SLS INTERNATIONAL INC
Form 424B3
June 17, 2005

PROSPECTUS

SLS INTERNATIONAL, INC.

7,817,000 SHARES OF COMMON STOCK

OFFERED BY SELLING STOCKHOLDERS

This prospectus relates to the sale of up to 7,817,000 shares of our common stock by selling stockholders. The selling stockholders will receive the common stock upon conversion of our outstanding Series B Preferred Stock and upon exercise of outstanding warrants and options. The prices at which the selling stockholders may sell the shares will be determined by the prevailing market price for the shares or in negotiated transactions. We will not receive any proceeds from the sale of our shares by the selling stockholders or from the conversion of the Series B Preferred Stock. We may receive up to $28,822,000 from the exercise of the warrants and options, if they are exercised in full. We will use the proceeds from any exercise of warrants and options for working capital purposes.

Our common stock is quoted on the Nasdaq Over-The-Counter Bulletin Board under the symbol SITI.OB. On May 23, 2005, the last reported sale price for our common stock as reported on the Nasdaq Over-The-Counter Bulletin Board was $2.01 per share.

The securities offered in this prospectus involve a high degree of risk. You should consider the Risk Factors beginning on page 4 before purchasing our common stock.

Neither the securities and exchange commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of the prospectus. Any representation to the contrary is a criminal offense.

SLS INTERNATIONAL, INC.

1650 W. Jackson

Ozark, Missouri 65721

(417) 883-4549

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Unless otherwise specified, the information in this prospectus is set forth as of May 31, 2005, and we anticipate that changes in our affairs will occur after such date. We have not authorized any person to give any information or to make any representations, other than as contained in this prospectus, in connection with the offer contained in this prospectus. If any person gives you any information or makes representations in connection with this offer, do not rely on it as information we have authorized. This prospectus is not an offer to sell our common stock in any state or other jurisdiction to any person to whom it is unlawful to make such offer.

PROSPECTUS SUMMARY

This summary does not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus including Risk Factors and the consolidated financial statements before making an investment decision.

The Company

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. Our executive offices are located at 1650 W. Jackson, Ozark, Missouri, 65721, with telephone number (417) 883-4549.

The Offering by the Selling Stockholders

We entered into a promotion agreement with Global Drumz, Inc., pursuant to which we granted an option to purchase 1,000,000 shares of our common stock for $2.00 per share and a warrant to purchase 1,000,000 shares of our common stock for $7.00 per share. Global Drumz, one of the selling stockholders under this prospectus, is offering for sale up to 2,000,000 shares of our common stock, which are the shares issuable upon exercise of the option and warrant.

In November 2003, we entered into a consulting services agreement with William F. Fischbach, pursuant to which we issued 400,000 shares of our common stock. At the time of the agreement, we agreed to register 100,000 of such shares. On the date of the initial filing of the registration statement containing this prospectus, Mr. Fischbach owned 125,000 shares and we agreed to register all such 125,000 shares (rather than the initial requirement of 100,000), permitting Mr. Fischbach to offer such 125,000 shares for sale pursuant to this prospectus.

In March 2004, we commenced a private placement of up to 1,000,000 shares of Series B Preferred Stock at $20.00 per share. Each share is convertible into ten shares of our common stock six months after purchase. Attached to each share of Series B Preferred Stock are ten of our Class C Warrants. Each Class C Warrant has a term of three years and provides the right to purchase one share of our common stock at $7.00 per share. The Class C Warrants are immediately exercisable and detachable from the preferred share.

In connection with the private placement, we entered into an agreement with Kenny Securities Corp. to provide certain services to us. As compensation for such services, we agreed to pay Kenny Securities (a) a cash placement fee equal to 7% of the amount sold by Kenny Securities in the private placement; (b) warrants to purchase, at $2.00 per share, a number of shares of common stock equal to 10% of the number of shares issuable upon conversion of the Series B Preferred Stock sold by Kenny Securities; and (c) Class C Warrants for the same number of shares. We issued warrants to purchase up to 125,000 shares of our common stock at $2.00 per share to Kenny Securities for sales made by Kenny Securities in the private placement. Kenny Securities also received Class C Warrants to purchase 125,000 shares of our common stock, which shares are included in the shares offered hereby.

In the private placement, which closed on July 27, 2004, 272,100 shares of the Series B Preferred Stock were sold for $5,442,000 and will be convertible into 2,721,000 shares of our common stock. We have issued a total of 2,846,000 Class C Warrants, 2,721,000 of which were attached to shares of the Series B Preferred Stock and 125,000 of which were issued to Kenny Securities.

