SINGING MACHINE CO INC
Form 10-Q/A
January 18, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q/A-2

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

For quarter ended September 30, 2004

0 - 24968
Commission File Number

THE SINGING MACHINE COMPANY, INC.

(Exact Name of Small Business Issuer as Specified in its Charter)

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

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

(954) 596-1000
(Issuer'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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes|_| No |X|

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 ON SEPTEMBER 30, 2004
Common Stock, $0.01 par value	9,202,318

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY

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

Assets

Current Assets
- Cash and cash equivalents
- Restricted Cash
- Accounts Receivable, less allowances of $295,089 and $98,009, respectively
- Due from manufacturer
- Inventories
- Prepaid expenses and other current assets

Insurance receivable
Refundable tax

Total Current Assets

Property and Equipment, at cost less accumulated depreciation of $2,700,000 and $2,567,000, respectively
Other Non-Current Assets

Total Assets

Liabilities and Shareholders' Equity

Current Liabilities
Bank overdraft
Accounts payable
Accrued expenses
Customer credits on account
Due to factor
Convertible debentures, net of unamortized discount of 0 and $2,554,511, respectively
Subordinated debt-related parties
Income tax payable

Total Current Liabilities

Long Term liabilities
Convertible debentures, net of unamortized discount of $2,498,263 and 0, respectively

Total Long Term Liabilities

Shareholders' Equity
Preferred stock, $1.00 par value; 1,000,000 shares authorized, no shares issued and outstanding- - Common stock, Class A, $.01 par value; 100,000 shares authorized; no shares issued and outstan-ing - Common stock, $0.01 par value; 18,900,000 shares authorized; 9,202,318 and 8,752,318 shar92,023ued and outstan87,523 Additional paid-in capital 11,028,636 10,052,498 Accumulated deficit (10,721,019) (9,923,207)

Total Shareholders' Equity

Total Liabilities and Shareholders' Equity

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

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THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ending	Three Months Ending
	Sept 30, 2004	Sept 30, 2003

NET SALES	$ 18,753,288	$ 32,851,576
COST OF GOODS SOLD	14,492,944	27,431,545
GROSS PROFIT	4,260,344	5,420,031
OPERATING EXPENSES		
Advertising	352,206	867,325
Commissions	313,143	547,156
Compensation	649,565	1,343,812
Freight & Handling	206,456	495,955
Royalty Expense	333,602	749,167
Selling, general and administrative expenses	1,248,535	2,669,154
TOTAL OPERATING EXPENSES	3,103,507	6,672,569
INCOME (LOSS) FROM OPERATIONS	1,156,837	(1,252,538)
OTHER INCOME (EXPENSES)	--	
Other income(expense)	105,571	(90,649)
Interest expense	(129,504)	(262,094)
Interest expense - Amortization of discount on convertible debentures	(411,206)	(56,801)
NET OTHER EXPENSES	(435,139)	(409,544)
INCOME (LOSS) BEFORE INCOME TAXES	721,698	(1,662,082)
INCOME TAXES BENEFIT	--	1,005,413
NET INCOME (LOSS)	$ 721,698	$ (656,669)
INCOME (LOSS) PER COMMON SHARE:		
Basic	$ 0.08	(0.08)
Diluted	$ 0.06	(0.08)
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES:		
Basic	8,811,014	8,490,658
Diluted	12,813,594	8,490,658

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS.

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THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	FOR SIX MONTHS E
	2004

CASH FLOWS FROM OPERATING ACTIVITIES	
Net Loss	$ (797,812)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities	
Depreciation and amortization	177,380
Amortization of discount/deferred fees on convertible debentures	743,886
Stock compensation	293,000
Changes in assets and liabilities:	
Accounts Receivable	(3,667,789)
Insurance receivable	800,000
Due from manufacturer	(148,999)
Inventories	2,512,992
Prepaid expenses and other assets	200,537
Other non-current assets	132,194
Accounts payable	2,500,274
Accrued expenses	(2,084,279)
Customer credits on account	(550,863)
Current income taxes	1,294,061
Net cash provided by (used in) operating activities	1,404,582
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property and equipment	(575,495)
Restricted cash	(670,019)
Net cash used in investing activities	(1,245,514)
CASH FLOWS FROM FINANCING ACTIVITIES	
Borrowing from revolving credit facilities	
Repayment to revolving credit facilities	--
Borrowing from factoring	474,968
Bank Overdraft	(62,282)
Proceeds from issuance of convertible debt	--
Payment of financing fees related to convertible debt	--
Proceeds from note payable	--
Proceeds from related party loan	240,000
Payments on related party loan	(240,000)
Proceeds from exercise of stock options and warrants	--
Net cash provided by financing activities	412,686
INCREASE IN CASH AND CASH EQUIVALENTS	571,754
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	356,342
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 928,096
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
CASH PAID FOR SIX MONTHS ENDING SEPTEMBER 30	
Interest	$ 238,740
Taxes	$ --

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS.

THE SINGING MACHINE COMPANY, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of The Singing Machine Company, Inc. and its subsidiary (the "Company", "The Singing Machine"). All significant intercomany transactions and balances have been eliminated. The unaudited consolidated financial statements have been prepared in conformity with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission and therefore do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments (consisting of normal recurring accruals), which, in the opinion of management, are necessary for a fair presentation of the financial statements, have been included. Operating results for the period ended September 30, 2004 are not necessarily indicative of the results that may be expected for the remaining quarters or the year ending March 31, 2005 due to seasonal fluctuations in The Singing Machine's business, changes in economic conditions and other factors. For further information, please refer to the Consolidated Financial Statements and Notes thereto contained in The Singing Machine's Annual Report on Form 10-K for the year ended March 31, 2004.

INVENTORIES

Inventories are comprised of electronic karaoke audio equipment, accessories, and compact discs and are stated at the lower of cost or market, as determined using the first in, first out method.

INCOME TAXES.

Significant management judgment is required in developing The Singing Machine's 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 assets will not be realized. At March 31, 2004 and September 30, 2004, the Company concluded that a valuation allowance was needed against all of the Company's deferred tax assets, as it was not more likely than not that the deferred taxes would be realized. At September 30, 2004 and March 31, 2004, The Singing Machine had gross deferred tax assets of $8.7 million and $8.2 million, against which the Company recorded full valuation allowances.

For the three months ended September 30, 2004, the Company recorded no tax provision. This occurred because the Company has net operating losses for the year to date period. The Company has not recorded a benefit for the current period's losses because realizability is unlikely.

The Company operates within multiple taxing jurisdictions and is 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 income taxes have been made.

RECLASSIFICATIONS

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

STOCK BASED COMPENSATION

The Company accounts for stock options issued to employees using the intrinsic value method in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation cost is measured on the date of grant as the excess of the current market price of the underlying stock over the exercise price. Such compensation amounts are amortized over the respective vesting periods of the option grant. The Company applied the

disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 148", which permits entities to provide pro forma net earnings (loss) and pro forma earnings (loss) per share disclosures for employee stock option grants as if the fair-valued based method defined in SFAS No. 123 had been applied to options granted.

Had compensation cost for the Company's stock-based compensation plan been determined using the fair value method for awards under that plan, consistent with Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock Based Compensation", the Company's net loss would have been changed to the pro-forma amounts indicated below.

		SEPTEMBER 30, 2004	SEPTEM
Net loss	As reported	$(797,812)	
	Pro forma	$(956,776)	
Net loss per share - basic & diluted	As reported	$(0.09)	
	Pro forma	$(0.18)	

The effect of applying SFAS No. 123 is not likely to be representative of the effects on reported net earnings for future years due to, among other things, the effects of vesting.

For stock options and warrants issued to consultants, the Company applies the fair value method of accounting as prescribed by SFAS No.123. There were no consulting expenses relating to grants for the quarters ended September 30, 2004 and 2003.

For financial statement disclosure purposes and for purposes of valuing stock options and warrants issued to consultants, the fair market value of each stock option granted was estimated on the date of grant using the Black-Scholes Option-Pricing Model in accordance with SFAS No. 123 using the following weighted-average assumptions:

For the period ended September 30, 2004:

Expected dividend yield 0%, risk-free interest rate of 4%, volatility 81.5% and expected term of five years.

For the period ended September 30, 2003:

Expected dividend yield 0%, risk-free interest rate of 4%, volatility 79.9% and expected term of five years.

NOTE 2 - GOING CONCERN

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern.

The Company has an accumulated deficit in shareholders equity and is experiencing difficulty in keeping payments current with various vendors. As a result, the Company's independent registered public accounting firm has expressed substantial doubt in the Company's ability to continue as a going concern in their report for the years ended March 31, 2004 and 2003, which was included in the Company's annual report on Form 10-K.

Operations will be financed using the following methods:

- Vendor Financing. The Company's key vendors in China have agreed to manufacture on behalf of the Company, without advanced payments.

- A significant amount of committed customer orders have been sold under customer letters of credit terms. The customer's letters of credit will be used as collateral to provide advances to our vendors. The customers will pay and take title of the karaoke machines in China as the karaoke machines are shipped. This will generate immediate funds to pay the vendors and generate additional cash flows.

- Asset based lending facility with an US bank for factoring credit of $2.5 million to financing the account receivables in the USA

On June 16 2004, Edward Steele, former officer and director, advanced $40,000 to us. The loan was interest free and paid in full on August 30, 2004.

On July 14, 2004, Josef A. Bauer, a director, advanced a short-term loan of $200,000 to us which we are to use to meet our working capital obligations. The interest rate on the loan is 8.5% per annum and the loan is payable on demand. On August 26, 2004, we repaid Mr. Bauer a total of $202,109, including $2,109 in interest.

There can be no assurances that forecasted results will be achieved or that additional financing will be obtained. The financial statements do not include any adjustments relating to the recoverability and classification of asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

NOTE 3 - LOANS AND LETTERS OF CREDIT

CREDIT FACILITY

The Hong Kong Subsidiary maintains separate credit facilities at two international banks. The primary purpose of the facilities is to provide the Subsidiary with the following abilities:

o Overdraft protection facilities o Issuance and negotiation of letters of credit o Trust receipts o A Company credit card

These facilities are secured by a corporate guarantee from the U.S. Company, restricted cash on deposit with the lender and require that the Company maintain a minimum tangible net worth. The maximum available credit under the facilities is $2.0 million. The credit facilities have been increase to $4 million by increasing fixed deposit with the bank, which is used as collateral. The balance due at September 30, 2004 and March 31, 2004 was 0 and $62,282, respectively. The interest rate is approximately 4%. At September 30, 2004, the Company has used all credit facilities to open the letter of credit to the factories for the purchase. The company does not have any additional availability under these facilities.

