SLS INTERNATIONAL INC
Form 10QSB
May 15, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)
|X| Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2002

or

|_| Transition Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

For the Transition Period from _________ to ___________

Commission File Number: 333-43770

SLS INTERNATIONAL, INC.

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

Delaware	52-2258371
(State of Incorporation)	(IRS Employer Identification No.)
3119 South Scenic Springfield, Missouri	65807
(Address of Principal Executive Offices)	(Zip Code)

Issuer's Telephone Number, Including Area Code: (417) 883-4549

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. N/A

Yes |_| No |_|

On May 1, 2002, 19,160,528 shares of SLS International, Inc. common stock were outstanding.

Transitional Small Business Disclosure Format (check one):

Yes |_| No |X|

SLS INTERNATIONAL, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SLS International, Inc.
Condensed Balance Sheet

	March 31, 2002 (unaudited)	December 31, 2001 (audited)
Assets		
Current assets:		
Cash	$ 0	$ 48,390
Accounts receivable	149,406	69,185
Inventory	245,204	250,998
Prepaid expenses and other current asset	1,570	2,081
Total current assets	396,180	370,654
Fixed assets:		
Vehicles	47,376	47,376
Equipment	50,731	50,731
Leasehold improvements	3,376	3,376
	101,483	101,483
Less accumulated depreciation	68,240	64,594

Net fixed assets	33,243	36,889
	$ 429,423	$ 407,543
Liabilities and Shareholders' Deficit		
Current liabilities:		
Current maturities of long-term debt and notes payable	$ 369,597	$ 371,640
Accounts payable	232,198	196,833
Due to shareholders	29,886	31,886
Accrued liabilities	78,364	67,029
Total current liabilities	710,045	667,388
Long-term debt, less current maturities	0	2,321
Commitments and contingencies:		
Shareholders' deficit:		
Preferred stock not issued but owed to buyers, $.001 par, 5,000,000 shares authorized; 168,000 and 102,000 shares at March 31, 2002 and December 31, 2001	168	102
Discount on preferred stock	(262,129)	(166,694)
Contributed capital - preferred	776,432	446,298
Common stock, $.001 par; 75,000,000 shares authorized; 19,156,528 shares and 19,019,528 shares issued at March 31, 2002 and December 31, 2001	19,157	19,020
Common stock not issued but owed to buyers; 40,000 shares at December 31, 2001	0	40
Contributed capital - common	1,758,828	1,710,425
Retained deficit	(2,573,078)	(2,271,357)
Total shareholders' deficit	(280,622)	(262,166)
	$ 429,423	$ 407,543

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

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SLS International, Inc.
Condensed Statement Of Operations

	For The Three Months Ended March 31, 2002	2001
	(unaudited)	
Revenue	$ 135,186	$ 39,748
Cost of sales	51,375	21,321

Gross profit	83,811	18,427
General and administrative expenses	309,341	209,929
Loss from operations	(225,530)	(191,502)
Other income (expense):		
Interest expense	(6,433)	(14,621)
Interest and miscellaneous, net	7	6
	(6,426)	(14,615)
Loss before income tax	(231,956)	(206,117)
Income tax provision	0	0
Net loss	$ (231,956)	$ (206,117)
Deemed dividend associated with beneficial conversion of preferred stock	(68,765)	0
Net loss available to common shareholders	$ (300,721)	$ (206,117)
Basic and diluted earnings per share	$ (0.01)	$ (0.01)
Weighted average shares outstanding	20,728,195	14,152,009

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

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SLS International, Inc.
Condensed Statement Of Cash Flows

	For The Three Months Ended March 31,	
	2002	2001
	(unaudited)	
Operating activities:		
Net loss	$(231,956)	$(206,117)
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	3,646	3,602
Change in assets and liabilities-		
Accounts receivable	(80,221)	(14,430)
Inventory	5,794	5,937
Prepaid expenses and other current asset	511	(573)
Accounts payable	35,365	59,684
Due to shareholders	(2,000)	2,038
Deferred revenue	0	5,000
Accrued liabilities	11,335	21,958