Under this prospectus, the selling stockholders are offering up to 7,817,000 shares of our common stock, which are the shares issuable upon conversion of the Series B Preferred Stock and upon exercise of the options and warrants described above. On May 23, 2005, there were 43,702,810 shares of our common stock outstanding and 192,050 shares of Series B preferred stock outstanding (80,050 shares of previously issued Series B preferred stock have converted to common stock). Upon the exercise of the options and warrants described above, and the conversion of the remaining unconverted Series B Preferred Stock, the number of shares offered by this prospectus represents 15.5% of our total common stock outstanding on May 23, 2005. The selling stockholders are not required to sell their shares, and any sales of common stock by the selling stockholders are entirely at the discretion of the selling stockholders.

We will receive no proceeds from the sale of shares of common stock in this offering. However, if all of the warrants and options are exercised in full, we may receive up to $19,572,000 in proceeds from the exercise of the Class C Warrants, up to $9,000,000 in proceeds from the exercise of the options and warrants held by Global Drumz, and up to $250,000 from the exercise of the $2.00 warrants issued to Kenny Securities. Kenny Securities also holds 125,000 of the Class C Warrants included above. Any proceeds received upon the exercise of such options and warrants will be used for working capital and general corporate purposes.

OTC Bulletin Board Symbol

Our stock trades on the Nasdaq Over-The-Counter Bulletin Board under the symbol SITI.OB. On May 23 2005, the last reported sale price for our common stock was $2.01 per share.

Rescission Offer

From May 1, 2002 through May 10, 2004, warrant holders exercised 2,545,800 of our Class A Warrants and 22,600 of our Class B Warrants for a total of 2,568,400 shares of common stock. The warrant holders paid an aggregate of $1,340,700 for these exercises. From May 1, 2002 through May 10, 2004, the registration statement that we filed with the U.S. Securities and Exchange Commission to register the common stock issuable upon exercise of these warrants may not have been current because the registration statement had not been amended to include our most recent audited financial statements. As a result, the former warrant holders may be entitled to demand a rescission of their previous exercises of common stock. We intend to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. Once made, the rescission offer is expected to remain open for 30 days. The rescission offer would require us to repurchase the shares of common stock issued upon exercise of the warrants 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. If all warrant holders accepted the rescission offer, we 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. The current market price is over the $.50 exercise price of the Class A Warrants, and if that remains true, we would expect no former holders of Class A Warrants to accept the rescission offer. The current market price is below the $3.00 exercise price of the Class B Warrants. Only 22,600 Class B Warrants were exercised during the rescission offer period, making our potential rescission liability to the former Class B Warrant holders equal to $67,800 plus interest, which amount would be reduced to the extent of any sales of the underlying common stock by the former warrant holders.

RISK FACTORS

An investment in our common stock involves various risks, including those described in the risk factors below. You should carefully consider these risk factors, together with all of the other information included in this report, before you decide to invest in our common stock. If any of the following risks, or any other risks not described below, develop into actual events, then our business, financial condition, results of operations, or prospects could be materially adversely affected, the market price of our common stock could decline further and you could lose all or part of your investment.

RISKS RELATED TO OUR BUSINESS

We Have a History of Losses and May Not Be Profitable in the Future if We Do Not Achieve Sufficient Revenue to Absorb Recent and Planned Expenditures.

We have experienced significant operating losses since investing in the development of ribbon driver technology in 1998 and, through December 31, 2004, have an accumulated retained deficit of approximately $23,541,337. If we do not achieve continued revenue growth sufficient to absorb our recent and planned expenditures, we could experience additional losses in future periods. These losses or fluctuations in our operating results could cause the market value of our common stock to decline.

We Will Depend on Additional Capital.

Our ability to implement our strategy and expand our operations largely depends on our access to capital. To implement our long-term strategy, we plan to make ongoing expenditures for the expansion and improvement of our product line and the promotion of our products. To date, we have financed our operations primarily through sales of equity and the issuance of notes. We will need to issue additional equity or other securities to obtain the financing required to continue our operations. However, additional capital may not be available on terms acceptable to us. Our failure to obtain sufficient additional capital could curtail or alter our growth strategy or delay needed capital expenditures.

Our Dependence upon Third-Party Dealers for Sales Makes Us Vulnerable to the Efforts of Others Which Are Beyond Our Control.

Our distributors may not continue their current relationships with us and they may give higher priority to the sale of our competitors products. In addition, to be effective, distributors must devote significant technical, marketing and sales resources to an often lengthy sales cycle. Our current and future distributors may not devote sufficient resources to market our products effectively and economic or industry conditions may adversely affect their ability to market or sell for us. A reduction in sales efforts or a discontinuation of distribution of our products by any distributor could lead to reduced sales and greater net losses.

We May Not Gain Market Acceptance of Our Ribbon Driver Technology.

