SLS INTERNATIONAL INC
Form 10-Q/A
August 03, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A
Amendment No. 1

(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, 2005 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 Registrant as Specified in its Charter)

Delaware	52-2258371
(State of Incorporation)	(IRS Employer Identification No.)
1650 W. Jackson Ozark, Missouri	65721
(Address of Principal Executive Offices)	(Zip Code)

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

3119 S. Scenic, Springfield, MO 65807
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 requirements 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 ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act subsequent to the distribution of securities under a plan confirmed by a court. N/A

Yes |_| No |_|

On May 11, 2005, 43,432,810 shares of SLS International, Inc. common stock were outstanding.

SLS INTERNATIONAL, INC.

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

EXPLANATORY NOTE

SLS International, Inc. is filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, as filed with the U.S. Securities and Exchange Commission on May 16, 2005, to remove one sentence from Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, Financial Condition. That sentence, which appeared on page 12 of the May 16, 2005 filing stated, "The report of our accountants contains an explanatory paragraph indicating that these factors raise doubt about our ability to continue as a going concern. This statement is not accurate, because the report of our accountants did not contain such an explanatory paragraph. This Amendment No. 1 responds to comments of the Staff of the Securities and Exchange Commission in connection with its review of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.

This Amendment No. 1 does not affect the original financial statements or, except as explicitly stated above, the footnotes as originally filed. This

Amendment No. 1 does not reflect events that have occurred after the original filing of the Quarterly Report on Form 10-Q filed on May 16, 2005 and does not modify or update the disclosures in the Quarterly Report on Form 10-Q as filed in any way except with regard to the specific modifications described in this Explanatory Note.

This Amendment No. 1 should be read in conjunction with the original filing of our Quarterly Report on Form 10-Q and our other filings made with the Securities and Exchange Commission subsequent to the filing of the original Quarterly Report on Form 10-Q.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEET

	March 31, 2005 (unaudited)
Assets	
Current assets:	
Cash	$ 4,814,195
Certificates of deposit	4,000,000
Accounts receivable, less allowance for doubtful accounts of $45,000 as of March 31, 2005 and December 31, 2004	362,822
Inventory	2,063,503
Deposits - inventory	126,461
Deposits - merger	--
Prepaid expenses and other current assets	101,440
Total current assets	11,468,421
Fixed assets:	
Building	3,500,240
Vehicles	255,044
Equipment	234,805
Leasehold improvements	245,681
Construction in progress	320,508
	4,556,278
Less accumulated depreciation	141,472
Net fixed assets	4,414,806
	$ 15,883,227
Liabilities and Shareholders' Equity	
Current liabilities:	

Current maturities of long-term debt and notes payable	$ 29,101
Accounts payable	192,776
Accrued liabilities	36,224
Total current liabilities	258,101
Notes payable, less current maturities	9,732
Commitments and contingencies:	
Shareholders' equity:	
Preferred stock, Series A, $.001 par, 2,000,000 shares authorized; 233,700 and 346,873 shares issued as of March 31, 2005 and December 31, 2004	234
Preferred stock, Series B, $.001 par, 1,000,000 shares authorized; 193,050 and 196,050 shares issued as of March 31, 2005 and December 31, 2004	193
Preferred stock, Series C, $.001 par, 25,000 shares authorized; 14,450 and no shares issued as of March 31, 2005 and December 31, 2004	14
Deposits on Preferred stock, Series C	--
Contributed capital - preferred	20,626,936
Common stock, $.001 par; 75,000,000 shares authorized; 43,032,810 shares and 41,751,080 shares issued as of March 31, 2005 and December 31, 2004	43,034
Common stock not issued but owed; 703,071 and 300,000 shares at March 31, 2005 and December 31, 2004	703
Contributed capital - common	26,215,610
Unamortized cost of stock issued for services	(1,830,070
Retained deficit	(29,441,261
Total shareholders' equity	15,615,394
	$ 15,883,227