RELATED PARTY LOANS

On July 14, 2004, Josef A. Bauer, a director, advanced a short-term loan of $200,000 to us which we are to use to meet our working capital obligations. The interest rate on the loan is 8.5% per annum and the loan is payable on demand. On August 26, 2004, we repaid Mr. Bauer a total of $202,109, including $2,109 in interest.

On June 16, 2004, Edward Steele, former officer and director, advanced $40,000 to us. The loan was interest fee and paid in full on August 30, 2004.

On or about July 10, 2003, certain officers and directors of our company advanced $1 million to our company pursuant to written loan agreements. The officer was Yi Ping Chan and the directors were Josef A. Bauer and Howard Moore. Mr. Moore resigned from our Board, effective as October 17, 2003. Additionally, Maureen LaRoche, a business associate of Mr. Bauer, participated in the financing. The loans accrue interest at 9.5% per annum and as of September 30, 2004, all interest was accrued, and the unpaid amount totaled approximately $23,750. These loans were originally scheduled to be repaid by October 31, 2003 and are now due on demand. These loans were subordinated to Milberg's factoring agreement, which we terminated effective as of July 14, 2004 and subsequently subordinated to Crestmark Bank.

NOTE 4 - ACCOUNTS RECEIVABLE FACTORING AGREEMENT

On August 4, 2004, the Company has started to factor its accounts receivables through Crestmark bank in Detroit, Michigan. The agreement allows the Company, at the discretion of Crestmark, to factor its outstanding receivables, with recourse, up to a maximum of the lesser of $2.5 million or 70% of eligible accounts receivable. The Company will pay 1% of gross receivables in fees with a $9,000 minimum maintenance fee per month. The average balance of the line will be subject to interest on a monthly basis at prime plus 2%. The rate is currently 6.75%. The agreement contains a liquidated damages fee of $162,000 for early termination.

Crestmark Bank also received a security interest in all of the Company's accounts receivables and inventory located in the United States. The Company's debenture holders have subordinated their $4 million secured convertible debentures to the Crestmark debt.

As of September 30, 2004, the outstanding amount due to Crestmark bank for factoring is $474,968.

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NOTE 5 - CONVERTIBLE DEBENTURES WITH WARRANT

In September 2003, the Company issued $4 million of 8% Convertible Debentures in a private offering which are due February 20, 2006 ("Convertible Debentures").

The net cash proceeds received by the Company were $3,745,000 after deduction of cash commissions and other expenses.

The Convertible Debentures are convertible at the option of the holders and were initially convertible into 1,038,962 common shares at a conversion price of $3.85 per common share subject to certain anti-dilution adjustment provisions, at any time after the closing date. The repayment of the Convertible Debentures was subordinated to a factoring agreement with Milberg Factors, which was terminated as of July 14, 2004.

These Convertible Debentures were issued with 457,143 detachable stock purchase warrants with an exercise price of $4.025 per share. These warrants may be exercised at anytime after September 8, 2003 and before September 7, 2006 and are subject to certain anti-dilution provisions. The warrants are also subject to an adjustment provision; whereas the price of the warrants may be changed under certain circumstances.

The Convertible Debentures bear interest at the stated rate of 8% per annum. Interest is payable quarterly on March 1, June 1, September 1, and December 1. The interest may be payable in cash, shares of Common Stock, or a combination thereof subject to certain provisions and at the discretion of the Company.

In accounting for this transaction, the Company allocated the proceeds based on the relative estimated fair value of the stock purchase warrants and the convertible debentures. This allocation resulted in a discount on the convertible debentures of $3.3 million, which is being amortized over the life of the debt on a straight-line basis to interest expense, which is not materially different from effective interest method.

On February 9, 2004, the Company amended its convertible debenture agreements to increase the interest rate to 8.5% and to grant warrants to purchase an aggregate of 30,000 shares of the Company's common stock to the debenture holders on a pro-rata basis. These concessions are in consideration of the debenture holder's agreements to (i) enter into new subordination agreements with Milberg, (ii) to waive all liquidated damages due under the transaction documents through July 1, 2004 and (iii) to extend the effective date of the Form S-1 registration statement until July 1, 2004. The new warrants have an exercise price equal to $1.52 per share and the fair value of these warrants was estimated by using the Black-Scholes Option-Pricing Model and totaled $30,981. This amount was expensed as a component of selling, general and administrative expenses during the three months ended December 31, 2003. Pursuant to the Convertible Debenture agreements, the Company was required to register the shares of common stock underlying the debentures and detachable stock purchase warrants issued in connection with the debentures. The registration of the common shares was required to be effective by July 1, 2004.

On November 8, 2004, the Company executed a letter agreement with the debenture holders, whereby the Company agreed to change the interest rate on the debenture to 9% in exchange for the debenture holders agreeing to (i) execute a subordination agreement with Crestmark Bank, (ii) waive all liquidated damages due under the transaction documents through January 7, 2005, and (iii) withdraw any demand for repayment under the debenture.

According to the anti-dilution adjustment provision, If the Singing Machine sells shares of its common stock at an effective price less than Set Price, the debentures' holders are entitled to convert their debentures into shares at a new conversion price, which equals to the original set price minus 75% of the difference between the Set Price and the new price if the event occurs before September 8, 2004. On July 30, 2004, the Singing Machine received the court approval of the Class Action Lawsuit (case# 03-CV-80596). The Singing Machine issued 400,000 shares to the plaintiff as part of the settlement on September 23, 2004. The market closing price on July 30, 2004 was $0.60 per share. The

event has triggered the conversion price reset for the convertible debentures.

According to the Emerging Issue Task Force (EITF) Issue No. 00-27, if the terms of a contingent conversion option do not permit an issuer to compute the number of shares that the holder would receive if the contingent event occurs and the conversion price is adjusted, an issuer should wait until the contingent event occurs and then compute the resulting number of shares that would be received pursuant to the new conversion price. The incremental intrinsic value that resulted from the price reset equals additional shares multiplied by the stock market price at the issuing date of the debentures, which would be recorded as discount of convertible debentures and amortized over the remaining life of the debentures. The new adjusted conversion price of stock is $1.41 [3.85-(3.85-0.60) X 75%] while the conversion price of warrant is $1.46. As of July 30,2004, the number of shares issuable upon conversion of debenture is 2,831,858. The amount of $687,638 was recorded as additional discounts of the debentures and will be amortized for the remaining life of the debentures. Total amortization for the six months ending September 30, is $743,921 and the unamortized discount is $2,498,263 as of September 30, 2004.

In connection with the Convertible Debentures the Company paid financing fees as follows: 103,896 stock purchase warrants, with a fair value of $268,386, 28,571 shares of common stock with a fair value of $141,141, and cash of $255,000. Total financing fees of $664,527 were recorded as deferred fees and are being amortized over the term of the debentures.

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The unamortized deferred fees are reported in other non-current assets in the accompanying balance sheets and total $378,246 as of September 30, 2004.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

LEGAL MATTERS

From July 2, 2003 through October 2, 2003, seven securities class action lawsuits and a shareholder's derivative action were filed against us and certain of our officers and directors in the United States District Court for the Southern District of Florida on behalf of all persons who purchased our securities during the various class action periods specified in the complaints. On September 18, 2003, United States District Judge William J. Zlock entered an order consolidating the seven (7) purported class action law suits and one (1) purported shareholder derivative action into a single action case styled Frank Bielansky v. the Company, Salberg & Company, P.A., et al - Case Number: 03-80596 - CIV - ZLOCK (the "Class Action"). The complaints that were filed allege violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Rule 10(b)-5. The complaints seek compensatory damages, attorney's fees and injunctive relief.

The Company entered into a settlement agreement with the plaintiffs in the Class Action in March 2004. At a hearing in April 2004, the Court gave preliminary approval for the settlement and directed that notices be sent to shareholders pursuant to the Settlement Agreement. The notices advised shareholders of their rights and responsibilities concerning the settlement. The Court set a hearing on July 30, 2004 before Judge Zlock to consider final approval of the settlement. At the hearing, Judge Zlock signed the order giving final approval to the settlement. The terms of the settlement will be implemented after all final appeals period have expired.

Pursuant to the terms of the settlement agreement, we are required to make a cash payment of $800,000 and Salberg & Company, P.A., our former auditor, is

required to make a payment of $475,000. Our cash payment of $800,000 is covered by our liability insurance and our insurer has placed this payment in an escrow account. In addition, we are obligated to issue 400,000 shares of our common stock to the plaintiffs. The settlement obligates us to implement certain corporate governance changes, including an expansion or our Board of Directors to six members with independent directors comprising at least 2/3 of the total Board seats.

As of March 31, 2004, the Company recorded an expense equal to the total estimated cost of the settlement less the amount expected to be reimbursed by the Company's insurance carrier. The net charge associated with this matter totaled approximately $462,000 and was included as a component of selling, general and administrative expenses for the three months ended March 31, 2004.

The court entered an order approving the settlement agreement on July 30, 2004. The Company has issued the 400,000 shares to the plaintiffs on September 23, 2004. The cost of the 400,000 shares is $240,000 based on the stock closing price on September 23, 2004. The remaining balance of the accrued expense in the amount of $222,000 ($462,000 - $240,000) has been recorded as the reduction of selling, general and administrative expenses for 3 months ending September 30, 2004.

NOTE 7 - STOCKHOLDERS' EQUITY

COMMON STOCK ISSUANCES

During the six months ended September 30, 2004 and 2003, the Company issued the following shares of stock.

Sept 30,	Number of Shares Issued	Proceeds to Company
2004	450,000	None
2003	320,000	$652,800

On May 11, 2004, the Company issued 50,000 shares of common stock to a former executive for consulting services rendered. The Company expensed the consulting costs in the three months ended December, 31, 2003, the period which services were provide.

On September 23, 2004, the Company has issued the 400,000 thousand shares to the plaintiffs on September 23, 2004 for the class action settlement.

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EARNINGS (LOSS) PER SHARE

In accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share," basic earnings per share are computed by dividing the net earnings for the period by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding including the effect of common stock equivalents.

4,002,580 common stock equivalents have been included in the diluted per share calculations in the six months periods ended September 30, 2004 and 2003.