We believe that revenues from our ribbon driver product line will account for a material portion of our revenue for the foreseeable future. Our future financial performance will depend on the market acceptance of our ribbon driver technology and products. To date, we have had limited sales of products containing our new technology ribbon drivers. If our ribbon driver technology and product line do not gain sufficient positive market acceptance, we may not achieve anticipated revenue, profits or continued viability.

In the Loudspeaker Market, We Are Subject to Intense Competition.

Although our ribbon driver loudspeaker products are relatively new and emerging, the markets for loudspeaker products are extremely competitive and we expect such competition to increase. The market for sound enhancement products in general is intensely competitive and sensitive to new product introductions or enhancements and marketing efforts by our competitors. The market is sustained by ongoing technological developments, frequent new product announcements and introductions, evolving industry standards and changing customer requirements. We expect to experience increasing levels of competition in the future. Although we have attempted to design our loudspeaker systems to compete favorably with competitive products, we may not be able to establish and maintain our competitive position against current or potential competitors. Aggressive competition could cause us to have sales and profitability below expectations.

If We Are Unable to Hire or Retain Qualified and Skilled Personnel as Necessary, We May Not Be Able to Develop New Products or Successfully Manage Our Business.

We believe our success will depend in large part upon our ability to identify, attract and retain highly skilled managerial, engineering, sales and marketing, finance and operations personnel. However, we may not be successful in identifying, attracting and retaining such personnel. Our success also depends to a great degree upon the continued contributions of our key management, engineering, sales and marketing, finance and manufacturing personnel, many of whom would be difficult to replace. In particular, we believe that our future success depends on John Gott, Chief Executive Officer. We presently maintain key person life insurance on Mr. Gott in the amount of $5 million, but we do not have an employment contract with him. If we experience the loss of the services of any of our key personnel, we may be unable to identify, attract or retain qualified personnel in the future. This could make it difficult for us to manage our business and meet key objectives, or achieve or sustain profits.

Our Patent Application May Not Be Issued and Even If It Is Issued, We Still May Not Be Able to Adequately Protect the Patent or Our Other Intellectual Property.

In September 2002, we filed a U.S. patent application on our proprietary ribbon driver technology. Our success will depend in significant part on our ability to obtain, preserve and defend U.S. patent protection for this technology. The patent may not be issued from the patent application. The issuance of a patent is not conclusive as to its validity or enforceability and, if a patent is issued, it is uncertain how much protection, if any, will be given to our patent if we attempt to enforce it. Litigation, which could be costly and time consuming, may be necessary to enforce our current patents or any patent issued in the future or to determine the scope and validity of the proprietary rights of third parties. A competitor may successfully challenge the validity or enforceability of a patent or challenge the extent of the patent s coverage. If the outcome of litigation is adverse to us, third parties may be able to use our patented technology without payment to us. Even if we are successful in defending such litigation, the cost of litigation to uphold the patent can be substantial. 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.

It is possible that competitors may infringe our patents or successfully avoid them through design innovation. To stop these activities we may need to file a lawsuit. These lawsuits are expensive and would consume time and other resources. In addition, there is a risk that a court would decide that our patent is not valid, that we do not have the right to stop the other party from using the inventions, or that the competitor s activities do not infringe our patent.

Our competitive position is also dependent upon unpatented technology and trade secrets, which may be difficult to protect. Others may independently develop substantially equivalent proprietary information and techniques that would legally circumvent our intellectual property rights. Currently, we have not registered any potential trademarks and we may not be able to obtain registration for such trademarks.

The Use of Our Technologies Could Potentially Conflict With the Rights of Others.

Our competitors, or others, may have or may acquire patent rights that they could enforce against us. If our products conflict with patent rights of others, third parties could bring legal actions against us or our suppliers or customers, claiming damages and seeking to enjoin manufacturing and marketing of the affected products. If these legal actions are successful, in addition to any potential liability for damages, we could be required to alter our products or obtain a license in order to continue to manufacture or market the affected products. We may not prevail in any legal action and a required license under the patent may not be available on acceptable terms or at all. The cost to us of any litigation or other proceeding relating to intellectual property rights, even if resolved in our favor, could be substantial.

We Must Expand Our Operations to Commercialize Our Products, Which We May Not Be Able to Do.

We will need to expand and effectively manage our operations and facilities to successfully pursue and complete our commercialization efforts. We will need to add personnel, including management, and expand our capabilities, which may strain our existing managerial, operational, financial and other resources. To compete effectively and manage our growth, we must train, manage and motivate a substantially larger employee base, accurately forecast demand for our products and implement operational, financial and management information systems. In the event that we fail to expand or manage our growth effectively or if we cannot recruit qualified employees, our commercialization efforts could be curtailed or delayed.