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

SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	For the Three Months Ended March 31, 2005	2004
Revenue	$ 824,720	$ 420,916
Cost of sales	486,162	252,916
Gross profit	338,558	168,000
General and administrative expenses	3,032,430	2,956,689
Loss from operations	(2,693,872)	(2,788,689)
Other income (expense):		
Interest expense	(438)	(505)

Interest and miscellaneous, net	48,176	5,376
	47,739	4,871
Loss before income tax	(2,646,133)	(2,783,818)
Income tax provision	--	--
Net loss	(2,646,133)	(2,783,818)
Deemed dividend associated with beneficial conversion of preferred stock	(3,246,112)	(971,477)
Dividend - preferred series C	(7,678)	--
Net loss availiable to common shareholders	$ (5,899,923)	$ (3,755,295)
Basic and diluted loss per share	$ (0.14)	$ (0.13)
Weighted average shares outstanding	42,697,378	28,743,930

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

SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the Three Mon
Ended March 31,

	2005	20
Operating activities:		
Net loss	$ (2,646,133)	$ (2,7
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	36,341	
Amortization of cost of stock issued for services	253,903	
Expense of stock & options granted for services	871,175	7
Goodwill impairment charge	--	1,1
Change in assets and liabilities:		
Accounts receivable, less allowance for doubtful accounts	(91,393)	
Inventory	(154,915)	(2
Deposits - inventory	(76,461)	
Deposits - merger	100,000	
Prepaid expenses and other current assets	91,376	
Accounts payable	(154,204)	(
Accrued liabilities	(594,278)	
Cash used in operating activities	(2,364,589)	(1,1
Investing activities:		
Investment in certificates of deposit	(4,000,000)	
Additions of fixed assets	(4,023,843)	(
Cash provided by (used in) investing activities	(8,023,843)	(
Financing activities:		
Sale of stock, net of expenses	4,490,988	2,6
Acquistion of subsidiary	--	(3
Borrowing on notes payable	--	
Repayments of notes payable	(1,219)	
Cash provided by financing activities	4,489,769	2,3
Increase (decrease) in cash	(5,898,663)	1,2
Cash, beginning of period	10,712,858	1,4
Cash, end of period	$ 4,814,195	$ 2,6
Supplemental cash flow information:		
Interest paid	$ 438	$
Income taxes paid (refunded)	--	
Dividend -preferred series C paid in common stock	7,678	
Noncash investing activities:		
Stock issued and options granted for services	$ 871,175	$ 7

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

SLS INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements at March 31, 2005 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of financial position as of March 31, 2005 and results of operations and cash flows for the three months ended March 31, 2005. 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 2004 financial statements have been reclassified to conform to the 2005 presentations. The statements should be read in conjunction with the financial statements and footnotes thereto included in our Form 10-KSB for the year ended December 31, 2004.

NOTE 2 - NOTES PAYABLE

At December 31, 2004 and March 31, 2005, there is a note payable to an individual in the amount of $25,000. This note bears interest of 7% and is due in September 2005. There is also a note payable for equipment in the amount of $15,052 and $13,833 as of December 31, 2004 and March 31, 2005, respectively. This note bears interest of 5.16% and matures in September of 2008. Interest expense for the year ended December 31, 2004 and the quarter ended March 31, 2005 was $1,907 and $438 respectively.

NOTE 3 - STOCK TRANSACTIONS

In July 2003, we entered into an endorsement agreement with the recording artist Sting through Steerpike Ltd. The agreement grants 1,100,000 options in exchange for future endorsements of our products. Each option is convertible into one share of common stock at a strike price of $0.25 and is exercisable for a period of five years. Expense associated with the options will be recorded over the two-year period of the agreement beginning July 31, 2003 and ending July 31, 2005. Expense will be recorded at fair market value, using the Black-Scholes pricing model, on an accelerated method, thereby recording a larger portion of the costs in the earlier months of the two-year period. Consulting expense relating to this agreement was $75,260 for the quarter ended March 31, 2005. As of March 31, 2005 approximately 1,081,850 of the 1,100,000 options have been earned and expensed. Expenses to be recorded in the remaining quarters of the year ended December 31, 2005 are unknown at this time because they are partly based on the market price over those periods.