Cash used in operating activities	(257,526)	(122,901)
Investing activities:		
Additions to fixed assets	0	(240)
Cash used in investing activities	0	(240)
Financing activities:		
Sale of common stock	48,500	0
Sale of preferred stock	165,000	0
Borrowing of notes payable	0	115,000
Repayments of notes payable	(4,364)	(7,940)
Cash provided by financing activities	209,136	107,060
(Decrease) increase in cash	(48,390)	(16,081)
Cash, beginning of quarter	48,390	17,657
Cash, end of quarter	$ 0	$ 1,576
Supplemental cash flow information:		
Interest paid	$ 0	$ 1,143
Income taxes paid (refunded)	0	0

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

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SLS INTERNATIONAL, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements at March 31, 2002 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of financial positions as of March 31, 2002 and results of operations and cash flows for the three months ended March 31, 2002. All such adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative of the results expected for a full year. Certain amounts in the 2001 financial statements have been reclassified to conform to the 2002 presentations. The statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's Form 10-KSB for the year ended December 31, 2001.

NOTE 2 - COMMITMENTS AND CONTINGENCIES

Going Concern

The accompanying unaudited condensed financial statements at March 31, 2002 have been prepared in conformity with generally accepted accounting principles which contemplate the continuance of the Company as a going concern. The Company has suffered losses from operations during the three months ended March 31, 2002 and the years ended December 31 2001, 2000, and 1999. The Company's cash position may be inadequate to pay all of the costs associated with the introduction of its new loudspeakers. Management intends to use borrowings and security sales to mitigate the effects of its cash position, however no assurance can be given that debt or equity financing , if and when required, will be available. The unaudited condensed financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should the Company be unable to continue in existence.

NOTE 3 - NOTES PAYABLE

The interest rate on the current notes are 7% and the maturity date is six months from the date of each note.

NOTE 4 - STOCK TRANSACTIONS

In May, 2001, the Company completed a public offering. The number of shares sold was 4,000,000. Included with the purchase of the shares was a Class A warrant and a Class B warrant. The Class A warrants expire on August 4, 2002 and are exercisable at a price of $.50 per share. The Class B warrant has a term of 2 years and are exercisable at a price of $3.00 per

share. The warrants are detachable from the common stock but are not separable from each other until the Class A warrant is exercised.

From January 1, 2002 to March 31, 2002, 97,000 Class A warrants were exercised for 97,000 shares of common stock for a total of $48,500. 3,115,000 Class A warrants are outstanding as of March 31, 2002. No Class B warrants have been exercised as of March 31, 2002.

In the three months ended March 31, 2002, the Company issued 66,000 shares of preferred stock for $165,000. This preferred stock contained beneficial conversion features. The features allows the holder to convert the preferred to 10 shares of common stock after a one year period. A discount on preferred shares of $165,200 relating to the beneficial conversion feature was recorded on these sales which will be amortized over a one year period beginning with the date the shareholders purchased their shares. $69,765 was amortized to retained earnings in the three months ended March 31, 2002. At March 31, 2002, the unamortized beneficial conversion on preferred shares was $262,129.

NOTE 5 -- SUBSEQUENT EVENTS

In April of 2002, the Company issued 60,000 share of preferred stock for $150,000.

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

OVERVIEW

We manufacture premium-quality loudspeakers and sell them through our dealer networks. The speakers use our proprietary ribbon-driver technology and are generally recognized in the industry as high-quality systems. We sell a Professional Line of loudspeakers, a Commercial Line of loudspeakers, and Home Theatre systems.

From the early 1970's through 1999 we derived substantially all of our revenue from marketing, renting, selling and installing sound and lighting systems. In June 1999, due to the favorable customer acceptance of our recently custom designed loudspeaker systems, we ceased these historical operations and began focusing all efforts towards becoming a loudspeaker manufacturer and selling to dealers and contractors on a wholesale basis. As a result, we have been essentially in a development stage, as we are bringing to market products that we introduced in 2000 and 2001 and designing and bringing to market additional products.