The following represents the antidiluted common stock equivalents for the six

months ended September 30, 2004 and 2003:

o Options to purchase 579,682 and 1,019,400 shares of common stock, respectively, with exercise prices ranging from $0.57 to $9.00 and $1.11 to $9.00, respectively.

o Warrants to purchase 591,040 shares of common stock, respectively, with exercise price at $1.46. There were none used in 2003.

o Convertible debentures convert into 2,831,858 shares of common stock, respectively, with conversion price at $1.41. There were none used in 2003.

NOTE 8 - SEGMENT INFORMATION

The Company operates in one segment and maintains its records accordingly. The majority of sales to customers outside of the United States are made by the Company's Subsidiary in Hong Kong. Sales by geographic region for the quarter ended September 30 were as follows:

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

	FOR THE THREE MONTHS ENDING SEPT 30		FOR THE SIX MONTHS ENDING SEPT 30	
	2004	2003	2004	2003
North America	$ 15,657,623	$ 17,690,952	$ 18,079,845	$ 21,553,954
Europe	2,857,421	14,467,066	4,262,903	17,809,897
Australia	238,245	310,579	238,245	310,579
Others	--	382,979	29,168	805,121
	$ 18,753,289	$ 32,851,576	$ 22,610,161	$ 40,479,551

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

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10- Q, including without limitation, statements containing the words believes, anticipates, estimates, expects, and words of similar import, constitute forward-looking statements. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the Securities and Exchange Commission.

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, and its subsidiary (the "Singing Machine," "we," or "us") are primarily engaged in the design, marketing, and sale of consumer karaoke audio equipment, accessories, and musical recordings. The products are sold directly to distributors and retail customers. Our electronic karaoke machines and audio software products are marketed under The Singing Machine(R) trademark, in addition to MTV, Nickelodeon and Care Bear trademarks.

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

Our karaoke machines and karaoke software are currently sold in such major retail outlets as Best Buy, Circuit City, Costco, Kohl's, J.C. Penney, Radio Shack and Sam's Club.

We had a net income of $721,698 and a net loss of $797,812 for the three months September 30, 2004 respectively. These improvements were partially offset by non-cash charges to income for the amortization of discount on the debenture. The amortization costs related to the debenture was $411,206 in the quarter compared to the amortization costs in the amount of $56,801 in the comparative quarter since the debenture was not finalized until September 16, 2003

QUARTER ENDED SEPTEMBER 30, 2004 COMPARED TO THE QUARTER ENDED SEPTEMBER 30, 2003

NET SALES

Net sales for the quarter ended September 30, 2004 were $18,753,289 compared to net sales of $32,851,576 for the comparative period of 2003. Sales decreased $14,098,287 or 42% from the comparative period. The decrease in sales is a combination of four primary reasons:

1) Management made a decision not to pursue lower margin businesses which tie up cash flow buy not providing enough profit margin. 2) The variety of karaoke machines offered to the trade was scaled back from prior years. This has helped us manage our working capital more effectively with an improved control over inventories and accounts payables to our vendors. 3) Our liquidity concerns discouraged customers from purchasing from us.
4) Our major distributors in Europe ordered less karaoke machines because they had a high level of inventory from last year.

GROSS PROFIT

Gross profit for the quarter ended September 30, 2004 was $4,260,345 or 22% of sales as compared to $5,420,031 or 16% of sales for the quarter ended September 30, 2003. The increase in gross margin percentage compared to the prior year is

due primarily to sales of the new models at higher gross profit margin percents than older models, and also the sales of existing older models that have been written down to the lower of cost or market, in the prior year.

OPERATING EXPENSES

Total operating expenses were $3,103,507 for the quarter ended September 30, 2004, compared to $6,672,569 for the comparative period of 2003. Operating expenses decreased compared to prior period by 53% or $3,569,062. This decrease

of expenses is a result of two primary factors:

o In fiscal 2004 and 2005, one of our primary objectives is to reduce our operating expenses. Total controllable operating expenses decreased 52% from the comparative last year quarter or $2,114,866. Controllable expenses include selling, general and administrative expenses and compensation expense. Selling, general and administrative expense was reduced by $1,050,861 or 53%, to $1,248,535, from $2,669,154. Compensation expense on a comparative basis was reduced by $649,565 or 51% to $694,247 from $1,343,812. In addition legal and professional fees were reduced by$222,000 in the quarter, as a result of an over accrual for expenses relating to the final settlement and issuance of shares relating to the class action law suit.

o In addition, variable selling related expenses -advertising, commissions, freight & handling and royalty, decreased as a percent of sales from 8.0% to 6.4% of sales. In total, variable expenses decreased $1,454,196, from $2,659,603 in the quarter ended September 30, 2003 to $1,205,407 in the quarter ended September 30, 2004.

Management anticipates that the controllable operating expense will continue to be at approximately the same level or lower levels as the quarter ended September 30, 2004 for the balance of the fiscal year.

OTHER INCOME/EXPENSES

Net other expenses were $435,139 for the quarter ended September 30, 2004, compared to other expense of $409,544 for the quarter ended September 30, 2003. The increase over prior year is the result of non-cash amortization of the discount on the convertible debentures totaling $411,206 compared to $56,801 for the comparative period of last year. The Company did not close on the convertible debenture until September 8, 2003, therefore for the comparative period; the amortization on discount of the convertible debentures was $56,801. Interest expense decreased for the quarter ended September 30, 2004 vs. the quarter ended September 30, 2003. For the quarter ended September 30, 2004 interest expense decreased to $129,504 from $262,094. The decrease is a result of reduced borrowings, compared to the prior year. Other income of $105,571 for quarter ending September 30, 2004, is a result of the write off old credit balance due to customers from accounts receivable, which were not deemed to be applicable to customers' current balances.

INCOME TAXES

For the three month ended September 30, 2004, The Company has not recorded a tax provision, since the Company has net operating losses for the six months ending September 30, 2004. The Company has not recorded a benefit for the current period's losses because realizability is unlikely.

SIX MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THE SIX MONTHS ENDED SEPTEMBER 30, 2003

NET SALES

Net sales for the six months ended September 30, 2004 were $22,610,161, compared to net sales of $40,479,551 for the comparative period of 2003. Sales decreased $ 17,869,390 or 44% from the comparative period. . The decrease in sales is a combination of four primary reasons:

1) We loss approximately $2.3 million in sales because we made a decision not to pursue low margin accounts which tied up cash flow by not providing us with

enough profit margin.

2) We loss approximately $1.5 million in sales because we did not meet customers demands to introduce new karaoke models as a result of our inventories being overstocked.

3) We loss approximately $11.3 million in sales from customers that were discouraged from purchasing from us because of our liquidity concerns.

4) We loss approximately $7 million in sales to our distributors in Europe due to high levels of inventories on hand from the prior year.

The decrease in sales from above accounts was partly offset by an increase in sales from other accounts.

GROSS PROFIT

Gross profit for the six months ended September 30, 2004 was $5,030,484 or 22% of sales as compared to $7,146,140 or 17% of sales for the six months ended September 30, 2003. The year to date gross margins of 84% was generated in the second quarter. The increase in gross margin percentage compared to the prior year was due primarily to sales of the newer models at a higher gross profit margin. In addition, the sales of existing older models have been written down to the lower of cost or market in the prior year.

OPERATING EXPENSES

Total operating expenses were $4,957,941 for the six months ended September 30, 2004, compared to $10,532,916 for the comparative period of 2003. Operating expenses decreased compared to prior period by 52% or $5,574,975. This decrease of expenses is a result of two primary factors:

o In fiscal years 2004 and 2005, one of managements primary objectives was to continually reduce our operating expenses. Total controllable operating expenses for six months ending September 30, 2004 decreased 51% from the comparative period last year or $3,788,268. Controllable expenses include selling, general and administrative expenses and compensation expense. Selling, general and administrative expense was reduced by $2,668,657 or 53%, to $2,178,226, from $4,846,883.

The decrease of the selling, general and administration expenses of $2,226,657 were due to:

o decrease of $121,000 of accounting fees, which is related to the improvement of our accounting department;

o decrease of $290,000 of consulting fees, which is related to a cut down in consulting related to our borrowing agreement with our previous lender;

o decrease of $165,000 of contribution expenses.

o decrease of $508,000 of legal expense, which is related to the reversal of over accrued legal expense for the year ended March 31, 2004 for the class action settlement in the amount of approximate $250,000 and reduction of the legal expenses.

o decrease of $345,000 of the rental expenses, which is related to the early termination of our warehouse facility in Rancho Dominguez, CA and subleasing our existing facilities;

o decrease of $360,000 of repair fee, which is result of we set up our QC facility in our Campton, CA warehouse, and we only send the defective product to

factory for repair;

o decease of $165,000 loan amortization cost, which is related to the termination of borrowing agreement with our previous lender.

Compensation expense on a comparative basis was reduced by $1,119,611 or 45% to $1,335,780 from $2,455,391. The decrease of the compensation expenses is the result of the corporate down size. We had 43 employees at the September 30, 2003 compared to 28 employees as at September 30, 2004.

In addition, variable selling related expenses, advertising, commissions, freight & handling and royalty, decreased as a percent of sales from 7.9% to 6.3% of sales. In total, variable expenses decreased $1,796,707, from $3,230,642 in the six months ended September 30, 2003 to $1,433,935 in the quarter ended September 30, 2004.

OTHER INCOME/EXPENSES

Net other expenses were $870,354 for the six months ended September 30, 2004, compared to other expense of $590,343 for the six months ended September 30, 2003. The increase over prior year is the result of amortization of the discount on the convertible debentures totaling $743,921 compared to $56,801 for the comparative period of last year. Singing Machine did not close on the convertible debenture until September 8, 2003. Interest expense decreased for the six months ended September 30, 2004 vs. the six months ended September 30, 2003. For the six months ended September 30, 2004 interest expense decreased to $243,704 from $450,562. The decrease is a result of reduced borrowings, compared to the prior year.

INCOME TAXES

Singing Machine has not recorded a benefit for the current period's losses because its realizability is unlikely.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2004, Singing Machine had cash on hand of $928,096 in addition to $1,544,302 of restricted cash and no bank overdrafts, for a total of $2,472,398 compared to cash on hand of $356,342 and restricted cash of $874,283 and a bank overdraft of $62,282 at March 31, 2004, for a net balance of $1,168,343. From March 31,2004 to September 30, 2004 the cash balances increased $1,304,055. Our current liabilities decreased to $14,148,459 from $15,200,581 as of March 31, 2004. We had net working capital of $35,702 as of September 30, 2004 and a net working capital of $(1,382,939) as of March 31, 2004.