In November 2003, an agreement was signed with William Fischbach for consulting services to be performed November 10, 2003 to November 10, 2006. As compensation for consulting services we issued 400,000 shares of common stock on November 11, 2003. Using the market value of the date the agreement was signed, the shares were valued at $780,000 and recorded as a debit in the equity section of the balance sheet as unamortized cost of stock issued for services. The cost is amortized over the three-year period of the agreement. Consulting expense relating to this agreement was $65,000 for the quarter ended March 31, 2005. On March 31, 2005 there was $418,671 remaining in unamortized stock issued for services for this agreement. The agreement also calls for the issuance of options, not to exceed an aggregate of 800,000, to Mr. Fischbach on January 1 of each year based on the previous year's performance levels. No options were issued on January 1, 2004 or 2005 under this agreement. As of March 31, 2005, Mr. Fischbach had earned no options based on his performance in the quarter ended March 31, 2005. The agreement also calls for additional compensation to Mr. Fischbach in the form of a cash fee of 2% of the dollar amount of value provided in a merger, acquisition, or other transaction resulting directly from Mr. Fischbach's services. As of March 31, 2005, Mr. Fischbach had earned no cash fee based on the value provided to us in the quarter ended March 31, 2005.

In December 2004, an agreement was signed with W. Curtis Hargis Co. (Hargis) for consulting services. As compensation for consulting services we agreed to issue 100,000 options upon reaching an agreement with a retailer introduced to us by Hargis. This occurred on March 21, 2005. We also agreed to issue Hargis one option to purchase one share of common stock for every $100 in sales from the retailer provided that Hargis shall not be entitled to receive in excess of 500,000 options. The options have a term of three years and have a strike price equal to the average price of the Company's common stock for the five trading days immediately prior to the day the options are earned. As of March 31, 2005, Hargis had earned 101,529 options to purchase common stock. Using the Black-Scholes pricing method, the options were valued at $62,886 and recorded as consulting expense in the quarter ended March 31, 2005. The agreement also calls for additional compensation to Hargis in the form of a cash fee of 2% of the net sales realized from the retailer. As of March 31, 2005, Hargis had earned no cash fee based on the value provided to us in the quarter ended March 31, 2005.

In January of 2005, the Company completed a private placement of 15,000 shares of its Series C Preferred Stock for an aggregate purchase price of $15,000,000. The proceeds were $13,340,408, net of expenses. Expenses associated with the offering, are legal costs of $132,558 and expenses related to a finder's fee. The finder was compensated 6% of the gross offering funds received, $900,000, and 40,000 warrants for every $1,000,000 raised in the offering. The finder received 600,000 warrants, which were valued at $627,034 using the Black-Scholes pricing model.

The Series C Preferred Stock contains a beneficial conversion feature. The feature allows the holder to convert each share of preferred to 400 shares of common stock and accrues a 6% premium to the stated face value of the shares of preferred stock, which would be convertible into additional shares of common stock. A discount on preferred shares of $3,246,112 relating to the beneficial conversion feature was recorded. As of March 31, 2005, the full discount had been amortized to retained earnings.

The 6% premium accrues to the face value of the preferred stock and compounds quarterly. As of March 31, 2005, the face value of the 14,450 outstanding shares is $14,654,323, of which $204,323 is premium. The face value of the preferred stock is convertible into common stock at $2.50 per share. As a result, on March 31, 2005, the 14,450 outstanding shares of preferred stock were convertible into 5,861,729 shares of common stock.

Attached to each Series C Preferred share are 400 Class D warrants. Each Class D warrant has a term of five years and provides the right to purchase one share of our common stock at $6.00 per share, subject to certain adjustments. The Company may redeem the warrants and may require the holders to convert the preferred stock to common stock if certain conditions are met. Using the Black-Scholes model for pricing, the Class D warrants were valued at $1,506,112.

