **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 condensed consolidated statements of operations.

## **STOCK BASED COMPENSATION**

The Company follows the provisions of the FASB 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 income 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, 2017 and 2016 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, 2017 and 2016, the stock option expense was \$55,237 and \$9,329, 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 10% 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, 2017 and 2016 was \$235,300 and \$205,050, respectively. As of June 30, 2017 and March 31, 2017 there was an accrual for cooperative advertising allowances of \$207,132 and \$167,378, respectively. These amounts were a component of accrued expenses in the condensed consolidated balance sheets.



**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, 2017 and 2016, these amounts totaled \$58,608 and \$45,636 respectively.

## 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, 2018 is estimated to be approximately 35%. The effective tax rate for the full year ended March 31, 2017 was approximately 33%. As of June 30, 2017 and March 31, 2017, The Singing Machine had gross deferred tax assets of approximately \$1.8 million and \$1.5 million respectively. The Company recorded an income tax benefit of approximately \$282,000 and \$169,000 for the three months ended June 30, 2017 and 2016, respectively.

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, 2017 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, 2017, the Company is subject to U.S. Federal income tax examinations for the tax years ended March 31, 2015 and subsequent years.

## COMPUTATION OF LOSS PER COMMON SHARE

Loss per common share is computed by dividing the net loss by the weighted average of common shares outstanding during the period. As of June 30, 2017 and 2016 total potential dilutive shares from common stock options amounted to approximately 1,870,000 and 1,605,000 shares, respectively, however these shares were not included in the computation of diluted earnings per share for the three months ended June 30, 2017 and June 30, 2016 because their effect was anti-dilutive.

## RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued 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. 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 now effective for annual reporting periods beginning April 1, 2018 including interim periods within that reporting period. Management plans to adopt ASU 2014-09 using the full retrospective method of implementation. Management has assessed the effect of implementing ASU 2014-09 to determine the effect on the Company's financial statements. After examining the Company's performance obligations in its contracts, most of the Company's customers (other than distributors) have "customer acceptance rights" in that customers are allowed to return defective goods within a specified period after shipment (between 6 and 9 months) after goods have been shipped. Currently, the Company recognizes a liability for the estimated net amount of sales less related cost of goods sold of expected returned goods at the time of sale. The liability for defective goods is included in warranty provisions on the consolidated balance sheets. The implementation of ASU 2014-09 will require that the cost of the estimated returned goods be reflected in inventory and the amount of estimated sales to be credited to the customer be recognized in liabilities on the consolidated balance sheets.

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 price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The Company adopted ASU 2015-11 on April 1, 2017 and the adoption had no effect on the condensed consolidated financial statements.



In February 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires lessees to recognize a right-of-use asset and a lease liability on its Balance Sheet regardless of whether a lease is identified as financial lease or an operating lease. If the lease is identified as a financial lease, then the lessee must recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of income and classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. If the lease is identified as an operating lease then the lessee must recognize a single lease cost in the statement of income, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis and classify all cash payments within operating activities in the statement of cash flows. Both quantitative and qualitative disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years beginning April 1, 2019; including interim periods within those fiscal years, with early adoption permitted. Management has assessed the effect of implementing ASU 2016-02 to determine the effect on the Company's financial statements. The Company has several operating leases of which two are long-term real estate agreements that are subject to the requirements of ASU 2016-02 which will have a significant impact on the Company's consolidated financial statements and will require recognition of a right-to-use asset and a liability for payments.

### 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 7 – BANK FINANCING). As of June 30, 2017 and March 31, 2017, PNC Bank owed the Company \$0 and \$242,859, 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, 2017	March 31, 2017
Finished Goods	\$6,849,815	\$6,126,346
Inventory in Transit	2,137,061	-
Less: Inventory Reserve	325,000	700,000
Inventories, net	\$8,661,876	\$5,426,346

**NOTE 5 - PROPERTY AND EQUIPMENT**

A summary of property and equipment is as follows:

	USEFUL LIFE	June 30, 2017	March 31, 2017
Computer and office equipment	5 years	\$285,650	\$285,650
Furniture and fixtures	7 years	45,707	4,312
Warehouse equipment	7 years	238,471	238,471
Molds and tooling	3-5 years	2,770,754	2,626,813
		3,340,582	3,155,246
Accumulated depreciation		2,785,654	2,742,441
		\$554,928	\$412,805

Depreciation expense for the three months ended June 30, 2017 and June 30, 2016 was \$43,213 and \$43,795, respectively.