We May Acquire Other Businesses or Technologies, and We May Not be Able to Integrate and Operate the Acquisitions.

In March 2004 we acquired Evenstar, Inc. From time to time, we have considered the acquisition of other businesses or other technologies, and we continue to consider such acquisitions as opportunities arise. Some of these businesses and technologies, including Evenstar, are directly related to our business and others are not. If we make any such acquisitions, we may not be able to efficiently combine our operations with those of the businesses or technologies we acquire without encountering difficulties. These difficulties could result from a variety of issues, including incompatible operating practices, corporate cultures, product lines, or technologies. As a result, we may have difficulties in integrating, managing and operating the acquired businesses and technologies.

RISKS RELATED TO OUR SECURITIES

Since Our Common Stock is Thinly Traded, It Can Be Subject to Extreme Rises or Declines in Price, and You May Not Be Able to Sell Your Shares at or Above the Price You Paid.

You may have difficulty reselling shares of our common stock. You may not be able to resell your shares at or above the price you paid, or at a fair market value. The stock markets often experience significant price and volume changes that are not related to the operating performance of individual companies. These broad market changes may cause the market price of our common stock to decline regardless of how well we perform as a company.

Future Sales of Common Stock Could Depress the Price of Our Common Stock.

Future sales of substantial amounts of our common stock pursuant to Rule 144 under the Securities Act of 1933 or otherwise could have a material adverse impact on the market price for the common stock at the time. On February 1, 2005, there were approximately 25,011,318 outstanding shares of our common stock held by stockholders that are deemed restricted securities as defined by Rule 144 under the Securities Act. The resale of many of these shares has been registered on a registration statement filed with the U.S. Securities and Exchange Commission. Upon sale pursuant to such registration statement, the shares would no longer be restricted securities. Also, under certain circumstances, these shares may be sold without registration pursuant to the provisions of Rule 144. In general, under Rule 144, a person (or persons whose shares are aggregated) who has held the stock for one year may, under certain circumstances, sell within any three-month period a number of restricted securities that does not exceed the greater of 1% of the shares outstanding or the average weekly trading volume during the four calendar weeks preceding the notice of sale required by Rule 144. In addition, Rule 144 permits, under certain circumstances, the sale of restricted securities without any quantity limitations by a non-affiliate who has held the security for two years. Any sales of shares by stockholders pursuant to a registration statement or Rule 144 may have a depressive effect on the price of our common stock.

We May Have Liability for Prior Issuances of Our Stock.

From May 1, 2002 through May 10, 2004, warrant holders exercised 2,545,800 of our Class A Warrants and 22,600 of our Class B Warrants for a total of 2,568,400 shares of common stock. The warrant holders paid an aggregate of $1,340,700 for these exercises. From May 1, 2002 through May 10, 2004, the registration statement that we filed with the U.S. Securities and Exchange Commission to register the common stock issuable upon exercise of these warrants may not have been current because the registration statement had not been amended to include our most recent audited financial statements. As a result, the former warrant holders may be entitled to demand a rescission of their previous exercises of common stock. We intend to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. Once made, the rescission offer is expected to remain open for 30 days. The rescission offer would require us to repurchase the shares of common stock issued upon exercise of the warrants 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. If all warrant holders accepted the rescission offer, we 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. The current market price is over the $.50 exercise price of the Class A Warrants, and if that remains true, we would expect no former holders of Class A Warrants to accept the rescission offer. The current market price is below the $3.00 exercise price of the Class B Warrants. Only 22,600 Class B Warrants were exercised during the rescission offer period, making our potential rescission liability to the former Class B Warrant holders equal to $67,800 plus interest, which amount would be reduced to the extent of any sales of the underlying common stock by the former warrant holders.

Shares of Convertible Preferred Stock May Not Have Been Validly Issued.

In 2001 - 2003, we sold shares of our Convertible Preferred Stock, which is sometimes reflected in our financial statements as our Series A Preferred Stock. We subsequently discovered that the certificate of designation for the Convertible Preferred Stock had not been filed, and we made such filing in December 2004. The delay in filing the certificate of designation may have resulted in the shares of Convertible Preferred Stock not being validly issued under Delaware law. We are assessing the effects of the delay and determining what actions we will take, if any, to remedy the effects of the delay. To date, we have issued 1,891,473 shares of the Convertible Preferred Stock, all of which were issued prior to the filing of the certificate of designation and 350,873 of which remain outstanding. All other shares have converted to common stock on a 10-to-1 basis, at a conversion price of $0.25 per share.

Our Internal Controls Over Financial Reporting May Not be Effective and Our Independent Auditors May Not be Able to Certify as to Their Effectiveness.