In June 2000, we asked dealers and distributors to sell our Professional Line of products. These dealers and distributors started to form our current network of approximately 50 dealers and 7 foreign distributors and we began shipping to them. However, most of the Professional Line required new ribbon drivers that we completed and implemented into the product line in early 2001.

In September 2000, we introduced our Home Theatre systems and sales for those systems began immediately. From September through December 2000, we added 20 new Home Theatre dealers in the US and began marketing efforts to establish distributors and dealers outside the US.

In June 2001, we introduced a Commercial Line of loudspeakers that utilize our PRD500 Ribbon Driver and in September of 2001 we finished the development of our PRD1000 Ribbon Driver and began implementing them into our Professional Line. Our PRD drivers upgraded the previous drivers that we purchased from third-party manufacturers and the cost to us is one-sixth of the price that we had been paying for the previous drivers.

SLS International, Inc. was formed on July 25, 2000 and had no previous operations. On the same date, this corporation merged with Sound and Lighting Specialist Inc., its sole shareholder. All of the financial information reported for periods prior to the merger are the results of operations of Sound and Lighting Specialist, Inc. All of the operating activity reported for periods after the merger are the results of operations of SLS International, Inc. After effectiveness of the merger, Sound and Lighting Specialist, Inc. ceased to exist as a separate corporate entity. The information in this section should be read together with the financial statements, the accompanying notes to the financial statements and other sections included in this report.

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RESULTS OF OPERATIONS

Quarter ended March 31, 2002 as compared to the quarter ended March 31, 2001. For the quarter ended March 31, 2002, revenue increased to $135,186 from $39,748 in 2001, a 240% increase, resulting primarily from the expansion of our loudspeaker product line and the continued growth in sales of our loudspeakers. Our gross profit percentage increased to approximately 62% in the 2002 period from approximately 46% in the 2001 period, primarily as a result of our conversion to in-house manufacturing of our ribbon drivers from our previous outsourcing of such components. Despite the revenue increase of $95,438 and the improvement in gross profits, our net loss increased by $25,839, to $231,956 in the first quarter of 2002 as compared to a net loss of $206,117 in the comparable quarter of 2001. The greater net loss was the result of increased general and administrative expenses, discussed below.

General and administrative expense for the 2002 first quarter increased to $309,341 from $209,929 in the 2001 first quarter, primarily as a result of a new employee handling our development of a transducer, a new controller for our financial operations, a new national sales manager, increased trade show participation to promote our products, and consultant expense targeted toward increased exposure and relations with top musical artists.

Interest expense decreased to $6,433 in the 2002 first quarter as compared to $14,621 in the 2001 first quarter, due to decreased borrowings.

Quarter ended March 31, 2001 as compared to the quarter ended March 31, 2000. Sales for the first quarter totaled $39,748 compared to $46,421 in 2000. The decrease in revenue resulted from SLS restructuring the business to begin producing loudspeakers with the ribbon drivers.

General and administrative expense rose to $209,929 for the quarter ended March 31, 2001 compared to $159,979 for the quarter ended March 31, 2000. The increase was attributable to an increase in fees associated with the ribbon driver, trade show participation and professional fees.

Interest expense was $14,621 in 2001 compared to $2,812 in 2000 because of additional borrowings on notes payable.

The net loss for the quarter was $206,117 in 2001, an increase of $55,221 from a loss of $150,896 in 2000.

FINANCIAL CONDITION

On March 31, 2002, our current liabilities exceeded current assets by $313,865, compared to $296,734 on December 31, 2001. Total liabilities exceeded total assets by $280,622, compared to $262,166 on December 31, 2001. The increased working capital deficit was due to the decrease in cash, discussed below, as well as increases in accounts payable and accrued liabilities, partially offset by increased accounts receivable, as a result of the continued expansion of our operations.

We have experienced operating losses and negative cash flows from operating activities in all recent years. The losses have been incurred due to the development time and costs in bringing our products through engineering and to the marketplace. In addition we have not paid notes payable and accounts payable on due dates. The report of our accountants contains an explanatory paragraph indicating that these factors raise substantial doubt about our ability to continue as a going concern.