**NOTE 6 - 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, 2017 and March 31, 2017, obligations to customers for returns and allowances reclassified from accounts receivable were \$108,175 and \$38,460, respectively.

## NOTE 7 – BANK FINANCING

### Revolving Credit Facility

On June 22, 2017, the Company renewed the existing revolving credit facility (the “Revolving Credit Facility”) with PNC Bank, National Association (“PNC”) for an additional three years expiring on July 15, 2020. The outstanding loan balance cannot exceed \$15,000,000 during peak selling season between August 1 and December 31 (with the ability of the Company to request an additional \$5,000,000 of availability during peak selling season if required) and is reduced to a maximum of \$7,500,000 between January 1 and July 31. At June 30, 2017 and March 31, 2017, the outstanding balance of the Revolving Credit Facility was \$683,986 and \$0, respectively. 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 and up to 90% of eligible foreign credit insured accounts 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) 60% of the cost of eligible inventory or (b) 85% of net orderly liquidation value percentage of eligible inventory (annual inventory appraisals required); minus

Applicable reserves including a dilution reserve equal to 100% 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 \$5,000,000.

\$500,000 eligible in-transit inventory sublimit within the \$5,000,000 total inventory.

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 \$300,000 per year.

As of June 30, 2017, the Company was in compliance with all financial covenants.

Interest on the Revolving Line of Credit is accrued at .75% 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 2.75% 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 will be calculated on the basis of a 360 day year for the actual number of days elapsed and will be payable quarterly in arrears. During the three months ended June 30, 2017 and 2016 the Company incurred interest expense of \$283 and \$0, respectively, on amounts borrowed against the line of credit. During the three months ended June 30, 2017 and 2016 the Company incurred an unused facility fee of \$6,963 and \$7,031, 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 \$924,431. Costs associated with renewal of the Revolving Credit Facility of approximately \$40,000 were deferred and will be amortized over the term of the agreement. During the three months ended June 30, 2017 and 2016 the Company incurred amortization expense of \$21,606 and \$18,519, respectively, associated with the amortization of deferred financing costs from the original Revolving Credit Facility.

### **Term Note Payable**

In connection with the amendments above and in addition to the maximum availability limits on the Revolving Line of Credit, the agreement also includes a two-year term note ("Term Note") in the amount of \$1,000,000 the proceeds of which were used to pay down a portion of the subordinated related party debt of approximately \$1,924,000 in June 2017. The term note bears interest at 1.75% per annum over PNC's announced prime rate or 1, 2, or 3 month PNC LIBOR Rate plus 3.75%. The term note is payable in quarterly installments of \$125,000 plus accrued interest with the first installment due on August 1, 2017.

The subordination agreement has been amended reducing the amount of related party subordinated debt to the remaining amount due of approximately \$924,000. Provision has also been made to allow repayment of the remaining \$924,000 in quarterly installments of \$123,000 including interest accrued at 6% per annum commencing September 30, 2017. Payments of \$123,000 are only permitted upon receipt of the Company's 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. As part of the Conditions to Installment Payment of the subordinated debt, payments not made under this note that cannot be made as a result of the foregoing prohibition shall not be deemed an Event of Default and can be made as soon as the Company is able to demonstrate that it meets the liquidity requirements defined above.

**NOTE 8 - COMMITMENTS AND CONTINGENCIES****LEGAL MATTERS**

Management is currently not aware of any legal proceedings.

**OPERATING LEASES**

The Company has operating lease agreements for office and warehouse facilities in Fort Lauderdale, Florida; Ontario, California; and Macau expiring at varying dates. The lease for our office facilities in Fort Lauderdale, Florida expired in 2016. On August 31, 2016 we signed a lease extension that included the current occupied space as well as additional office space adjacent to our current space. The lease extension will commence upon completion of tenant improvements and will terminate 78 months after commencement. During the tenant improvement construction period rent will remain the same as the expired lease and will be paid on a month-to-month basis. Rent expense for the three months ended June 30, 2017 and 2016 was \$161,309 and \$164,531, respectively. In addition, the Company maintains various warehouse equipment and office equipment operating leases. Future minimum lease payments under property and equipment leases with terms exceeding one year as of June 30, 2017 are as follows:

	Operating Leases
For period ending June 30,	
2018	\$504,183
2019	524,272
2020	524,272
2021	87,378
	\$1,640,105

**NOTE 9 - STOCK OPTIONS**

A summary of stock option activity for the three months ended June 30, 2017 is summarized below:

