SLS INTERNATIONAL INC
Form 10QSB
August 14, 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 June 30, 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 Offic	(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, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. N/A

Yes [_] No [_]

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

Transitional Small Business Disclosure Format (check one):
Yes No x

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SLS INTERNATIONAL, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SLS International, Inc.
Condensed Balance Sheet

	June 30, 2002 (unaudited)
Assets	
Current assets:	
Cash	$ 0
Accounts receivable	214,862
Inventory	366,935
Prepaid expenses and other current assets	1,570

Total current assets	583,367
Fixed assets:	
Vehicles	47,376
Equipment	50,731
Leasehold improvements	3,376
	101,483
Less accumulated depreciation	71,886
Net fixed assets	29,597
	$ 612,964
Liabilities and Shareholders' Deficit	
Current liabilities:	
Current maturities of long-term debt and notes payable	$ 414,325
Accounts payable	231,788
Due to shareholders	29,886
Accrued liabilities	82,726
Total current liabilities	758,725
Long-term debt, less current maturities	0
Commitments and contingencies:	
Shareholders' deficit:	
Preferred stock not issued but owed to buyers, $.001 par, 5,000,000 shares authorized; 278,000 and 102,000 shares at June 30, 2002 and December 31, 2001	278
Discount on preferred stock	(467,668)
Contributed capital - preferred	1,392,322
Common stock, $.001 par; 75,000,000 shares authorized; 19,160,528 shares and 19,019,528 shares issued at June 30, 2002 and December 31, 2001	19,161
Common stock not issued but owed to buyers; 40,000 shares at December 31, 2001	0
Contributed capital - common	1,760,824
Retained deficit	(2,850,678)
Total shareholders' deficit	(145,761)
	$ 612,964

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 Six Months Ended

	June 30, 2002	June 30, 2001
	(unaudited)	
Revenue	$ 324,516	$ 110,523
Cost of sales	115,638	69,883
Gross profit	208,878	40,640
General and administrative expenses	569,748	512,115
Loss from operations	(360,870)	(471,475)
Other income (expense):		
Interest expense	(13,263)	(27,299)
Interest and miscellaneous, net	38	1,548
	(13,225)	(25,751)
Loss before income tax	(374,095)	(497,226)
Income tax provision	0	0
Net loss	(374,095)	(497,226)
Deemed dividend associated with beneficial conversion feature of preferred stock	(205,226)	0
Net loss available to common shareholders	$ (579,321)	$ (497,226)
Basic and diluted earnings per share	$ (0.03)	$ (0.03)
Weighted average shares outstanding	19,151,000	15,677,000

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 June 30, 2002	For The Three Months Ended June 30, 2001
	(unaudited)	
Revenue	$ 189,330	$ 70,775
Cost of sales	64,262	48,562
Gross profit	125,068	22,213
General and administrative expenses	260,407	302,186
Loss from operations	(135,339)	(279,973)
Other income (expense):		
Interest expense	(6,830)	(12,678)

Interest and miscellaneous, net	30	1,542
	(6,800)	(11,136)
Loss before income tax	(142,139)	(291,109)
Income tax provision	0	0
Net loss	(142,139)	(291,109)
Deemed dividend associated with beneficial conversion feature of preferred stock	(136,461)	0
Net loss available to common shareholders	$ (278,600)	$ (291,109)
Basic and diluted earnings per share	$ (0.01)	$ (0.02)
Weighted average shares outstanding	19,160,000	17,082,000

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 Six Months Ended June 30,	
	2002	2001
	(unaudited)	
Operating activities:		
Net loss	$ (374,095)	$ (497,226)
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	7,292	7,621
Change in assets and liabilities-		
Accounts receivable	(145,677)	(44,645)
Inventory	(115,937)	(2,614)
Prepaid expenses and other current assets	511	79,168
Accounts payable	34,954	(93,329)
Due to shareholders	(2,000)	3,820
Accrued liabilities	15,698	8,945
Cash used in operating activities	(579,254)	(538,260)
Investing activities:		
Additions to fixed assets	0	(9,257)
Cash used in investing activities	0	(9,257)
Financing activities:		
Sale of common stock	50,500	1,052,000

Sale of preferred stock	440,000	0
Borrowing of notes payable	50,000	135,000
Repayments of notes payable	(9,636)	(422,325)
Cash provided by financing activities	530,864	764,675
(Decrease) increase in cash	(48,390)	217,158
Cash, beginning of period	48,390	17,657
Cash, end of period	$ 0	$ 234,815
Supplemental cash flow information:		
Interest paid	$ 0	$ 0
Income taxes paid	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 June 30, 2002 have been prepared in accordance with generally accepted accounting principles in the United States 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 June 30, 2002 and results of operations and cash flows for the six months ended June 30, 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 June 30, 2002 have been prepared in conformity with generally accepted accounting principles in the United States which contemplate the continuance of the Company as a going concern. The Company has suffered losses from operations during the six months ended June 30, 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% with maturity periods of six months. The notes have matured and are now demand notes.

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.