Cash flows provided by operating activities were $1,404,583 for the six months ended September 30, 2004. Cash provided by operating activities primarily related to a decrease in inventory, increase in accounts payable and receipt of the tax refund in the amount of $1.1 million. This compares to a negative cash flow from operations of $4,380,280 for the comparative six month period of fiscal 2004 a improvement of $5,784,863. The significant changes were a result of managements focus and control of working capital items, specifically inventory and accounts receivable.

o Our main focus this year is to sell through the old inventory carried over from previous years. We have developed less new model this years so we could sell out the old items. As a result of this focus, the inventory was decreased by $2.5 million.

o Our accounts receivable increased by $3.7 million due to the seasonal operation. We started our delivery to our customers in second quarter of the year. Our accounts receivable will increase in the second quarter of the year

and decrease by the end of the third quarter.

o Our accounts payable increased by $2.5 million due to the seasonal operation. We are not current with our primary vendor in China, in the amount of $1.6 million at September 30, 2004. We have paid down approximately $700,000 that is past due to the China vendor in the quarter ending September 30, 2004. We have verbally agreed to a payment plan that will continue through March 2005 without paying interest and penalty for the past due amounts.

o Accrued expenses decreased as a result of the class action settlement in the amount of $1.1 million, of which $800,000 was paid by our insurance company and $240,000 was settle by 400,000 shares of common stock. We also paid approximate $200,000 for the music royalties.

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Cash used in investing activities for the six months ended September 30, 2004 was $1,245,515. Cash used in investing activities resulted from the purchase of fixed assets in the amount of $575,495, which consists of the tooling and molds required for production of new machines for this fiscal year, and the increase of fixed deposit in the bank, which is used as collateral for the additional credit facility.

o We have received a federal tax refund in the amount of $1,122,093 in the quarter ending September 30, 2004. The funds were used to pay down loans from related party in the amount of $240,000, make a fixed deposit in HSBC in the amount of $400,000, to obtain additional credit facility of $1.2 million to finance purchases of new Karaoke machines and pay down old accounts payable balances of approximately $400,000 to Singing Machine's Chinese vendor.

Cash flows provided by financing activities were $412,686 for the six months ended September 30, 2004. This cash inflow was primarily advances from Crestmark Bank pursuant to the new factoring financial institution.

As of September 30, 2004, we have been advanced $474,968 by Crestmark bank. The Company could borrow up to the lesser of the $2.5 million or 70% of the eligible accounts receivable. We only factor the sales originated from the warehouses in the United State to the customer within United State. The factor company determines the eligible receivable based on their own credit standard, and the accounts' aging. As of September 30, 2004, the funds available to borrow from Crestmark bank are approximately $35,000.

o Our Hong Kong subsidiary, International SMC, has credit facilities at HSBC and Fortis Bank. The primary purpose of these facilities is to provide International SMC with access to letters of credit so that it can purchase inventory for direct shipment of goods into the United States and international markets. These facilities are secured by a corporate guarantee from the U.S. parent company and restricted cash on deposit with the lender. The maximum credit under the facilities is $2.0 million. International SMC has increased the fixed deposit in the amount of $640,000 with HSBC. The fixed deposit was used as collateral for additional credit facility of $1.9 million. International SMC has utilized the additional facility to open the letter of credit to the factories for the new shipment. The balance at September 30, 2004 and March 31, 2004 was $0 and $62,282, respectively. The interest rate is approximately 4% per annum. As of September 30, 2004 there was no availability under these facilities. If we need to use the facilities, we would use the available cash to retire the letter of credit or to increase our fixed deposit as collateral to increase our facilities.

o On July 14, 2004, a director, Jay Bauer, advanced us a short-term loan of

$200,000, to be used to meet working capital obligations. The loan bears interest at 8.75% per annum and has been repaid on August 26, 2004.

On November 8, 2004, Singing Machine executed a letter agreement with the debenture holders, whereby Singing Machine agreed to change the interest rate on the debenture to 9% in exchange for the debenture holders agreeing to (i) execute a subordination agreement with Crestmark Bank, (ii) waive all liquidated damages due under the transaction documents through January 7, 2005, and (iii) withdraw any demand for repayment under the debenture.

As of September 30, 2004, our available or unrestricted cash on hand has increased by $571,754 to $928,096 from $356,342. Our average monthly fixed operating costs are approximately $600,000, which includes the compensation and the selling, general & administration expenses. We expect that we will need approximately $1.8 million for working capital during the next three-month period. Our primary expenses are normal operating costs including salaries, lease payments for our warehouse space in Compton, California and other operating costs.

During the three-month period between October and December 2004, we plan on financing our working capital needs from

o Borrowing from our factoring agreement;

o Sales of existing inventory;

o Continued support from factories in China in financing our purchases of karaoke machines for fiscal 2005; and

o Utilizing credit facilities that are available to International SMC to finance all direct shipments.

Our sources of cash for working capital in the long term, 12 months and beyond, are the same as our sources during the short term. If we need additional financing, we intend to approach other financing companies for financing. If we need to obtain additional financing and fail to do so, it may have a material adverse effect on our ability to meet our financial obligations and to continue our operations.

During fiscal 2005, we will strive to keep our operating costs at a minimum. In order to reduce the need to maintain inventory in our warehouses in California and Florida, we intend to generate a larger share of our total sales through sales directly from International SMC. Sales originating from International SMC are shipped directly to our customers from the ports in China and are primarily backed by customer letters of credit. Our customers take title to the merchandise at their consolidators in China and are responsible for their shipment, duty, clearance and freight charges to their locations. We will also assist our customers in the forecasting and management of their inventories of our product to reduce the amount of required warehouse inventory.

We are also planning to finance a significant amount of our working capital needs with customer-issued letters of credit, using International SMC's credit facility with the Hong Kong Bank and relying on financing from one of our factories in China.

Customer orders can be cancelled at any time prior to delivery and we cannot assure you that our customers will complete these purchases. In the event that we do not sell sufficient products in our second and third quarter, we will

consider other sources of financing, such as trying to secure an additional credit facility, private offerings and/or a venture capital investment. We expect that our profit margin for sales of our karaoke products will continue to be under price pressure. During fiscal 2005, we plan on introducing three new karaoke machines, which will command higher prices and a higher profit margin. We also will continue to cut operating expenses.

Our commitments for debt and other contractual arrangements are summarized as follows:

		Years ending March 31,			
	Total	2005	2006	2007	2008
Merchandise License Guarantee	$ 525,000	$ 375,000	$ 150,000	$ --	$ -
Property Leases	$2,285,847	$ 838,792	$ 579,851	$ 495,545	$ 371,65
Equipment Leases	$ 71,746	$ 31,197	$ 19,502	$ 13,044	$ 6,31
Subordinated Debt - Related Party	$1,000,000	$ --	$1,000,000	$ --	$ -
Convertible Debentures	$4,000,000	$ --	$4,000,000	$ --	$ -
Interest payments	$ 896,667	$ 441,667	$ 455,000	$ --	$ -

Each of the contractual agreements (except the equipment leases) provides that all amounts due under that agreement can be accelerated if we default under the terms of the agreement. For example, if we fail to make a minimum guaranteed royalty payment that is required under a Merchandise License Agreement on a timely basis, the licensor can declare us in default and require that all amounts due under the Merchandise License Agreement are immediately due and payable.

Merchandise license guarantee reflects amounts that we are obligated to pay as guaranteed royalties under our various license agreements. In fiscal 2005, we have guaranteed minimum royalty payments under our license agreements with Care Bears, MTV, Nickelodeon and Motown (Universal Music).

Property leases represents leases for office and warehouse space in California, Florida and Hong Kong. Equipment leases represent leases for forklifts and copy machines.

On September 8, 2003, we issued an aggregate of $4,000,000 of 8% convertible debentures in a private offering to six accredited investors. The debentures initially are convertible into 1,038,962 shares of our common stock at $3.85 per share, subject to adjustment in certain situations. The conversion price has been reset to $1.41 on July 30, 2004 pursuant to the antidilutions provisions and the debentures are now convertible into 2,836,879 shares of common stock. It may have significant impact on Singing Machine's results of operaton. We also issued an aggregate of 457,143 warrants to the investors. The initial exercise price of the warrants is $4.025 per share and the warrants expire on September 7, 2006. The exercise price has been adjusted to $1.46 on July 30, 2004 based on the antidilution adjustment. We have an obligation to register the shares of common stock underlying the debentures and warrants.

On February 9, 2004 we amended our convertible debenture agreements to increase the interest rate to 8.5% and to grant warrants to purchase an aggregate of 30,000 shares of our common stock to the debenture holders on a pro-rata basis. These concessions are in consideration of the debenture holder's agreements to (i) enter into new subordination agreements with Milberg, (ii) to waive all liquidated damages due under the transaction documents through July 1, 2004 and (iii) to extend the effective date of the Form S-1 registration statement until

July 1, 2004. The new warrants have an exercise price equal to $1.52 per share and the fair value of these warrants was estimated by using the Black-Scholes Option-Pricing Model and totaled $30,981. This amount was expensed as a component of selling, general and administrative expenses. Pursuant to the convertible debenture agreements, we were required to register the shares of common stock underlying the debentures and detachable stock purchase warrants issued in connection with the debentures. The registration of the common shares was required to be effective by July 1, 2004.

Because we did not have the registration statement declared effective by July 14, 2004, we are in technical default of the convertible debenture agreements. As such, we are accruing liquidated damages in the amount of $80,000 per month. Additionally, the convertible debenture holders could declare us in default of the convertible debentures and accelerate all payments due under the convertible debentures, which is the principal amount of $4 million plus any liquidated damages and other fees that are assessed. We are working to cure our event of default by filing the registration statement as soon as possible. Additionally, we are trying to enter into another amendment of the convertible debentures and transaction documents with the convertible debenture holders which would extend the filing date for the registration statement and eliminate all liquidated damages. There can be no assurances that we will be able to enter into an amendment of the convertible debenture agreements.

GOING CONCERN

We have taken the following steps to improve our operation, which believe will overcome the going concern qualification:

1) Reduce our operating expense and return the operation to profitability.

Management's highest priority is to return Singing Machine to profitability for a full year of operations. In order to accomplish this, management is continually examining how we do business and the related costs necessary to run the business. We are currently reviewing warehousing costs and the opportunities for subleasing excess space in Compton California. We are also looking at reducing the amount of leased office space for our administrative personnel. We have also under taken an evaluation of the costs we incur for quality inspection, repacking and minor repair of products, returned from our customers.