We are experiencing significant cash shortages; in fact, we had $0 in cash on March 31, 2002. However, in April 2002, we raised $150,000 through the sale of 60,000 shares of preferred stock. In order to continue operations, we have been dependent on raising additional funds and have continued to sell preferred stock in the beginning of 2002 to raise capital. In the first quarter of 2002 we sold preferred stock for $165,000. In addition, we have outstanding warrants, which, upon exercise, have provided additional funding of $48,500 during the first quarter of 2002.

Long-term notes payable decreased slightly to $369,597 on March 31, 2002. Two notes totaling $16,328 are secured with equipment and borrowings from individuals are unsecured and mature in the first quarter of 2002; however, these notes are payable to existing shareholders that are not making a demand on the notes and will continue to accrue the 7% interest for an indefinite period of time. We expect that these shareholders will continue to permit these notes to remain outstanding, but they have the right to demand full payment at any time and they may do so, which would have a material adverse effect on our financial condition.

There is intense competition in the speaker business with other companies that are much larger and national in scope and have greater financial resources than we have. We will require additional capital to continue our growth in the wholesale speaker market. We are relying upon our ability to obtain the necessary financing through the issuance of equity and upon our relationships with our lenders to sustain our viability.

In the past, we have been able to privately borrow money from individuals by the issuance of notes and have sold our common stock to raise capital. We intend to continue to do so as needed. However, we cannot be certain that we will continue to be able to successfully obtain such financing. If we fail to do so, we may be unable to continue as a viable business.

FORWARD LOOKING INFORMATION

This report, as well as our other reports filed with the SEC and our press releases and other communications, contain forward-looking statements made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. Forward-looking statements include all statements regarding our expected financial position, results of operations, cash flows, dividends, financing plans, strategy, budgets, capital and other expenditures, competitive positions, growth opportunities, benefits from new technology, plans and objectives of management, and markets for stock. These forward-looking statements are based largely on our expectations and, like any other business, are subject to a number of risks and uncertainties, many of which are beyond our control. The risks include those stated in the "Risk Factors" section of this report and economic, competitive and other factors affecting our operations, markets, products and services, expansion strategies and other factors discussed elsewhere in this report and the other documents we have filed with the Securities and Exchange Commission. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this report will in fact prove accurate, and our actual results may differ materially from the forward-looking statements.

PART II - OTHER INFORMATION

Item 2. Changes in Securities.

Please refer to the section titled "Use of Proceeds" in Item 5 of our Annual Report on Form 10-KSB for a description of our offering of Units that closed on May 2, 2001 pursuant to a Registration Statement on Form SB-2, registration number 333-43770, with an effective date of February 4, 2001. During the quarter ended March 31, 2002, we issued an aggregate of 97,000 shares of our common stock in connection with the exercise of Class A Warrants issued as part of the Units in the May 2, 2001 offering. The total proceeds received upon exercise of the warrants were $48,500.

In the quarter ended March 31, 2002, the Company issued 66,000 shares of preferred stock for $165,000 in cash. All sales were made to accredited investors. Each share of preferred stock is convertible into ten shares of common stock after one year. The issuances were made in reliance on Section 4(2) of the Securities Act of 1933, as amended.

The net proceeds from the exercise of Class A Warrants and the sale of preferred stock in the first quarter of 2002 were used for working capital purposes. We did not use any registered securities broker-dealers in connection with any exercises of the Warrants or sales of preferred stock. All of the foregoing uses of proceeds were direct or indirect payments to nonaffiliates.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits. The following are being filed as exhibits to this Report:

-- None

(b) Reports on Form 8-K. We filed no Reports on Form 8-K during the quarter ended March 31, 2002.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SLS INTERNATIONAL, INC.
(Registrant)

Date: May 15, 2002

By /s/ John Gott
John Gott
President and
Chief Financial Officer
(Principal Financial Officer)

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