In the quarter ended March 31, 2005, 113,173 shares of preferred stock, series A, were converted to 1,131,730 shares of common stock. There are 237,700 shares outstanding as of March 31, 2005.

In the quarter ended March 31, 2005, 3,000 shares of preferred stock, series B, were converted to 30,000 shares of common stock. There are 193,050 shares outstanding as of March 31, 2005.

In the quarter ended March 31, 2005, 550 shares of preferred stock, series C, were converted into 220,000 shares of common stock. 100,000 of these common shares were not issued until April of 2005 and are therefore shown in these financial statements as stock not issued but owed as of March 31, 2005. There are 14,450 shares outstanding as of March 31, 2005. The premium on these converted shares was $7,678 and is recorded in these financial statements as a stock dividend. The premium converted at $2.50 per share into an additional 3,071 shares of common stock. These shares were not issued as of March 31, 2005 and are therefore shown in these financial statements as stock not issued but owed.

In the quarter ended March 31, 2005, 30,000 options were granted for consulting services. The options have a strike price equal to the market price on their grant date, ranging from $2.18 to $2.51. Using the Black-Scholes pricing model, the options were valued at $33,150 and recorded as consulting expense.

In the quarter ended March 31, 2005, 730,000 options were granted to directors of the Company. The options have a strike price of $2.50. Using the Black-Scholes pricing model, the options were valued at $490,868 and recorded as compensation expense.

In January of 2005, an agreement was signed with New AV Ventures, LLC (AV) for consulting services to be performed January 31, 2005 to January 31, 2010. As compensation for consulting services the Company agreed to issue 300,000 shares of common stock. These shares were issued in April of 2005 and are therefore shown on these financial statements as shares not issued but owed as of March 31, 2005. Using the market value on the date the agreement was signed, the shares were valued at $720,000 and recorded as a debit in the equity section of the balance sheet as unamortized cost of stock issued for services. The cost will be amortized over the five-year period of the agreement. Consulting expense relating to this agreement was $36,000 for the quarter ended March 31, 2005. On March 31, 2005 there was $684,000 remaining in unamortized stock issued for services for this agreement. The Company also agreed to give AV a percentage of future sales to certain vendors and one option to purchase one share of common stock for each $100 of sales to vendors generated by AV provided that AV shall not be entitled to receive in excess of 700,000 options. The options will have a term of five years and have a strike price equal to the average price of the Company's common stock for the five trading days immediately prior to January 1 of the following year. As of March 31, 2005, New AV Ventures, LLC has earned no cash fee or options under this agreement.

NOTE 4 - UNAMORTIZED COST OF STOCK ISSUED FOR SERVICES

We have issued or agreed to issue shares of common stock and options as part of various consulting agreements. The costs of these issuances are recorded as a debit in the equity section of the balance sheet as unamortized cost of stock issued for services. The balance is amortized into consulting expense over the lives of the various consulting agreements. For the quarter ended March 31, 2005, $253,903 was amortized into consulting expense. Unamortized cost of stock issued for services was $1,830,070 as of March 31, 2005.

NOTE 5 - CONSULTING, PROMOTIONAL AND INVESTOR RELATIONS SERVICES

Consulting and investor relation services expense was $746,569 for the quarter ended March 31, 2005. Consulting and investor relation expenses incurred are detailed below:

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Consulting expenses relating to stock issued for consulting agreements was $253,903 (See Note 4) in the quarter ended March 31, 2005. Consulting expenses relating to options issued for services was $171,296 (See Note 3) for the quarter ended March 31, 2005.

Various individuals and corporations performed consulting services and investor relation services for us during the quarter ended March 31, 2005 and were paid $321,370.

NOTE 6 - BUILDING AND RELATED PARTY TRANSACTIONS

We paid rent of $18,750 for January of 2005 to a company 50% owned by our President.