June 30, 2017

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	Number of Options	Weighted Average Exercise Price
Stock Options:		
Balance at beginning of period	1,970,000	\$ 0.19
Granted	480,000	0.49
Exercised	-	-
Forfeited	-	-
Balance at end of period	2,450,000	\$ 0.23
Options exercisable at end of period	1,870,000	\$ 0.18

The following table summarizes information about employee stock options outstanding at June 30, 2017:

Range of Exercise Price	Number Outstanding at June 30, 2017	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at June 30, 2017	Weighted Average Exercise Price
\$.03 - \$.33	1,850,000	5.4	0.15	1,750,000	0.13
\$.45 - \$.93	600,000	6.2	0.48	120,000	0.45
*	2,450,000			1,870,000	

**NOTE 10 - GEOGRAPHICAL INFORMATION**

All sales to customers outside of the United States for the three months ended June 30, 2017 and 2016 were made by the Macau Subsidiary. Sales by geographic region for the periods presented are as follows:

	FOR THE THREE MONTHS ENDED June 30,	
	2017	2016
North America	\$3,568,122	\$4,541,145
Europe	371,611	318,247
	\$3,939,733	\$4,859,392

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



## **NOTE 11 –RELATED PARTY TRANSACTIONS**

### **DUE TO/FROM RELATED PARTIES**

On June 30, 2017 and March 31, 2017, in the aggregate the Company had \$557,647 and \$0, respectively, due from related parties for goods and services sold to these companies.

On June 30, 2017 and March 31, 2017, the Company had amounts due to other related party companies in the amounts of \$149,787 and \$0 for goods, repair services, engineering fees, storage and administrative services provided to the Company by these related parties.

### **SUBORDINATED DEBT**

In connection with the Revolving Credit Facility the Company was required to subordinate related party debt to Starlight Marketing Development, Ltd. (“subordinated debt”) in the amount of \$1,924,431. The Revolving Credit Facility renewal agreement includes a Term Note in the amount of \$1,000,000, the proceeds of which were used to pay down a portion of the subordinated debt. The remaining subordinated debt of \$924,431 bears interest at 6% and is scheduled to be paid in quarterly installments of \$123,000 which include interest commencing September 30, 2017. With the current renewal agreement expiring on July 15, 2020 the subordinated debt has been classified as a current portion of \$446,221 and a long-term portion of \$478,210 as of June 30, 2017 on the condensed consolidated balance sheets. Since the original agreement expired on July 14, 2017 the subordinated related party debt was classified as a current liability as of March 31, 2017 on the condensed consolidated balance sheets.

### **TRADE**

During the three months ended June 30, 2017 and June 30, 2016 the Company sold \$310,772 and \$192,976, respectively to Winglight Pacific, Ltd. (“Winglight”), 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 Winglight for the three months ended June 30, 2017 and June 30, 2016 was 21.5% and 15.4%, respectively. The product was shipped to Cosmo Communications of Canada (“Cosmo”), another related company and the Company’s primary distributor of its products to Canada. These amounts were included as a component of net sales in the accompanying condensed consolidated statements of operations.

During the three months ended June 30, 2017 and June 30, 2016 the Company sold an additional \$270,157 and \$123,499, respectively of product to Cosmo from its California warehouse facility. These amounts were included as a component of net sales in the accompanying condensed consolidated statements of operations.

The Company purchased products from Starlight Electronics Co. Ltd (“SLE”). The purchases from SLE for the three month periods ended June 30, 2017 and 2016 were \$32,870 and \$710,453 respectively. Product purchases were included as a component of cost of goods sold in the accompanying condensed consolidated statements of operations.

The Company purchased services from Starlight Consumer Electronics USA, Inc., (“SCE”) a related party. The purchases from SCE for the three month periods ended June 30, 2017 and 2016 were \$79,824 and \$51,900, respectively. These amounts were included as a component of general and administrative expenses in the accompanying condensed consolidated statements of operations.

The Company purchased services from Merrygain Holding Co. Ltd, (“Merrygain”) a related party. The purchases from Merrygain for the three month periods ended June 30, 2017 and 2016 were \$38,487 and \$0, respectively. These amounts were included as a component of general and administrative expenses in the accompanying condensed consolidated statements of operations.

The Company has annually renewable service and logistics agreements with affiliates of China Sinostar Group Co. Ltd. (“Sinostar”) The affiliates pay the Company for services based on actual warehouse space occupied. For the three month periods ended June 30, 2017 and 2016, the Company received approximately \$5,000 and \$18,671, respectively, in service fees from affiliates that are included in general and administrative expenses in the accompanying consolidated statements of income.