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From January 1, 2002 to June 30, 2002, 101,000 Class A warrants were exercised for 101,000 shares of common stock for a total of $50,500. 3,111,000 Class A warrants are outstanding as of June 30, 2002. No Class B warrants have been exercised as of June 30, 2002.

In the six months ended June 30, 2002, the Company issued 176,000 shares of preferred stock for $440,000. 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 $506,200 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. $205,226 was amortized to retained earnings in the six months ended June 30, 2002. At June 30, 2002, the unamortized beneficial conversion on preferred shares was $467,668.

NOTE 5 - SUBSEQUENT EVENTS

In July of 2002, the Company issued 24,000 shares of preferred stock for $60,000.

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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 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 use our PRD500 Ribbon Driver and, in September 2001, we finished the development of our PRD1000 Ribbon Driver and began implementing it into our Professional Line. Our PRD drivers upgraded the previous drivers that we purchased from third-party manufacturers and the cost to us is approximately 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.

RESULTS OF OPERATIONS

Quarter ended June 30, 2002 as compared to the quarter ended June 30, 2001. For the quarter ended June 30, 2002, revenue increased to $189,330 from $70,775 in 2001, a 168% 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 66% in the 2002 period from approximately 31% 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. As a result of the revenue increase and the improvement in gross profits, as well as a $41,779 decrease in general and administrative expense, our net loss decreased to $142,139 in the first quarter of 2002 as compared to a net loss of $291,109 in the comparable quarter of 2001.

General and administrative expense for the 2002 second quarter decreased to $260,407 from $302,186 in the 2001 second quarter, primarily as a result of expenses for trade shows and greater advertising expenses incurred in 2001.

Interest expense decreased to $6,830 in the 2002 second quarter as compared to $12,678 in the 2001 second quarter, due to decreased borrowings.

Six months ended June 30, 2002 as compared to the six months ended June 30, 2001. For the first six months of 2002, revenue increased to $324,516 from $110,523 in 2001, a 194% 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 64% in the 2002 period from approximately 37% 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. As a result of the revenue increase and the improvement in gross profits, our net loss decreased to $374,095 in the first half of 2002 as compared to a net loss of $497,226 in the first half of 2001.

General and administrative expense for the first six months of 2002 increased to $569,748 from $512,115 in 2001, primarily as a result of the hiring of a sales manager and consulting expenses incurred for investor relations and public relations.

Interest expense decreased to $13,263 in the 2002 period as compared to $27,299 in the 2001 period, due to decreased borrowings.

FINANCIAL CONDITION

On June 30, 2002, our current liabilities exceeded current assets by $175,358, compared to $296,734 on December 31, 2001. Total liabilities exceeded total assets by $145,761, compared to $262,166 on December 31, 2001. The decreased working capital deficit was due primarily to an increase in accounts receivable and inventory, funded in large part by the sales of equity described below and increased sales, as well as increases in accounts payable and accrued liabilities, partially offset by a decrease in cash, increased accounts payable and other increased liabilities incurred from our expanding 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 June 30, 2002. However, in July 2002, we raised $60,000 through the sale of 24,000 shares of preferred stock, and we had $214,862 in accounts receivable on June 30,2002, which we have been collecting in the ordinary course of business. In order to continue operations, we have been dependent on raising additional funds and have continued to sell preferred stock in 2002 to raise capital. In the first half of 2002 we sold 176,000 shares of preferred stock for $440,000. In addition, we have outstanding warrants, which, upon exercise, have provided additional funding of $50,500 during the first half of 2002.

Long-term notes payable increased slightly to $414,325 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.

We expect our revenue to grow rapidly in the next few quarters, as our marketing initiatives continue to take effect. In the second quarter of 2002, a Korean distributor committed to purchase $1,000,000 in products over the next twelve months. Also, our sales representatives are reporting exceptional response from our customers, resulting in increases in product orders. Accordingly, we have increased production to accommodate the anticipated growth. Further, we expect that our profit margin, already at approximately 65%, will improve as our revenue increases. Taking into account all of these factors, we currently forecast to report a profit in the fourth quarter of 2002.

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 our Annual Report on Form 10-KSB and economic, competitive and other factors affecting our operations, markets, products and services, expansion strategies and other factors discussed elsewhere in this report, in our Annual Report on Form 10-KSB and in 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 1. Legal Proceedings.

On April 4, 2002, Alfred V. Greco filed a claim in the Supreme Court of the State of New York, County of New York, for unpaid legal fees, seeking a total of $50,772, plus interest, costs and disbursements. We have been in settlement discussions with Mr. Greco, and we expect to settle the claim during the third quarter of 2002.

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 June 30, 2002, we issued an aggregate of 4,000 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 $2,000.

In the quarter ended June 30, 2002, the Company issued 110,000 shares of preferred stock for $275,000 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 second 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.

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

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

99.1 Certification of Periodic Report

(b) Reports on Form 8-K.

We filed no Reports on Form 8-K during the quarter ended June 30, 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: August 14, 2002

By /s/ John Gott

John Gott

President and
Chief Financial Officer
(Principal Financial Officer)