In February of 2005, we exercised an option to purchase a building from a company 50% owned by our President. The purchase price was $3,500,000. We are currently in the process of moving into the new facility.

NOTE 7 - SUBSEQUENT EVENTS

In April of 2005, we issued 400,000 shares of common stock that were owed as of March 31, 2005.

The Company intends to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. During such period, the registration statement that the Company filed with the US Securities and Exchange Commission to register the common stock issuable upon exercise of the warrants may not have been "current" because it had not been amended to include the Company's most recent audited financial statements. As a result, the former warrant holders may be entitled to rescind their purchases and the Company has decided to make the rescission offer. Once made, the rescission offer is open for 30 days. The rescission offer would require the Company to purchase warrants back at their original exercise price, $.50 for the Class A warrants and $3.00 for the Class B warrants, at each warrant holder's option. The current market price is well above the $.50 exercise price of the Class A warrants so no adjustment to the financial statements for the year ended December 31, 2004 or the quarter ended March 31, 2005 has been made for the rescission offer. The current market price is below the $3.00 exercise price of the Class B warrants. Only 16,600 Class B warrants were issued in the period, so any effect of the rescission offer would be immaterial to these financial statements, therefore, no adjustment has been made. If all warrant holders accepted the rescission offer, the Company would be required to pay $1,340,700 plus interest, which amount would be reduced to the extent of the proceeds from any sales of the underlying common stock by the former warrant holders. Acceptance of the rescission offer by all former warrant holders could have a material adverse effect on these financial statements.

From 2001 to 2003, we sold shares of our Convertible Preferred Stock, which is reflected in these financial statements as our Series A Preferred Stock. The Company recently discovered that the certificate of designation for the Convertible Preferred Stock had not been filed, and the Company made such filing in December of 2004. The delay in filing the certificate of designation may have resulted in the shares of Convertible Preferred Stock not being validly issued. The Company is making an assessment of the effects of the delay and will determine what actions it will take, if any, to remedy the effects of the delay. Because the current stock price is well above the conversion price, no adjustments to these financial statements have been recorded.

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; Home Theatre systems; a line for recording and broadcast studios; a line for contractor installations and touring companies; a line of in-wall, in-ceiling and outdoor loudspeakers; and a line for the cinema and movie theater market.

From the early 1990's through 1999 we derived substantially all of our revenue from marketing, renting, selling and installing sound and lighting systems under the name Sound and Lighting Specialist Inc. 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.

We began selling loudspeakers in June 2000 when we introduced our Professional Line. We introduced our other lines of speakers in subsequent years, with the most recent being the Cinema line, which we started selling in 2004. Our products are primarily sold through a network of approximately 200 dealers for our Professional and Commercial lines, 20 dealers for our Home Theater line, and 15 foreign distributors. We recently began selling products directly through a corporate sales department that targets major "big box" retailers.

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 March 31, 2005 as compared to the quarter ended March 31, 2004. For the quarter ended March 31, 2005, revenue increased to $824,720 from $420,916 in the 2004 period, a 96% increase, resulting primarily from the positive results of a marketing program we started in January 2004 and our increased production capabilities resulting from a facilities expansion completed in December 2003. Our gross profit percentage increased to approximately 41% in the 2005 period from approximately 40% in the 2004 period, primarily as a result of the introduction of new proprietary products, manufacturing efficiencies in our new facility, and reduced materials cost by purchasing in volume.