We have shown a profit improvement in the first two quarters of the year. We had income from operation of $1.15 million and $0.07 million for the three months and six months ended September 30, 2004, respectively.

2) We are managing our cash flow effectively to meet the current and long- term liabilities.

We have substantially reduced our current liabilities to both our vendors in China and also our customers. As stated in our fiscal year ending March 31, 2004, we owed our major suppliers in China $2.4 million. Currently this liability has been reduced to approximately $800 thousand. At April 1, 2004 we owed our customers over $2.1 million for returned products. We have reduced this liability to approximately $500 thousand at October 31, 2004. This reduction in liabilities has gained the confidence from our suppliers and the customers and will allow us to expand our sales base for the year ended 2006 with sales to customers that would not purchase from us, until such liabilities were paid off. Specifically, liabilities were eliminated with Sears and Target. Together these two customers accounted for almost $900 thousand of liabilities at the beginning of the year. Base on the current cash management forecast, we should be able to

meet our liabilities for the next twelve months.

3) In August, 2004, we have reached agreement with Crestmark Bank to factor our accounts receivable.

Cresmark Bank will advance a maximum of $2.5 million against our accounts receivables, for working capital purposes. We will seek additional financing as needed.

To conclude the above discussion, we have taken necessary steps to return the operation to profitability, and should be able to meet our liabilities for the next twelve months. We expect to remove the going concern explanatory paragraph from our auditor report for the fiscal year ending 2005.

INVENTORY SELL THROUGH

We monitor the inventory levels and sell through activity of our major customers to properly accrue our sales return and maintain the appropriate level of inventory. As of December 17, 2004, we are not aware of any major customer that has a problem to sell through our inventory.

SEASONAL AND QUARTERLY RESULTS

Historically, our operations have been seasonal, with the highest net sales occurring in our fiscal second and third quarters (reflecting increased orders for equipment and music merchandise during the Christmas selling months) and to a lesser extent the first and fourth quarters of the fiscal year. Sales in our fiscal second and third quarter, combined, accounted for approximately 86% of net sales in fiscal 2004 and 2003, and 81% of net sales in fiscal 2002.

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 Singing Machine's operations. Singing Machine has historically passed any price increases on to its customers since prices charged by Singing Machine are generally not fixed by long- term contracts.

CRITICAL ACCOUNTING POLICIES

We prepared our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. As such, management is required to make certain estimates, judgments and assumptions that it believes are reasonable based on the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the periods presented. The significant accounting policies which management believes are the most critical to aid in fully understanding and

evaluating our reported financial results included accounts receivable - allowance for doubtful accounts, reserves on inventory, deferred tax assets and our Hong Kong income tax exemption.

Collectibility Of Accounts Receivable. The Singing Machine's allowance for doubtful accounts is based on management's estimates of the creditworthiness of

its customers, current economic conditions and historical information, and, in the opinion of management, is believed to be an amount sufficient to respond to normal business conditions. Management sets 100% reserves for customers in bankruptcy and other reserves based upon historical collection experience. Should business conditions deteriorate or any major customer default on its obligations to Singing Machine, this allowance may need to be significantly increased, which would have a negative impact on operations.

Inventory. The Singing Machine reduces inventory on hand to its net realizable value based on the expected 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 Singing Machine'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. At December 31, 2003 and March 31, 2004, we concluded that a valuation allowance was needed against all of our deferred tax assets, as it was not more likely than not that the deferred taxes would be realized. At March 31, 2004 and 2003, we had gross deferred tax assets of $8.2 million and $1.9 million, against which we recorded valuation allowances totaling $8.2 million and $0, respectively.

For the fiscal year ended March 31, 2004, we recorded a tax provision of $758,505. This occurred because the valuation allowance established against our deferred tax assets exceeded the amount of the benefit created from carrying back a portion of the current year's losses. The carry-back of the losses from the current year resulted in an income tax receivable of $1.1 million, which is included in refundable tax in the accompanying balance sheets. We have received the tax fund of $1.1 million on August 24, 2004, which has been used to pay the related parties' loan and the vendors. we have now exhausted our ability to carry back any further losses and therefore will only be able to recognize tax benefits to the extent that it has future taxable income.

Our subsidiary has applied for an exemption of income tax in Hong Kong. Therefore, no taxes have been expensed or provided for at the subsidiary level. Although no decision has been reached by the governing body, the parent company has reached the decision to provide for the possibility that the exemption could be denied and accordingly has recorded a provision for Hong Kong taxes in fiscal 2003 and 2002. There was no provision for Hong Kong income taxes in fiscal 2004 due to the subsidiary's net operating loss for the year. Hong Kong income taxes payable totaled $2.4 million at March 31, 2004 and 2003 and is included in the accompanying balance sheets as income taxes payable.

We effectively repatriated approximately $2.0 million, $5.6 million and $5.7 from its foreign operations in 2004, 2003 and 2002, respectively. Accordingly, these earnings were taxed as a deemed dividend based on U.S. statutory rates. We have no remaining undistributed earnings of Singing Machine's foreign subsidiary.

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 income taxes have been made.

Other Estimates. We makes 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.

FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF STOCK

RISKS ASSOCIATED WITH OUR BUSINESS

WE MAY BE DEEMED TO INSOLVENT AND WE MAY GO OUT OF BUSINESS

As of September 30, 2004, our cash position is limited. We are not able to pay all of our creditors on a timely basis. We are past due on approximately 24% of our accounts payable, which total $1.7 million as of September 30, 2004. If we are not able to pay our current debts as they become due, we may be deemed to be insolvent. We may be required to file a petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code or enter into some other form of liquidation or reorganization proceedings.

OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTANTING FIRM RAISED SUBSTANTIAL DOUBT ABOUT OUR ABILITY TO CONTINUE AS A GOING CONCERN AS OF MARCH 31, 2004 AND 2003

We received a report dated June 16, 2004 (except for the last paragraph of note 7 as to which the date is July 14, 2004) from our independent registered public accounting firm covering the consolidated financial statements for our fiscal year ended March 31, 2004 that included an explanatory paragraph which stated that the financial statements were prepared assuming the Singing Machine would continue as a going concern. This report stated that our operating performance in fiscal 2004 and our minimal liquidity raised substantial doubt about our ability to continue as a going concern. If we are not able to raise additional capital, we may need to curtail or stop our business operations. We may be required to file a petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code or enter into some other form of liquidation or reorganization proceedings.

WE HAVE JUST RECENTLY IMPLEMENTED A NUMBER OF PROCEDURES TO CORRECNT A NUMBER OF DEFICIENCIES WHICH CONSTITUTE MATERIAL WEAKNESSES IN OUR INTERNAL CONTROLS AND PROCEDURES IN WHICH WERE IDENTIFIED IN THE AUDIT OF OUR CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL 2004

The identified deficiencies in our internal controls were related to:

o weaknesses in our financial reporting processes as a result of a lack of adequate staffing in the accounting department,

o accounting for consigned inventory and inventor costing.

We have implemented a number of procedures to correct these weaknesses in our internal controls. Specifically, the Registrant has expanded its personnel responsible for certain financial reporting by retaining a Chief Financial Officer, a Principal Accounting Officer and added a member to the accounting staff. The Registrant has also developed a monthly procedure for reconciling the accounting for consigned inventory and inventory costing. However, no assurances can be given that we will be able to successfully implement our revised internal controls and procedures or that our revised controls and procedures will be effective in remedying all of the identified material weaknesses in our controls and procedures. If we are unable to implement these changes effectively or efficiently there could be a material adverse effect on our operations or financial results.

A SMALL NUMBER OF OUR CUSTOMERS ACCOUNT FOR A SUBSTANTIAL PORTION OF OUR REVENUES, AND THE LOSS OF ONE OR MORE OF THESE KEY CUSTOMERS COULD SIGNIFICANTLY REDUCE OUR REVENUES AND CASH FLOW

We rely on a few large customers to provide a substantial portion of our revenues. As a percentage of total revenues, our net sales to our five largest customers during the fiscal period ended March 31, 2004, 2003 and 2002 were approximately 53%, 67% and 87%, respectively. In fiscal 2004, three customers accounted for 20%, 12% and 8% of our net sales. The customers are Arbiter, Giochi and Best Buy, respectively. We do not have long-term contractual arrangements with any of our customers and they can cancel their orders at any time prior to delivery. A substantial reduction in or termination of orders from any of our largest customers would decrease our revenues and cash flow.

WE ARE RELYING ON SIX FACTORIES TO MANUFACTURE AND PRODUCE THE MAJORITY OF OUR KARAOKE MACHINES FOR FISCAL 2005, AND IF THE RELATIONSHIP WITH THESE FACTORIES IS DAMAGED OR INJURED IN ANY WAY, IT WOULD REDUCES OUR REVENUES AND PROFITABILITY

We have worked out a verbal agreement with six factories in China to produce approximately 95% of our karaoke machines in fiscal 2005. We owe one of these factories approximately $1.7 million as of November 10, 2004 and have worked out a payment plan with it. See the "Liquidity" Section. If the factory is unwilling or unable to deliver our karaoke machines to us, our business will be adversely affected. Because our cash on hand is minimal, we are relying on revenues received from the sale of our ordered karaoke machines to provide cash flow for our operations. If we do not receive cash from these sales, we may not be able to continue our business operations.

WE ARE SUBJECT TO THE RISK THAT SOME OF OUR LARGE CUSTOMERS MAY RETURN KARAOKE PRODUCTS THAT THEY HAVE PURCHASED FROM US AND IF THIS HAPPENS, IT WOULD REDUCE OUR REVENUES AND PROFITABILITY

In fiscal 2004 and 2003, a number of our customers and distributors returned karaoke products that they purchased from us. Our total returns represented 9.4% and 10.4% of our net sales in fiscal 2004 and fiscal 2003, respectively. In the fourth quarter of fiscal 2004, our customers returned goods valued at $1.8 million, or 2.5% of our net sales.

Because we are dependent upon a few large customers, we are subject to the risk that any of these customers may elect to return unsold karaoke products to us in the future. If any of our customers were to return karaoke products to us, it would reduce our revenues and profitability.