We are evaluating our internal controls over financial reporting in order to allow management to report on, and our independent auditors to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and rules and regulations of the SEC thereunder. We are currently performing the system and process evaluation and testing required (and any necessary remediation) in an effort to comply with management certification and auditor attestation requirements of Section 404. The management certification and auditor attestation requirements of Section 404 will initially apply to us as of either December 31, 2005 or December 31, 2006. In the course of our ongoing Section 404 evaluation, we will seek to identify areas of internal controls that need improvement and to design enhanced processes and controls to address these and any other issues that might be identified through this review. In the evaluation process, we may identify conditions that may result in significant deficiencies or material weaknesses in the future.

We cannot be certain as to the timing of completion of our evaluation, testing and any remediation actions or the impact of the same on our operations. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, our independent auditors may not be able to certify as to the effectiveness of our internal control over financial reporting and we may be subject to sanctions or investigation by regulatory authorities, including the SEC. As a result, there could be a negative reaction in the financial markets due to a loss of confidence in the reliability of our financial statements. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel. Any such action could negatively affect our results.

We expect to incur expenses of an aggregate of approximately $200,000 in 2005 in connection with our compliance with Section 404.

Certain Restrictive Covenants May Limit Our Ability to Raise Additional Capital and Affect Other Aspects of Our Business.

In our January 2005 private placement of Series C Preferred Stock and warrants, we entered into a securities purchase agreement with the investors. The agreement contains numerous covenants that limit our financing and other activities, including those described in the following paragraphs.

So long as at least 3,750 shares of the Series C Preferred Stock are outstanding and held by the original purchasers thereof, we may not pay any cash dividends, make distributions, redeem or repurchase any capital stock, or repay or prepay any indebtedness of ours other than as expressly required pursuant to the terms of such indebtedness.

So long as any shares of the Series C Preferred Stock are beneficially owned by the original purchasers thereof, we may not issue or sell any rights, warrants or options to subscribe for or purchase our common stock, or any other securities directly or indirectly convertible into or exchangeable or exercisable for our common stock, at an effective conversion, exchange or exercise price that varies or may vary with the market price of our common stock.

Prior to January 3, 2007, the investors in the January 2005 private placements have a right to participate in any issuance of equity securities, equity-linked securities, or convertible debt, subject to certain exceptions. The participation rights may prevent other potential investors from making offers for, or entering into agreements to purchase, our securities and thereby limiting our ability to raise capital.

If we issue our common stock at a price per share less than the then-current exercise price of the 6,000,000 warrants issued together with the sale of our Series C Preferred Stock, the exercise price of the warrants shall be adjusted downward pursuant to a formula set forth in the warrants.

We Are Obligated to Redeem Our Series C Preferred Stock Upon the Occurrence of Certain Events.

Pursuant to the terms of the certificate of designation for our Series C Preferred Stock, we are required to redeem the Series C Preferred Stock upon the occurrence of certain events, including the following:

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our common stock is suspended from trading on any of, or is not listed or quoted (and authorized) for trading on at least one of, the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market, the Nasdaq SmallCap Market or the Nasdaq Over-The-Counter Bulletin Board for an aggregate of ten or more trading days in any twelve-month period;

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the registration statement of which this prospectus is a part, after being declared effective, cannot be used by the holders of Series C Preferred Stock for the resale of all of the common stock issuable to them for an aggregate of more than 20 days, subject to certain exceptions;

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we make an assignment for the benefit of creditors, or apply for or consent to the appointment of a receiver or trustee for us or for a substantial part of our property or business, or such a receiver or trustee shall otherwise be appointed;

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bankruptcy, insolvency, reorganization or liquidation proceedings or other proceedings for the relief of debtors shall be instituted by or against us or any subsidiary of ours and if instituted against us or any of our subsidiaries by a third party, shall not be dismissed within 60 days of their initiation;

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if at least 3,750 shares of Series C Preferred Stock are outstanding and held by the original purchasers thereof and we do any of the following:

(a)

sell, convey or dispose of all or substantially all of our assets;

(b)

consummate specified mergers, consolidations or business combinations;

(c)

engage in transactions providing for sales or issuances by us or our stockholders that result in the purchaser owning or having the right to acquire greater than 35% of the outstanding shares of our common stock (calculated on a fully diluted basis); or

(d)

issue or agree to issue any equity or equity-linked securities or debt that is convertible into equity or in which there is an equity component, subject to certain exceptions;

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we either fail to make any payment with respect to any of our indebtedness in excess of $250,000, subject to certain exceptions, or default under any agreement binding us, subject to certain exceptions; or

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we breach any material term under the certificate of designation for our Series C Preferred Stock, the Series C Preferred Stock securities purchase agreement, the registration rights agreement or the warrants attached to the Series C Preferred Stock, subject to certain exceptions.