## **NOTE 12 – 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 warranty provision are presented in the following table:

	Three Months Ended	
	June 30, 2017	June 30, 2016
Estimated warranty provision at beginning of period	\$223,700	\$292,500
Costs accrued for future estimated returns	104,976	109,245
Returns received	(234,687)	(208,482)
Estimated warranty provision at end of period	\$93,989	\$193,263

**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, 2017 and 2016 totaled \$9,968 and \$9,867, respectively. The amounts are included as a component of general and administrative expense in the accompanying Condensed Consolidated Statements of Operations. 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 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, Best Buy, 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.

The Company's stock trades on the OTCQX Best Market under the ticker symbol "SMDM".

## 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, 2017 and 2016:

### The Singing Machine Company, Inc. and Subsidiaries

#### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	For Three Months Ended	
	June	June
	30,	30,
	2017	2016
Net Sales	100.0 %	100.0 %
Cost of Goods Sold	72.6 %	76.5 %
Gross Profit	27.4 %	23.5 %
Operating Expenses		
Selling expenses	11.8 %	8.7 %

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General and administrative expenses	34.5 %	25.7 %
Depreciation and amortization	1.1 %	0.9 %
<b>Total Operating Expenses</b>	<b>47.4 %</b>	<b>35.3 %</b>
<b>Loss from Operations</b>	<b>-20.0 %</b>	<b>-11.8 %</b>
<b>Other Expenses</b>		
Interest expense	0.0 %	-0.3 %
Financing costs	-0.5 %	-0.4 %
<b>Total Other Expenses</b>	<b>-0.5 %</b>	<b>-0.7 %</b>
<b>Loss before income tax benefit</b>	<b>-20.5 %</b>	<b>-12.5 %</b>
<b>Income tax benefit</b>	<b>7.1 %</b>	<b>3.5 %</b>
<b>Net Loss</b>	<b>-13.4 %</b>	<b>-9.0 %</b>

QUARTER ENDED JUNE 30, 2017 COMPARED TO THE QUARTER ENDED JUNE 30, 2016

**NET SALES**

Net sales for the quarter ended June 30, 2017 decreased to \$3,939,733 from \$4,859,392, a decrease of \$919,659 as compared to the same period ended June 30, 2016. This decrease was primarily due to timing shipments of special promotional goods made to a major customer of approximately \$1,300,000 for a Black Friday promotion that were made during the quarter ended June 30, 2016 with comparable goods currently scheduled to ship in the quarter ending September 30, 2017. This decrease was offset by increases of approximately \$300,000 in sales to both our Canadian and Europe distributors.

## **GROSS PROFIT**

Gross profit for the quarter ended June 30, 2017 decreased to \$1,079,149 from \$1,143,683 a decrease of \$64,534 as compared to the same period in the prior year. There was a decrease in gross profit of approximately \$202,000 due to decreased sales of Black Friday promotional goods which yield lower promotion priced gross margin to one major customer due to timing of shipments. This decrease was offset by the more favorable sales mix of non-promotional which yield stronger gross margin.

As a percentage of revenues, gross profit margin for the three months ended June 30, 2017 was 27.4% compared to 23.5% for the three months ended June 30, 2016. The increase of 3.9% was primarily due to a stronger sales mix of non-promotional goods that were shipped during the three-month period ended June 30, 2017 which yielded higher gross profit margin compared to last year's first quarter mix of shipments which included \$1,300,000 of special promotional sales which yielded a lower gross profit margin.

## **OPERATING EXPENSES**

For the quarter ended June 30, 2017, total operating expenses increased to \$1,866,191 compared to \$1,715,524 from the same period in the prior year. This represents an increase in total operating expenses of \$150,667 from the quarter ended June 30, 2016. Selling expenses increased by approximately \$39,000 primarily due to an increase in outbound freight due to increased domestic shipments versus direct import during the three months ended June 30, 2017 compared to the three month period ended June 30, 2016.

General and administrative expenses increased by approximately \$112,380 to \$1,359,231 for the three months ended June 30, 2017 compared to \$1,246,851 for the same period ended June 30, 2016. There was an increase in stock option compensation expense of approximately \$46,000 associated with board and officers' compensation. Expenses for increased services provided by related parties in China including quality control, inspection, storage services and new hires due to growth in sales increased by approximately \$23,000. Payroll related expenses increased by approximately \$29,000 due to new hires in both California and Florida locations to accommodate sales growth. The remaining increase in general and administrative expenses was primarily due to various other administrative expenses.