General and administrative expenses for the 2005 first quarter increased to $3,032,430 ($916,067 of which were non-cash charges) from $2,956,689 ($1,502,845 of which were non-cash charges) in the 2004 first quarter, a relatively insignificant increase of $75,741. The following table compares categories of our general and administrative expenses in the first quarter of 2005 to the first quarter of 2004:

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Non-cash G&A expense items:		
Charges for stock and options issued for consulting and investor relation services	$ 425,199	$ 654,343
Charges for options issued to directors	490,868	--
Impairment charge - Evenstar, Inc.	--	848,502
Total non-cash G&A expenses	916,067	1,502,845
Cash G&A expense items:		
Consulting and investor relation services	321,370	361,600
Advertising and promotion	812,747	82,366
Acquisitions - SA Sound	--	109,165
Acquisitions - Expiration of BG deal	100,000	--
Impairment charge - Evenstar, Inc.	--	300,000
Other cash G&A expenses	882,245	600,713
Total cash G&A expenses	2,116,363	1,453,844
Total G&A expenses	$3,032,430	$2,956,689

Due principally to the gross profit increase, partially offset by the slight increase in general and administrative expense, our net loss decreased to $2,645,696 in the first quarter of 2005 as compared to a net loss of $2,783,818 in the comparable quarter of 2004.

Other income (expense) increased to net other income of $47,739 in the 2005 first quarter as compared to net other income of $4,871 in the 2004 first quarter, primarily due to increased amounts of cash following our private placement of Series C Convertible Preferred Stock, which earned interest in bank accounts and certificates of deposit.

FINANCIAL CONDITION

On March 31, 2005, our current assets exceeded current liabilities by $11,210,757, compared to an excess of $12,229,108, on December 31, 2004. Total assets exceeded total liabilities by $15,615,831, compared to an excess of total assets over total liabilities of $12,645,461 on December 31, 2004. The changes in working capital, total assets, and total liabilities were principally due to the receipt of $13,340,408 in net proceeds from the closing of our private placement ($8,849,420 of which had been received prior to December 31, 2004) and the purchase of our new headquarters and manufacturing facility for $3,500,000. In the first quarter of 2005, we also invested $203,095 for a new vehicle, $320,508 for improvements to the new headquarters and manufacturing facility, reduced accounts payable by $154,204, and reduced accrued liabilities by

$594,716, as we paid a $600,000 liability accrued at December 31, 2004 for a finder's fee in connection with the January 2005 private placement of Series C Preferred Stock. Deposits - Merger decreased to $0, as we wrote off the $100,000 paid pursuant to Bohlender-Graebener Corporation upon expiration of such agreement. Deposits - Inventory increased by approximately $76,000 as we placed additional orders for materials to meet our increased production levels. On March 31, 2005, we had a backlog of orders of approximately $150,000.

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 order to continue operations, we have been dependent on raising additional funds, and as discussed above, on January 4, 2005, we completed a private placement of 15,000 shares of our Series C Convertible Preferred Stock for an aggregate purchase price of $15 million (net proceeds of $13,340,408). The investors also received five-year warrants to purchase an aggregate of 6,000,000 shares of our common stock at an exercise price of $6.00 per share, subject to certain adjustments. The preferred stock is initially convertible, at the holder's option, into an aggregate of 6,000,000 shares of our common stock, at a conversion price of $2.50 per share, subject to certain adjustments, and accrues a 6% premium to the stated value of the shares of preferred stock, which would be convertible into additional shares of common stock. We may redeem the warrants (or require the holder to exercise them) and may require holders to convert the preferred stock to common stock if certain conditions are met. Through March 31, 2005, holders had converted 550 shares of the Series C Preferred Stock into common stock, leaving 14,450 shares of Series C Preferred Stock outstanding.

In the 2004 first quarter, we entered into an agreement with the owners of SA Sound B.V. and SA Sound USA, Inc. giving us an option to acquire said companies at any time prior to February 27, 2004 for a purchase price of 370,000 euros, or approximately $467,000. We paid approximately $63,000 for this option. The option agreement entitled us to a refund of the option price if the due diligence performed disclosed any material adverse facts. After completion of the due diligence, we determined not to exercise the option to purchase and we have asserted a right to a refund of the option price. The sellers have challenged the return of the option fee.