Any such redemption would be made at a premium in excess of the purchase price of the shares of Series C Preferred Stock, as determined by a formula set forth in the certificate of designation for the Series C Preferred Stock. These requirements may cause us to pay a significant amount of money to redeem the Series C Preferred Stock or may cause us to avoid taking certain actions in order to prevent the occurrence of such redemption requirement.

We May Be Required to Pay Substantial Amounts to the Investors in Our January 2005 Private Placement Upon the Occurrence of Certain Events.

In connection with the January 2005 private placement of our Series C Preferred Stock and warrants, we agreed to file a registration statement to register the resale of shares of our common stock by the investors in the private placement. We have an obligation to register additional shares that may be issuable from time to time as a result of potential adjustments to the preferred stock and warrants. We filed a registration statement to register the resale of these shares, and the registration statement was declared effective in February 2005.

We could be required to pay amounts to each investor upon the occurrence of certain events, including (a) the number of the investors shares registered on the registration statement is less than the number then issued or issuable to such investors pursuant to the Series C Preferred Stock and warrants; (b) sales of our common stock can not be made pursuant to the registration statement; or (c) our common stock is not traded, listed or included for quotation, as applicable, on the Nasdaq Over-The-Counter Bulletin Board, certain stock exchanges or certain automated quotation systems. Each of the foregoing events are, to some extent, beyond our control.

If any of the foregoing events occur, then we would be required to pay each investor an amount equal to the product of (x) the number of shares of Series C Preferred Stock held by such investor (plus any shares of preferred stock that have been converted into shares of our common stock then held by such investor as if such shares of preferred stock had not been so converted) multiplied by the per share purchase price, multiplied by (y) .01, for each thirty-day period (or portion thereof) beginning April 3, 2005 and ending July 2, 2005, and .02 for each thirty-day period beginning July 2, 2005 (or portion thereof) and prior to the date the registration statement is declared effective by the SEC. Assuming that the 6,000,000 shares of Series C Preferred Stock currently outstanding remain the number outstanding during such periods, then the amounts payable pursuant to such provisions are $150,000 through July 2, 2005 and $300,000 thereafter.

FORWARD-LOOKING STATEMENTS

This registration statement, 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 registration statement and economic, competitive and other factors affecting our operations, markets, products and services, expansion strategies and other factors discussed elsewhere in this registration statement 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 registration statement will in fact prove accurate, and our actual results may differ materially from the forward-looking statements.

MARKET FOR OUR SHARES

Market Information

Our common stock is traded on the NASDAQ over-the-counter (OTC) Bulletin Board under the symbol SITI.OB and our corporate name is SLS International, Inc. On May 23, 2005, the last reported sale price for our common stock as reported on the Nasdaq Over-The-Counter Bulletin Board was $2.01 per share. The table below sets forth, by quarter, the sales information for our common stock as reported on the Over-the-Counter Bulletin Board in our last two fiscal years. The over-the-counter quotes reflect inter-dealer prices without retail mark-up, mark-down or commission and may not represent actual transactions.

	Bid Prices	
Period	**Low**	**High**
Quarter Ended March 31, 2005	$1.86	$2.85
Quarter Ended December 31, 2004	$1.47	$2.90
Quarter Ended September 30, 2004	$1.25	$2.85
Quarter Ended June 30, 2004	$2.21	$3.00
Quarter Ended March 31, 2004	$2.65	$3.46
Quarter Ended December 31, 2003	1.37	3.92
Quarter Ended September 30, 2003	0.75	1.85
Quarter Ended June 30, 2003	0.19	0.60
Quarter Ended March 31, 2003	0.20	0.45

Holders

On March 21, 2005, there were approximately 270 holders of record of our common stock, based on information furnished by our transfer agent. Shares of our common stock are also held in street name and may, therefore, be held by numerous beneficial owners.

Dividend Policy

We have not paid any cash dividends in our past two fiscal years and do not anticipate paying cash dividends in the foreseeable future. We intend to retain future earnings to fund the development and growth of our business. Any payment of dividends in the future will be at the discretion of our board of directors and will be dependent upon our earnings, financial condition, capital requirements and other factors deemed relevant by our board of directors.

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.

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, and SLS International, Inc. was the surviving corporation. 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.

<u>YEARS ENDED DECEMBER 31, 2004 AND DECEMBER 31, 2003</u>

RESULTS OF OPERATIONS

Year ended December 31, 2004 as compared to the year ended December 31, 2003. For the year ended December 31, 2004, revenue increased to $2,040,575 from $968,245 in 2003, as a result of the further roll-out of our product line and customer acceptance of our products. Gross profit percentage decreased to 26% in 2004 from 38% in 2003, primarily as a result of new personnel that were in training and sales of several large systems at high promotional discounts.