WE ARE SUBJECT TO PRESSURE FROM OUR CUSTOMERS RELATING TO PRICE REDUCTION AND FINANCIAL INCENTIVES AND IF WE ARE PRESSURED TO MAKE THESE CONCESSIONS TO OUR CUSTOMERS, IT WILL REDUCE OUR REVENUES AND PROFITABILITY

Because there is intense competition in the karaoke industry, we are subject to pricing pressure from our customers. Many of our customers have demanded that we lower our prices or they will buy our competitor's products. If we do not meet our customer's demands for lower prices, we will experience lower sales volume. In our fiscal year ended March 31, 2004, our sales to customers in the United States decreased because of increased price competition. During fiscal 2004, we sold 20.2% of our karaoke machines at prices that were equal to or below cost. We will not be able to stay in business if we continue to sell our karaoke machines at prices that are at or below cost. We are also subject to pressure

from our customers regarding certain financial incentives, such as return credits or large advertising or cooperative advertising allowances, which effectively reduce our selling prices. In fiscal 2004, we gave our customers $2.1 million of credits on these accounts because the sell-through of our products was not as strong as we had expected. We also provided our customers with advertising allowances in the amount of $2.3 million during fiscal 2004 and $4.1 million during fiscal 2003. We have historically offered advertising allowances to our customers because it is standard practice in the retail industry.

WE EXPERIENCE DIFFICULTY FORECASTING THE DEMAND FOR OUR KARAOKE PRODUCTS AND IF WE DO NOT ACCURATELY FORECAST DEMAND, OUR REVENUES, NET INCOME AND CASH FLOW MAY BE AFFECTED

Because of our reliance on manufacturers in Asia for our machine production, our production lead times range from one to four months. Therefore, we must commit to production in advance of customers orders. It is difficult to forecast customer demand because we do not have any scientific or quantitative method to predict this demand. Our forecasting is based on management's general expectations about customer demand, the general strength of the retail market and management's historical experiences. We overestimated demand for our products in fiscal 2003 and had $25.2 million in inventory as of March 31, 2003. Because of this excess inventory, we had liquidity problems in fiscal 2004 and our revenues, net income and cash flow were adversely affected. We had a net loss of $22.7 million in fiscal 2004, which limited our cash flow.

WE ARE SUBJECT TO THE COSTS AND RISKS OF CARRYING INVENTORY FOR OUR CUSTOMERS AND IF WE HAVE TOO MUCH INVENTORY, IT WILL AFFECT OUR REVENUES AND NET INCOME

Many of our customers place orders with us several months prior to the holiday season, but they schedule delivery two or three weeks before the holiday season begins. As such, we are subject to the risks and costs of carrying inventory during the time period between the placement or the order and the delivery date, which reduces our cash flow. As of March 31, 2003, we had $25.2 million in inventory on hand, which impacted our cash flow and liquidity from operations in fiscal 2004. As of June 30, 2004, our inventory was valued at $4.8 million. It is important that we sell this inventory during fiscal 2005, so we have sufficient cash flow for operations.

OUR SENIOR CORPORATE MANAGEMENT TEAM IS NEW TO THE SINGING MACHINE AND IS REQUIRED TO DEVOTE SIGNIFICANT ATTENTION TO OUR FINANCING AGREEMENTS AND SETTLING OUR CLASS ACTION LAWSUITS

Beginning on May 2, 2003, through the present date, four of our executive officers have resigned. We hired a new Chief Operating Officer, Yi Ping Chan on April 1, 2003, and a new Chief Financial Officer, Jeff Barocas, on April 9, 2004. Four new directors have joined our Board since October 31, 2004 and two of them had resigned since that date. Bernard Appel joined our Board effective as of October 31, 2003 and Harvey Judkowitz joined on March 29, 2004. Richard Ekstract joined our Board on October 31, 2003 and resigned for personal reasons on June 2, 2004. Joseph Testa joined our board on September 8, 2004 and resigned on October 22, 2004. We are in the process of searching for a new Chief Executive Officer and new directors. It will take some time for our new management and our new board of directors to learn about our business and to develop strong working relationships with each other and our employees. Our new senior corporate management's ability to complete this process has been and continues to be hindered by the time that it needs to devote to other pressing business matters. New management needs to spend significant time on overseeing our liquidity situation and overseeing legal matters . We cannot assure you that this major restructuring of our board of directors and senior management and the accompanying distractions, in this environment, will not adversely affect our results of operations.

OUR LICENSING AGREEMENT WITH MTV NETWORKS IS IMPORTANT TO OUR BUSINESS AND IF WE WERE TO LOSE OUT MTV LICENSE IT COULD AFFECT OUR REVENUES AND PROFITABILITY

Our license with MTV Networks is important to our business. We generated 11.8% and 32.3% of our consolidated net sales from products sold under the MTV license in fiscal 2004 and 2003, respectively. Our MTV license was extended through December 31, 2004. If we were to lose our MTV license, it would have an adverse effect on our revenues and net income.

OUR BUSINESS IS SEASONAL AND THEREFORE OUR ANNUAL OPERATING RESULTS WILL DEPEND, IN LARGE PART, ON OUR SALES DURING THE RELATIVELY BRIEF HOLIDAY SEASON

Sales of consumer electronics and toy products in the retail channel are highly seasonal, with a majority of retail sales occurring during the period from September through December in anticipation of the holiday season, which includes Christmas. A substantial amount of our sales occur during the second quarter ended September 30 and the third quarter ended December 31. Sales in our second and third quarter, combined, accounted for approximately 86% of net sales in fiscal 2004 and 2003 and 81% of net sales in fiscal 2002.

IF WE ARE UNABLE TO COMPETE IN THE KARAOKE PRODUCTS CATEGORY, OUR REVENUES AND NET PROFITABILITY WILL BE REDUCED

Our major competitors for karaoke machines and related products are Craig and Memorex. We believe that competition for karaoke machines is based primarily on price, product features, reputation, delivery times, and customer support. Our primary competitors for producing karaoke music are Compass, Pocket Songs, Sybersound, UAV and Sound Choice. We believe that competition for karaoke music is based primarily on popularity of song titles, price, reputation, and delivery times. To the extent that we lower prices to attempt to enhance or retain market share, we may adversely impact our operating margins. Conversely, if we opt not to match competitor's price reductions we may lose market share, resulting in decreased volume and revenue. To the extent our leading competitors reduce prices on their karaoke machines and music, we must remain flexible to reduce our prices. If we are forced to reduce our prices, it will result in lower margins and reduced profitability. Because of intense competition in the karaoke industry in the United States during fiscal 2004, we expect that the intense pricing pressure in the low end of the market will continue in the karaoke market in the United States in fiscal 2005. In addition, we must compete with all the other existing forms of entertainment including, but not limited to: motion pictures, video arcade games, home video games, theme parks, nightclubs, television and prerecorded tapes, CD's and video cassettes.

IF WE ARE UNABLE TO DEVELOP NEW KARAOKE PRODUCTS, OUR REVENUES MAY NOT CONTINUE TO GROW

The karaoke industry is characterized by rapid technological change, frequent new product introductions and enhancements and ongoing customer demands for greater performance. In addition, the average selling price of any karaoke machine has historically decreased over its life, and we expect that trend to continue. As a result, our products may not be competitive if we fail to introduce new products or product enhancements that meet evolving customer demands. The development of new products is complex, and we may not be able to complete development in a timely manner, or at all. To introduce products on a timely basis, we must:

o accurately define and design new products to meet market needs;

- design features that continue to differentiate our products from those of our competitors;
- transition our products to new manufacturing process technologies;
- identify emerging technological trends in our target markets;
- anticipate changes in end-user preferences wit respect to our customers' products;
- bring products to market on a timely basis at competitive prices; and
- respond effectively to technological changes or product announcements by others.

We believe that we will need to continue to enhance our karaoke machines and develop new machines to keep pace with competitive and technological developments and to achieve market acceptance for our products.

OUR PRODUCTS ARE SHIPPED FROM CHINA AND ANY DISRUPTION OF SHIPPING COULD PREVENT OR DELAY OUR CUSTOMERS' RECEIPT OF INVENTORY

We rely principally on four contract ocean carriers to ship virtually all of the products that we import to our warehouse facility in Compton, California. Retailers that take delivery of our products in China rely on a variety of carriers to import those products. Any disruptions in shipping, whether in California or China, caused by labor strikes, other labor disputes, terrorism, and international incidents or otherwise prevent or delay our customers' receipt of inventory. If our customers do not receive their inventory on a timely basis, they may cancel their orders or return products to us. Consequently, our revenues and net income would be reduced.

THE FACTORIES THAT MANUFACTURE OUR KARAOKE PRODUCTS ARE LOCATED IN THE PEOPLE'S REPUBLIC OF CHINA, SUBJECTING US TO RISKS COMMON IN INTERNATIONAL OPERATIONS. IF THERE IS ANY PROBLEM WITH THE MANUFACTURING PROCESS, OUR REVENUES AND NET PROFITABILITY MAY BE REDUCED.

We are dependent upon six factories in the People's Republic of China to manufacture the majority of our karaoke machines. One of these factories will be producing approximately 68% of our karaoke products in fiscal 2005. Our arrangements with these factories are subject to the risks of doing business abroad, such as import duties, trade restrictions, work stoppages, and foreign currency fluctuations, limitations on the repatriation of earnings and political instability, which could have an adverse impact on our business. Furthermore, we have limited control over the manufacturing processes themselves. As a result, any difficulties encountered by our third-party manufacturers that result in product defects, production delays, cost overruns or the inability to fulfill orders on a timely basis could adversely affect our revenues, profitability and cash flow. Also, since we do not have written agreements with any of these factories, we are subject to additional uncertainty if the factories do not deliver products to us on a timely basis.

WE DEPEND ON THIRD PARTY SUPPLIERS FOR PARTS FOR OUR KARAOKE MACHINES AND RELATED PRODUCTS, AND IF WE CANNOT OBTAIN SUPPLIES AS NEEDED, OUR OPERATIONS WILL BE SEVERELY DAMAGED

Our growth and ability to meet customer demand depends in part on our capability

to obtain timely deliveries of karaoke machines and our electronic products. We rely on third party suppliers to produce the parts and materials that our factories use to produce our karaoke products. If our suppliers are unable to provide our factories with the parts and supplies, the factories will be unable to produce our products. We cannot guarantee that we will be able to purchase the parts we need at reasonable prices or in a timely fashion. In the last several years, there have been shortages of certain chips that are used in our karaoke machines. If we are unable to anticipate any shortages of parts and materials in the future, the factories may experience severe production problems, which would impact our sales.