On March 12, 2004, we acquired Evenstar, Inc., by a merger with and into our newly formed, wholly owned subsidiary, Evenstar Mergersub, Inc. Evenstar is the owner of one issued patent and a second patent that was issued in September 2004. The patents are for Evenstar's digital amplification technology, which provides for substantially reduced production costs compared to amplifiers of comparable quality. In consideration for Evenstar, we paid $300,000 in cash and issued 300,000 shares of common stock to the stockholders of Evenstar. In connection with the acquisition, we hired the former president of Evenstar as the head of our new electronics division, with responsibility for designing and developing new electronics products. Our ability to integrate Evenstar into our operations will have a substantial effect on our future performance.

On April 2, 2004, we entered into a strategic alliance agreement with Bohlender-Graebener Corporation ("BG"). We paid BG $100,000 on April 2, 2004 for this agreement. The agreement term is for one year and can be extended for any length of time after the first year by mutual agreement between BG and us. During the term of the agreement BG is required to work with us, diligently and in good faith, to consummate a merger. During the first six months of the agreement, BG is not permitted to solicit any offer to purchase BG, and is not permitted to respond to any unsolicited offer. In addition to the above, BG has granted us exclusive sales and marketing rights to certain BG products and we have committed to purchase certain minimum quantities of various BG products at agreed-upon prices. Those purchase commitments are as follows; $175,000 in the third quarter of 2004, $175,000 in the fourth quarter of 2004, and $200,000 in the first quarter of 2005. In the event no agreement to merge the companies on mutually acceptable terms can be reached before termination of the agreement, BG will be entitled to keep the $100,000 cash payment as consideration for its performance under the agreement. In October 2004, we agreed to pay BG an additional $100,000 to extend certain terms of the strategic alliance agreement. In addition to the $100,000 payment, we also agreed to purchase 500 units of product. In return BG agreed to extend exclusive merger negotiations by six months, provide exclusivity for one of its products to us, and provide $100,000 in discounts against future product purchases. This agreement expired in April 2005.

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 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. On March 31, 2005, we had $4,814,195 in cash, a certificate of deposit for $2,000,000 maturing on December 10, 2005, and a certificate of deposit for $2,000,000 maturing on January 7, 2006. We believe this cash is more than sufficient to fund our planned operations for at least the next twelve months.

In the past, we have been able to privately borrow money from individuals by the issuance of notes, and we have been able to raise money by the issuance of preferred stock and common stock. 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 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, our Annual Report on Form 10-KSB 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our only current borrowing is under (1) a $25,000 note accruing interest at 7% and due in September 2005 and (2) a note payable on equipment in the principal amount of $13,833 at March 31, 2005, which bears interest at 5.16% and matures in September 2008. Both of these notes are at fixed rates and are not subject to fluctuation based on changes in interest rates.

Our management has invested $4,000,000 of current excess cash in two $2,000,000 certificates of deposit. One CD earns interest at 3.34% per annum and matures on December 10, 2005, and the other earns interest at 3.00% per annum and matures on January 7, 2006. The selection of this investment was made with the primary goal of preservation of principal, while obtaining a fixed yield. We have no other investments that are subject to market risk.

ITEM 4. CONTROLS AND PROCEDURES.

As of March 31, 2005, our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2005.

As a result of the audit of our financial statements for the year ended December 31, 2002, we were required to make restatements and reclassifications of our unaudited financial statements filed for the quarters ended March 31, June 30 and September 30, 2002. Such restatements and reclassifications call into question the effectiveness of our disclosure controls and procedures. In 2004, we hired a consultant to examine and consider enhancements to such controls and procedures. The consultant's work will continue throughout 2005.

We have made no changes in our internal control over financial reporting during the quarter ended March 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 6. Exhibits.

The following are being filed as exhibits to this Report:

Exhibit No.	Description of Exhibit
31	Rule 13a-14(a) / 15d-14(a) Certifications
32	Section 1350 Certifications

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 1, 2005

By /s/ John Gott

John Gott
President and

Chief Financial Officer
(Principal Financial Officer)