General and administrative expenses for 2004 increased to $9,179,555 ($5,115,554 of which were non-cash charges) from $4,492,237 in 2003 ($1,799,248 of which were non-cash charges). The following table compares categories of our general and administrative expenses in 2004 to 2003:

	Year Ended December 31, 2004	Year Ended December 31, 2003
Non-cash G&A expense items:		
Charges for stock and options issued for consulting and investor relation services	$ 4,179,266	$ 1,799,248
Charges for options issued to directors and officers	87,786	23,134
Impairment charge Evenstar, Inc.	848,502	0
Total non-cash G&A expenses	5,115,554	1,822,382
Cash G&A expense items:		
Consulting and investor relation services	802,748	1,304,905
Acquisitions SA Sound	109,165	
Impairment charge Evenstar, Inc.	300,000	
Other cash G&A expenses	2,852,088	1,364,950
Total cash G&A expenses		2,669,855

	4,064,001	
Total G&A expenses		$ 4,492,237
	$ 9,179,555	

Included in the increased general and administrative expenses are one-time charges totaling $1,658,889 for promotional services provided by performing artist Quincy Jones through Global Drumz, Inc. Of these charges, $1,408,889 are included in the table above as non-cash charges for stock and options issued for consulting and investor relation services and $250,000 are included as cash charges for consulting and investor relation services.

In 2004 we reported an increased net loss of $8,646,333 as compared to a net loss of $3,979,341 in 2003, primarily as a result of the increased general and administrative expenses as well as a decrease in other income, which were partially offset by increased revenue.

Other income decreased to $46,434 in 2004, compared to other income of $145,864 in 2003, due primarily to other income recognized in 2003 from the write-off of accounts payable.

Year ended December 31, 2003 as compared to the year ended December 31, 2002. For the year ended December 31, 2003, revenue increased to $968,245 from $790,582 in 2002, as a result of the further roll-out of our product line and customer acceptance of our products. Gross profit percentage increased to 38% in 2003 compared to 32% in 2002, primarily as a result of decreased cost of goods sold for larger quantity purchases, higher margins for certain new products and decreased cost of goods sold from partial outsourcing of certain products.

General and administrative expenses for 2003 increased to $4,492,238 from $2,468,565 in 2002, primarily as a result of increased expenses for consulting and investor relation services. In 2003, we spent an aggregate of $3,104,153 for such services, $1,799,248 of which was non-cash charges related to the issuance of stock or stock options for such services. In 2002, we spent an aggregate of $1,303,770 for such services, $1,074,229 of which was non-cash charges related to the issuance of stock for such services. Services rendered included promotional services, assistance with product promotion and distribution, business development services, marketing services, merger and acquisition services, public relations, investor relations, and capital raising. Excluding such consulting and investor relations services, our general and administrative expenses increased by $223,290 in 2003. This increase is attributed to increases in advertising expenses, accounting and legal expenses, property lease expenses, equipment lease expenses, and additional employees, partially offset by a decrease in bad debt expense.

In 2003, primarily as a result of the increased general and administrative expense, which was partially offset by increased revenue and an improved gross profit percentage, we reported an increased net loss of $3,979,341 as compared to a net loss of $2,242,325 in 2002.

Other income(expense) increased to $145,864 in other income in 2003, compared to other expense of $27,099 in 2002, due primarily to write-offs of accounts payable, a change in reserves for doubtful accounts, and income received from accounts receivable that were previously written off.

FINANCIAL CONDITION

On December 31, 2004, our current assets exceeded current liabilities by $12,229,108 as compared to December 31, 2003 when our current assets exceeded current liabilities by $1,945,227. On December 31, 2004, net assets exceeded total liabilities by $12,645,461 compared to December 31, 2003 when net assets exceeded total liabilities by $2,249,489. The improvement in working capital was due primarily to increases in cash resulting from the closing of our private placement of Series B Preferred Stock in July 2004 and a deposit on a private placement of Series C Preferred Stock, which sale of Series C Preferred Stock closed in January 2005, as further discussed below. We also increased our inventory, purchased equipment and made leasehold improvements, all of which resulted in an improved working capital position, partially offset by an increase in accrued liabilities.

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. However, the private placements in 2004 and January 2005 improved our working capital position sufficiently so that the reports of our accountants on our 2004 financial statements did not contain any qualifications.