## **LOSS FROM OPERATIONS**

Loss from operations increased \$215,201 this quarter to \$787,042 for the three months ended June 30, 2017 compared to a loss from operations of \$571,841 for the same period ended June 30, 2016. There was a decrease in gross profit

margin of approximately \$65,000 due to decreased sales as explained in Net Sales and Gross Profit as well as an increase in operating expenses of approximately \$150,000 as discussed in Operating Expenses above.

## **INCOME TAXES**

For the three months ended June 31, 2017 and 2016 the Company recognized an income tax benefit of \$281,921 and \$169,314, respectively, due to management's best estimate of the Company's full year effective tax rate of approximately 35% and 33%, respectively, for fiscal year ending March 31, 2018 and fiscal year ended March 31, 2017.

## **NET LOSS**

For the three months ended June 30, 2017 net loss increased to \$527,010 compared to a net loss of \$437,073 for the same period a year ago. The increase 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, 2017, Singing Machine had cash on hand of \$430,944 as compared to cash on hand of \$444,515 on June 30, 2016. We had working capital of approximately \$5.6 million as of June 30, 2017.

Net cash used in operating activities was \$2,333,145 for the three months ended June 30, 2017, as compared to \$1,473,229 used in operating activities the same period a year ago. During the three month period ending June 30, 2017 there was a net loss of approximately \$527,000, and an increase in accounts receivable of approximately \$1,100,000 primarily due to a customer with 90-day payment terms. There was an increase in inventory of approximately \$2,861,000 due to inventory received and in-transit in preparation for this year's seasonal sales and an increase of approximately \$316,000 in prepaid expenses primarily due to deposits on accessories to be shipped with finished products. There was a increase in accounts receivable from related parties of approximately \$558,000 primarily due to seasonal shipments to Cosmo. These uses of cash were offset by an increase in accounts payable of approximately \$3,100,000 primarily associated with the increase in inventory. These amounts used and provided by operating activities accounted for approximately 97% of the total net cash used in operating activities.

Net cash used in operating activities was \$1,473,229 for the three months ended June 30, 2016. During the three month period ending June 30, 2016 there was an increase in accounts receivable of approximately \$2,093,000 primarily due to early delivery of promotional items to one major customer. There was an increase in inventory of

approximately \$4,743,000 due to inventory received and in-transit in preparation for this year's seasonal sales. There was an increase of approximately \$325,000 in accounts receivable from related parties primarily due to seasonal shipments to Cosmo. These increases in cash used by operations were offset by an increase in trade accounts payable of approximately \$5,605,000. There was also an increase in accrued expenses of approximately \$84,000 associated with the ramp up of upcoming seasonal expenses.

Net cash used by investing activities for the three months ended June 30, 2017 was \$185,336 as compared to \$65,631 used by investing activities for the same period ended a year ago. Investment activity consisted of the purchase of molds and tooling of approximately \$145,000 and office furniture of approximately \$41,000 during the three months ended June 30, 2017. Investment activity during the three months ended June 30, 2016 consisted primarily of the purchase of molds and tooling.

Net cash provided financing activities for the three month period ended June 30, 2017 was \$643,986 compared to cash used in financing activities of \$133,215 for the same period ended of the prior year. We borrowed approximately \$700,000 from our Revolving Credit Facility for working capital and we also received a term note from the bank of \$1,000,000 the proceeds of which were used to pay down \$1,000,000 of the subordinated related party debt.

As of June 30, 2017, we continued to borrow from our Revolving Credit Facility, which provides for a maximum loan amount of \$15,000,000 during peak selling season (with the ability of the Company to request an additional \$5,000,000 of availability during peak selling season if required) 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.

## **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 determine our warranty provision based on historical return ratios and information available from the customers. We believe that our warranty provision reflects the proper amount of reserves to cover potential defective sales returns.

## **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 84% and 85% of net sales in fiscal 2017 and 2016, 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.

## **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**

The Company's interim financial statements were prepared in accordance with United States generally accepted accounting principles, which require management to make subjective decisions, assessments and estimates about the effect of matters that are inherently uncertain. As the number of variables and assumptions affecting the judgement increases such judgements become even more subjective. While management believes its assumptions are reasonable and appropriate, actual results may be materially different than estimated. The critical accounting estimates and assumptions have not materially changed from those identified in the Company's 2017 Annual Report.

## **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 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.\*

\* Filed herewith

17

**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, 2017 By: */s/ Gary Atkinson*  
Gary Atkinson  
Chief Executive Officer

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