CONSUMER DISCRETIONARY SPENDING MAY AFFECT KARAOKE PURCHASES AND IS AFFECTED BY VARIOUS ECONOMIC CONDITIONS AND CHANGES

Our business and financial performance may be damaged more than most companies by adverse financial conditions affecting our business or by a general weakening of the economy. Purchases of karaoke machines and music are considered discretionary for consumers. Our success will therefore be influenced by a number of economic factors affecting discretionary and consumer spending, such as employment levels, business, interest rates, and taxation rates, all of which are not under our control. Additionally, other extraordinary events such as terrorist attacks or military engagements, which adversely affect the retail environment may restrict consumer spending and thereby adversely affect our sales growth and profitability.

WE MAY HAVE INFRINGED THE COPYRIGHTS OF CERTAIN MUSIC PUBLISHERS AND IF WE VIOLATE FEDERAL COPYRIGHT LAWS, WE WILL BE SUBJECT TO MONETARY PENALTIES

Over the past several years, we have received notices from several music publishers who have alleged that we did not have the proper copyright licenses to sell certain songs included in our compact discs with graphics discs ("CDG"s). CDG's are compact discs which contain the musical recordings of the karaoke songs and graphics which contain the lyrics of the songs. We have settled or are in the process of settling all of these copyright infringement issues with these publishers. We have spent approximately $70,000 to settle these copyright infringement suits in fiscal year 2003 and 2004. These copyright infringement claims may have a negative effect on our ability to sell our music products to our customers. If we do not have the proper copyright licenses for any other songs that are included in our CDG's and cassettes, we will be subject to additional liability under the federal copyright laws, which could include settlements with the music publishers and payment of monetary damages.

WE MAY BE SUBJECT TO CLAIMS FROM THIRD PARTIES FOR UNAUTHORIZED USE OF THEIR PROPRIETARY TECHNOLOGY, COPYRIGHTS OR TRADE SECRETS AND ANY CLAIMS ASSERTED AGAINST US COULD AFFECT OUR NET PROFITABILITY

We believe that we independently developed the technology used in our electronic and audio software products and that it does not infringe on the proprietary rights, copyrights or trade secrets of others. However, we cannot assure you that we have not infringed on the proprietary rights of third parties or those third parties will not make infringement violation claims against us. During fiscal 2000, Tanashin Denki, Ltd., a Japanese company that holds a patent on a cassette tape drive mechanism alleged that some of our karaoke machines violated their patents. We settled the matters with Tanashin in December 1999. Subsequently in December 2002, Tanashin again alleged that some of our karaoke machines violated their patents. We entered into another settlement agreement with them in May 2003. In addition to Tanashin, we could receive infringement claims from other third parties. Any infringement claims may have a negative

effect on our profitability and financial condition.

WE ARE EXPOSED TO THE CREDIT RISK OF OUR CUSTOMERS, WHO ARE EXPERIENCING FINANCIAL DIFFICULTIES, AND IF THESE CUSTOMERS ARE UNABLE TO PAY US, OUR REVENUES AND PROFITABILITY WILL BE REDUCED

We sell products to retailers, including department stores, lifestyle merchants, direct mail retailers, which are catalogs and showrooms, national chains, specialty stores, and warehouse clubs. Some of these retailers, such as K-Mart, FAO Schwarz and KB Toys, have engaged in leveraged buyouts or transactions in which they incurred a significant amount of debt, and operated under the protection of bankruptcy laws. As of September 27, 2004, we are aware of only two customers, FAO Schwarz and KB Toys, which are operating under the protection of bankruptcy laws. Deterioration in the financial condition of our customers could result in bad debt expense to us and have a material adverse effect on our revenues and future profitability.

A DISRUPTION IN THE OPERATION OF OUR WAREHOUSE CENTERS IN CALIFORNIA OR FLORIDA COULD IMPACT OUR ABILITY TO DELIVER MERCHANDISE TO OUR STORES, WHICH COULD ADVERSELY AFFECT OUR REVENUES AND PROFITABILITY

A significant amount of our merchandise is shipped to our customers from one of our two warehouses, which are located in Compton, California, and Coconut Creek, Florida. Events such as fire or other catastrophic events, any malfunction or disruption of our centralized information systems or shipping problems may result in delays or disruptions in the timely distribution of merchandise to our customers, which could substantially decrease our revenues and profitability.

OUR BUSINESS OPERATIONS COULD BE DISRUPTED IF THERE ARE LABOR PROBLEMS ON THE WEST COAST

During fiscal 2004, approximately 39% of our sales were domestic warehouse sales, which were made from our warehouses in California and Florida. During the third quarter of fiscal 2003, the dock strike on the West Coast affected sales of two of our karaoke products and we estimate that we lost between $3 and $5 million in orders because we couldn't get the containers of these products off the pier. If another strike or work slow-down occurs and we do not have a sufficient level of inventory, a strike or work slow-down would result in increased costs to us and may reduce our profitability.

OUR OBLIGATION TO MAKE SEVERANCE PAYMENTS COULD PREVENT OR DELAY TAKEOVERS

Our employment agreement with Yi Ping Chan and Edward Steele requires us, under certain conditions, to make substantial severance payments upon resignation and after a change of control. Mr. Chan is entitled to a severance payment of $250,000 if he resigns after a change in control. Mr. Steele is entitled to a severance payment of $125,000 upon resignation or change of control. These provisions could delay or impede a merger, tender offer or other transaction resulting in a change in control of the Singing Machine, even if such a transaction would have significant benefits to our shareholders. As a result, these provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

RISKS ASSOCIATED WITH OUR CAPITAL STRUCTURE

OUR COMMON STOCK MAY BE DELISTED FROM THE AMERICAN STOCK EXCHANGE, WHICH MAY HAVE A MATERIAL ADVERSE IMPACT ON THE PRICING AND TRADING OF OUR COMMON STOCK

Our common stock is quoted on the American Stock Exchange ("Amex"). The Amex, as a matter of policy, will consider the suspension of trading in, or removal from listing of, any stock when, in the opinion of Amex, (i) the financial condition and/or operating results of an issuer appear to be unsatisfactory; (ii) it appears that the extent of public distribution or the aggregate market value of the stock has become so reduced as to make further dealings on the Amex inadvisable; (iii) the issuer has sold or otherwise disposed of its principal operating assets; or (iv) the issuer has sustained losses which are so substantial in relation to its overall operations or its existing financial condition has become so impaired that it appears questionable, in the opinion of Amex, whether the issuer will be able to continue operations and/or meet its obligations as they mature.

As of September 30, 2004, we have not received any notices from AMEX notifying us that they will delist us. However, we cannot assure you that Amex will not take any actions in the near future to delist our common stock. If our common stock were delisted from the Amex, we would trade on the Over-the-Counter Bulletin Board and the market price for shares or our common stock could decline. Further, if our common stock is removed from listing on Amex, it may become more difficult for us to raise funds through the sale of our common stock or securities convertible into our common stock.

IF WE SELL ANY OF OUR SECURITIES AT A PRICE LOWER THAN $1.41 PER SHARE, THE CONVERSION PRICE OF OUR DEBENTURES AT $1.41 PER SHARE WILL BE REDUCED AND THERE WILL BE ADDITIONAL DILUTION TO OUR SHAREHOLDERS

We already had to reset the conversion price from $3.85 per share to $1.41 per share. Given that the closing price for our common stock was $0.575 per share on September 27, 2004 it is possible that we may again need to sell additional securities for capital at a price lower than $1.41 per share. If we sell any securities at a price lower than $1.41 per share, the conversion price of our debentures currently set at $1.41 per share will be reduced and there will be more dilution to our shareholders if and when the debentures are converted into shares of our common stock. If we issue or sell any securities at a price less than $1.41 per share, the set price will be reduced by an amount equal to 50% of the difference between the set price and effective purchase price of such shares.

We have prepared a table, which show the adjustments that will be made to (i) the conversion price of our convertible debentures and (ii) the number of shares issued to the debenture holders, if we issue or sell our securities at the (a) closing price on September 27, 2004, which was $0.575 per share, and (b) 50% of the closing price on September 27, 2004, which is $0.2875 per share.

PRICE OF SINGING MACHINE COMMON STOCK	ADJUSTED CONVERSION PRICE OF DEBENTURE	NUMBER OF SHARES ISSUABLE UPON CONVERSION OF DEBENTURE
$ 0.575	$ 1.00	4,000,000
$ 0.2875	$ .85	4,705,882
$ 0.1438	$ 0.78	5,128,205

If the price of our securities continues to decrease, and we continue to issue or sell our securities at price below $1.41 per share, our obligation to issue shares upon conversion of the debentures is essentially limitless.

When the conversion price reset occurs, the effective conversion price will decrease, the value of beneficial conversion will increase. The additional value of beneficial conversion would be recognized as discount on the convertible debentures.

IF OUR OUTSTANDING DERIVATIVE SECURITIES ARE EXERCISED OR CONVERTED, OUR EXISTING SHAREHOLDERS WILL SUFFER DILUTION

As of November 3, 2004, there were outstanding stock options to purchase an aggregate of 1,101,490 shares of common stock at exercise prices ranging from $0.57 to $14.30 per share, not all of which are immediately exercisable. The weighted average exercise price of the outstanding stock options is approximately $3.68 per share. As of November 2004, there were outstanding immediately exercisable option to purchase an aggregate of 580,882 shares of our common stock. There were outstanding stock warrants to purchase 591,040 shares of common stock at exercise prices ranging from $1.52 to $4.03 per share, all of

which are exercisable. The weighted average exercise price of the outstanding stock warrants is approximately $3.98 per share. In addition, we have issued $4,000,000 of convertible debentures, which are initially convertible into an aggregate of 1,038,962 shares of common stock. Under anti-dilution provision, the convertible debentures are convertible into an aggregate of 2,831,858 shares of common stock. To the extent that the aforementioned convertible securities are exercised or converted, dilution to our stockholders will occur.

THE $4 MILLION PRIVATE PLACEMENT THAT WE CLOSED IN SEPTEMBER 2003 WILL AFFECT OUR ABILITY TO RAISE CAPITAL IN THE FUTURE

On September 8, 2003, we closed a private offering in which we issued $4 million of convertible debentures and stock purchase warrants to six institutional investors. As part of this investment, we agreed to several limitations on our corporate actions, some of which limit our ability to raise financing in the future. If we enter into any financing transactions during the one year period prior to September 8, 2004, we need to offer the institutional investors the right to participate in such offering in an amount equal to the greater of (a) the principal amount of the debentures currently outstanding or (b) 50% of the financing offered to the outside investment group. For example, if we offer to sell $10 million worth of our securities to an outside investment group, the institutional investors will have the right to purchase up to $5 million of the offering. This right may affect our ability to attract other investors if we require external financing to remain in operations. Furthermore, for a period of 90 days after the effective date of the registration statement registering shares of common stock issuable upon conversion of the convertible debentures and the warrants, we cannot sell any securities.