In 2004, 2003 and 2002, we entered into consulting agreements that required us to issue an aggregate of 3,815,452 shares of common stock, options to purchase 100,000 shares of Class A Preferred Stock (each such share of preferred stock converts into 10 shares of common stock), and options to purchase 2,500,000 shares of our common stock. Total expenses accrued under such agreements were $3,807,030, $2,443,056 of which has been amortized through December 31, 2004, and the remainder of which is to be amortized in subsequent periods over the respective terms of such agreements. The difference between such total expenses and the amount amortized is reflected as unamortized cost of stock issued for services on the balance sheet.

Accounts receivable decreased slightly to $271,429 on December 31, 2004, compared to $277,665 on December 31, 2003.

Net fixed assets increased to $427,304 on December 31, 2004, from $320,193 a year earlier, due primarily to leasehold improvements for additional office space and new equipment, including office furniture and computers.

Accrued liabilities increased to $630,503 on December 31, 2004 from $26,138 on December 31, 2003, because we accrued $600,000 of finder s fees payable in connection with the deposits on sales of Series C Preferred Stock, which closed in January 2005, as described below.

Compared to year-end 2003, we are currently experiencing a significantly improved cash position, as we had $10,712,858 in cash on December 31, 2004. Nevertheless, in order to continue to expand operations and fulfill our business plan, we will likely be required to raise additional funds.

In 2004 we privately sold our Series B Preferred Stock for total net proceeds of $5,102,250 in a private placement that commenced in March 2004 and closed in July 2004. We received funds from time to time upon sale of the preferred stock and placed the proceeds into our working capital upon receipt. Each share of Series B Preferred Stock is convertible into ten shares of our common stock six months after purchase. Prior to conversion, the shares have no voting rights. Attached to each preferred share are ten of our class C warrants. Each Class C Warrant has a term of three years and provides the right to purchase one share of our common stock at $7.00 per share. The Class C Warrants are immediately exercisable and detachable from the preferred share. If the average closing market price for our common stock is equal to or greater than $10.50 per share for a period of 30 days, then we are entitled to repurchase such warrants, with 30 days notice, at a price of $.001 per warrant.

In addition, we had outstanding warrants that, upon exercise, provided additional proceeds of $179,200 in 2004. The shares of common stock were issued pursuant to a registration statement declared effective by the U.S. Securities and Exchange Commission in 2001, registration statement number 333-43770. However, from May 1, 2002 through May 10, 2004, such registration statement may not have been current because the registration statement had not been amended to include our most recent audited financial statements. As a result, the former warrant holders may be entitled to demand a rescission of their previous exercises of common stock. We intend to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. Once made, the rescission offer is expected to remain open for 30 days. The rescission offer would require us to repurchase the shares of common stock issued upon exercise of the warrants 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. If all warrant holders accepted the rescission offer, we 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. The current market price is over the $.50 exercise price of the Class A Warrants, and if that remains true, we would expect no former holders of Class A Warrants to accept the rescission offer. The current market price is below the $3.00 exercise price of the Class B Warrants. Only 22,600 Class B Warrants were exercised during the rescission offer period, making our potential rescission liability to the former Class B Warrant holders equal to $67,800 plus interest, which amount would be reduced to the extent of any sales of the underlying common stock by the former warrant holders.

On January 4, 2005, we completed a private placement of our Series C Convertible Preferred Stock for an aggregate purchase price of $15 million. 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. On December 31, 2004, we were holding a deposit of $8,849,420, reflected on the consolidated balance sheet as Deposits on Preferred Stock, Series C, which was applied to the purchase of Series C Preferred Stock on January 4, 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 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 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.

QUARTER ENDED MARCH 31, 2005

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	**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. The report of our accountants contains an explanatory paragraph indicating that these factors raise doubt about our ability to continue as a going concern.

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.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the following selling stockholders:

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Global Drumz, who will receive shares of common stock upon exercise of options and warrants that it received pursuant to a promotion agreement

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Investors who will receive shares of our common stock upon conversion of our Series B Preferred Stock and exercise of our Class C Warrants

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Kenny Securities, who will receive shares of our common stock upon exercise of a warrant with an exercise price of $2.00 per share

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William F. Fischbach, who received 400,000 shares pursuant to a consulting services agreement, and may sell up to 125,000 of such shares pursuant to this prospectus.

We will receive no proceeds from the sale of shares of common stock in this offering. However, if all of the warrants and options are exercised in full, we may receive up to $19,572,000 in proceeds from the exercise of the Class C Warrants, up to $9,000,000 in proceeds from the exercise of the options and warrants held by Global Drumz, and up to $250,000 from the exercise of the $2.00 warrants issued to Kenny Securities. Kenny Securities also holds 125,000 of the Class C Warrants included above. Any proceeds received upon the exercise of such options and warrants will be used for working capital and general corporate purposes.

BUSINESS

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 w