Additionally, we cannot:

o sell any of our securities in any transactions where the exercise price is adjusted based on the trading price of our common stock at any time after the initial issuance of such securities; and

o sell any securities which grant investors the right to receive additional shares based on any future transaction on terms more favorable than those granted to the investor in the initial offering.

These limitations are in place until the earlier of February 20, 2006 or the date on which all the debentures are converted into shares of our common stock.

FUTURE SALES OF OUR COMMON STOCK HELD BY CURRENT STOCKHOLDERS AND INVESTORS MAY DEPRESS OUR STOCK PRICE

As of November 3, 2004, there were 9,02,813 shares of our common stock outstanding. Of these shares, approximately 5,954,796 shares are eligible for sale under Rule 144. We have filed two registration statements registering an aggregate 3,794,250 of shares of our common stock (a registration statement on

Form S-8 to register the sale of 1,844,250 shares underlying options granted under our 1994 Stock Option Plan and a registration statement on Form S-8 to register 1,950,000 shares of our common stock underlying options granted under our Year 2001 Stock Option Plan). An additional registration statement on Form S-1 was filed in October 2003, registering an aggregate of 4,959,228 shares of our common stock. The market price of our common stock could drop due to the sale of large number of shares of our common stock, such as the shares sold pursuant to the registration statements or under Rule 144, or the perception that these sales could occur.

OUR STOCK PRICE MAY DECREASE IF WE ISSUE ADDITIONAL SHARES OF OUR COMMON STOCK

Our Certificate of Incorporation authorizes the issuance of 18,900,000 shares of common stock. As of November 3, 2004, we had 9,202,813 shares of common stock issued. We have an obligation to issue up to:

1,692,530 shares issuable under outstanding options and warrants; and 2,831,858 shares upon conversion of the convertible debentures.

We have also reserved up to 207,791 additional shares for interest payment on the debentures. As such, our Board of Directors has the power, without stockholder approval, to issue up to 4,965,008 shares of common stock.

Any issuance of additional shares of common stock, whether by us to new stockholders or the exercise of outstanding warrants or options, may result in a reduction of the book value or market price of our outstanding common stock. Issuance of additional shares will reduce the proportionate ownership and voting power of our then existing stockholders.

PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW MAKE IT DIFFICULT FOR A THIRD PARTY TO ACQUIRE OUR COMPANY AND COULD DEPRESS THE PRICE OF OUR COMMON STOCK

Delaware law and our certificate of incorporation and bylaws contain provisions that could delay, defer or prevent a change in control of our company or a change in our management. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and

take other corporate actions. These provisions of our restated certificate of incorporation include: authorizing our board of directors to issue additional preferred stock, limiting the persons who may call special meetings of stockholders, and establishing advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk in the areas of changes in United States and international borrowing rates and changes in foreign currency exchange rates. In addition, we are exposed to market risk in certain geographic areas that have experienced or remain vulnerable to an economic downturn, such as China. We purchase substantially all of our inventory from companies in China, and, therefore, we are subject to the risk that such suppliers will be unable to provide inventory at competitive prices. While we believe that, if such an event were to occur we would be able to find alternative sources of inventory at competitive prices, we cannot assure you

that we would be able to do so. These exposures are directly related to our normal operating and funding activities. Historically and as of September 30, 2004, we have not used derivative instruments or engaged in hedging activities to minimize market risk.

FOREIGN CURRENCY RISK:

We have a wholly owned subsidiary in Hong Kong. Sales by these operations made on a FOB China or Hong Kong basis are dominated in U.S. dollars. However, purchases of inventory and Hong Kong operating expenses are typically denominated in Hong Kong dollars, thereby creating exposure to changes in exchange rates. Changes in the Hong Kong dollar/U.S. dollar exchange rates may positively or negatively affect our gross margins, operating income and retained earnings. We do not believe that near-term changes in the exchange rates, if any, will result in a material effect on our future earnings, fair values or cash flows, and therefore, we have chosen not to enter into foreign currency hedging transactions. We cannot assure you that this approach will be successful, especially in the event of a significant and sudden change in the value of the Hong Kong dollar.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report ("the Evaluation Date"), our management, including our chief executive officer and chief financial officer, conducted an evaluation ("Evaluation") of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934. In the course of the Evaluation, we identified significant material weaknesses in our internal disclosure controls and procedures.

In July 2004, Management and Grant Thornton LLP, advised our Audit Committee that during the course of the fiscal 2004 audit, they noted deficiencies in internal controls relating to:

- weakness in our financial reporting process as a result of a lack of adequate staffing in the accounting department, and

- accounting for consigned inventory and inventory costing.

Grant Thornton LLP advised the Audit Committee that each of these internal control deficiencies constitute a material weakness as defined in Statement of Auditing Standards No. 60. Certain of these internal control weaknesses may also constitute material weaknesses in our disclosure controls. In response, we hired an independent accounting firm as a consultant to review and implement procedures on inventory costing and valuation, as well accounts receivables and recognition in order to ensure that there were no material misstatements in our consolidated financial statements and to enable the completion of Grant Thornton LLP's audit of our consolidated financial statements for the fiscal year ended March 31, 2004. Our chief executive officer and our chief financial officer concluded that as of the Evaluation Date our disclosure controls and procedures were not effective, however as of the date of the filing of this amended report, our chief executive officer and our chief financial officer concluded that we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, to allow

timely decisions regarding required disclosure.

We are committed to improving our financial organization. As part of this commitment we have hired a new Chief Financial Officer, Financial Controller, a staff accountant as well as a EDI/Accounting administration person responsible for retrieving and updating customers sales information and inventory, since our fiscal year ending March 31, 2004 and the filing of this amended report. In addition, we have taken the following actions to correct our internal controls since our fiscal year ending March 31, 2004 and the filing of this amended report:

i) We assigned one of our qualified accountants on temporary assignment from our Hong Kong subsidiary, to assist the company in the monthly financial closing. We hired the qualified staff accountant on September 20, 2004. The addition of this qualified Staff Accountant will provide us with the ability to strengthen internal controls with the additional segregation of finance functions. In addition with the new staff accountant we have implemented standard month end closing procedures with specific due dates to improve the accuracy and timeliness of the financial statements.

ii) We have had several meetings with a customer, who we have consigned our inventory. The objective of these meetings was to establish standard procedures for monthly reporting and reconciliation to ensure that transactions are recorded correctly. We now have our customer's commitment to verify and reconcile the consigned inventory account on a monthly basis. We will monitor the procedures for the next two months to insure compliance to the new established procedures.

iii) We have implemented an actual FIFO perpetual cost system. Our inventory costing module has been integrated into our general ledger module. The costing information automatically flows through to the financial statements without manual entry and ensures the data integrity and accuracy. Also it eliminates and prevents the manual entry error, which has created costing problems in the past.

Although we currently believe we will not need to take additional steps to remediate the above-referenced material weaknesses, we will continue to evaluate the effectiveness of our design and operation of our disclosure controls and procedures on an ongoing basis, and will take further action as appropriate.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

CLASS ACTION AND DERIVATIVE LAWSUIT

From July 2, 2003 through October 2, 2003, seven securities class action lawsuits and a shareholder's derivative action were filed against us and certain of our officers and directors in the United States District Court for the Southern District of Florida on behalf of all persons who purchased our securities during the various class action periods specified in the complaints. On September 18, 2003, United States District Judge William J. Zlock entered an order consolidating the seven (7) purported class action law suits and one (1) purported shareholder derivative action into a single action case styled Frank Bielansky v. the Company, Salberg & Company, P.A., et al - Case Number: 03-80596 - CIV - ZLOCK (the "Class Action"). The complaints that were filed allege violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Rule 10(b)-5. The complaints seek compensatory damages, attorney's fees and injunctive relief.

We entered into a settlement agreement with the plaintiffs in the Class Lawsuit in March 2004. At a hearing in April 2004, the Court gave preliminary approval for the settlement and directed that notices be sent to shareholders pursuant to the Settlement Agreement. At a hearing on July 30, 2004, the Court entered an order approving the settlement agreement and it will become final after all applicable appeals periods have expired.

Pursuant to the terms of the settlement agreement, we are required to make a cash payment of $800,000 and Salberg & Company, P.A., our former auditor, is required to make a payment of $475,000. Our cash payment of $800,000 is covered by our liability insurance and our insurer has placed this payment in an escrow account. In addition, we are obligated to issue 400,000 shares of our common stock. The settlement would also obligate us to implement certain corporate governance changes, including an expansion or our Board of Directors to six members with independent directors comprising at least 2/3 of the total Board seats.

The court entered an order approving the settlement agreement on July 30, 2004. The Company has issued the 400,000 shares to the plaintiffs on September 23, 2004. The cost of the 400,000 shares is $240,000 based on the stock closing price on September 23, 2004.

ITEM 2. CHANGES IN SECURITIES

(a) On September 23, 2004, we issued 400,000 shares of our common stock to escrow for the benefit of the plaintiffs from the class action lawsuit. This

share issuance was exempt from registration pursuant to Section 3 (a) (10) of the Securities Act of 1933 pursuant to a court approved settlement dated July 30, 2004.

(b) Not Applicable.

(c)) Not Applicable

(d) Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Letter Agreement with Debenture Holders dated November 8, 2004 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
31.2 Certification of the Chief Financial Officer pursuant to Section 302 of

the Sarbanes-Oxley Act

32.1 Certifying Statement of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act 32.2 Certifying Statement of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act

(b) Reports on Form 8-K

The Company filed the following Current Reports on Form 8-K during the quarterly period ended September 30, 2004:

Date of Report	Items Reported	Financial Statements Filed
8-K	Current report, item 3.02	2004-09-28
8-K	Current report, items 5.02 and 9.01	2004-09-07
8-K	Current report, items 12 and 7	2004-08-17
10-Q	Quarterly report [Sections 13 or 15(d)]	2004-08-16

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.

Dated January 17, 2005 By: /s/ YI PING CHAN

Chief Executive Officer and
Chief Operating Officer

Dated: January 17, 2005 By: /s/ JEFFREY S. BAROCAS

Jeffrey S. Barocas
Chief Financial Officer (Principal Financial Officer and Accounting Officer)