SLS INTERNATIONAL INC
Form 10-Q/A
September 21, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

[X] Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 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

(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 [X]

On November 7, 2005, 46,283,310 shares of our common stock were outstanding.

SLS INTERNATIONAL, INC.

EXPLANATORY NOTE

SLS International, Inc. is filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, as filed with the U.S. Securities and Exchange Commission on November 14, 2005, to properly record certain stock transactions by our CEO, which for accounting and tax purposes are deemed to have been made by the company. This re-classification has resulted in the following changes to our financial statements:

Our CEO granted shares and options to various consultants in the second quarter of 2005, but the transactions were not previously recorded in the 10-Q for the nine months ended September 30, 2005. The recording of this expense results in an increase in general and administrative expense by $1,123,600 and corresponding changes in "common stock paid in capital" and "retained earnings" on the balance sheet. Prior versions of the 10-Q recorded $475,000 in compensation expense for shares transferred to employees by our CEO during the nine months ended September 30, 2005. These transfers were voided during 2005, which eliminates the entry for both tax and accounting purposes. This change results in a $475,000 reduction in general and administrative expense and corresponding changes in "common stock paid in capital" and "retained earnings" on the balance sheet.
These two changes resulted in a net increase of $648,600 in our net loss for the nine months ended September 30, 2005.

This Amendment No. 1 affects the original financial statements and the footnotes as originally filed, only to the extent described above. We have also made revisions to Management's Discussion and Analysis of Financial Condition and Results of Operations to reflect these changes in our financial statements.

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 November 14, 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.

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SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2005	Decem 2
	(unaudited)	(au
Assets		
Current assets:		
Cash	$ 301,705	$ 10,
Certificates of Deposits	2,000,000	
Accounts receivable, less allowance for doubtful accounts of $45,000 for September 30, 2005 and December 31, 2004	365,633	
Inventory	4,674,498	1,
Deposits - inventory	58,000	
Deposits - Merger	--	
Prepaid expenses and other current assets	573,188	
Total current assets	7,973,024	13,
Fixed assets:		
Construction in Progress		
Building	4,161,230	
Vehicles	283,233	
Equipment	620,165	
Leasehold improvements	4,370	
	5,068,998	
Less accumulated depreciation	219,111	
Net fixed assets	4,849,887	
Prepaid Expense	87,914	
Total assets	$ 12,910,825	$ 13,
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt and notes payable	$ 760	$
Accounts payable	704,665	
Customer Deposits	76,377	
Accrued liabilities	866	
Total current liabilities	782,668	1,
Notes payable, less current maturities	7,293	
Accrued Liabilities Class D Warrants	12,804	
Total Long term liabilities	20,097	
Total liabilities	802,765	1,
Commitments and contingencies:		
Temporary Equity:		
Preferred Stock, Series A, $.001 par, 2,000,000 shares authorized; 76,000 and 346,873 shares		

issued as of September 30, 2005 and December 31, 2004	76	
Contributed Capital - preferred	396,225	1,
Common Stock, $.001 par; 75,000,000 shares authorized; 2,568,400 shares and 2,568,400 shares issued as of September 30, 2005 and December 31, 2004	2,568	
Contributed Capital - common	1,338,132	1,
Shareholders' equity:		
Preferred stock, Series B, $.001 par, 1,000,000 shares authorized; 97,200 shares issued as of September 30, 2005 and 196,050 shares issued as of December 31, 2004	97	
Preferred stock, Series C, $.001 par 25,000 shares authorized; 14,450 and no shares issued as of September 30, 2005 and December 31, 2004	14	
Deposits on Preferred stock, series C	--	8,
Contributed capital - preferred	16,981,107	5,
Common stock, $.001 par; 75,000,000 shares authorized; 43,539,910 shares and 39,184,000 shares issued at September 30, 2005 and December 31, 2004	43,540	
Common stock not issued but owed to buyers; 1,428,071 shares and 183,000 shares at September 30, 2005 and December 31, 2004	1,428	
Contributed capital - common	30,506,100	20,
Unamortized cost of stock issued for services	(1,482,266)	(1,
Unamortized cost of stock issued for compensation	(2,217,971)	
Retained deficit	(33,460,990)	(23,
Total shareholders' equity	12,108,060	12,
	$ 12,910,825	$ 13,

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

SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	For The Nine Months Ended September 30, 2005 (unaudited)	For The Nine Months Ended September 30, 2004 (unaudited)
Revenue	$ 2,889,149	$ 1,502,559
Cost of sales	1,966,665	814,230
Gross profit	922,484	688,328
General and administrative expenses	8,981,827	7,438,310
Loss from operations	(8,059,343)	(6,749,980)
Other income (expense):		
Interest expense	(445)	(1,469)
Interest and miscellaneous, net	136,232	28,198

Gain (loss) on disposal of fixed assets	(234,158)	--
Gain (loss) on valuation of D warrants	1,493,308	--
	1,394,937	26,729
Loss before income tax	(6,664,406)	(6,723,252)
Income tax provision	--	--
Net loss	(6,664,406)	(6,723,252)
Deemed dividend associated with beneficial conversion of preferred stock	(3,253,790)	(3,874,061)
Premium - preferred series C	(7,678)	--
Net loss available to common shareholders	$ (9,925,874)	$(10,597,313)
Basic and diluted earnings per share	$ (0.22)	$ (0.34)
Weighted average shares outstanding	44,526,987	30,995,380

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

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SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	For The Three Months Ended September 30,	
	2005	2004
	(unaudited)	
Revenue	$ 1,209,076	$ 576,336
Cost of sales	847,787	333,048
Gross profit	361,289	243,288
General and administrative expenses	3,313,312	1,569,381
Loss from operations	(2,952,023)	(1,326,093)
Other income (expense):		
Interest expense	(8)	(451)
Interest and miscellaneous, net	69,893	8,495
Gain (loss) on valuation of D warrants	224,858	--
	294,744	8,044

Loss before income tax	(2,657,280)	(1,318,048)
Income tax provision	--	--
Net loss	(2,657,280)	(1,318,048)
Deemed dividend associated with beneficial conversion of preferred stock	--	(1,164,676)
Premium - preferred series C	--	--
Net loss available to common shareholders	$ (2,657,280)	$ (2,482,724)
Basic and diluted earnings per share	$ (0.06)	$ (0.07)
Weighted average shares outstanding	46,839,714	34,851,513

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

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SLS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	For The Nine Months Ended September 30,	
	2005	2004
	(unaudited)	
Operating activities:		
Net loss	$ (6,664,406)	$ (6,723
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	125,502	38
Amortization of cost of stock issued for services	398,012	210
Expense of stock options granted for services	1,395,790	2,719
Compensation expense for stock sold to employees	475,000	
Loss (gain) on disposal of fixed assets	234,158	(3
Gain on valuation of D warrants	(1,493,308)	
Goodwill impairment charge	--	1,148
Change in assets and liabilities-		
Accounts receivable, less allowance for doubtful accounts	(94,204)	(87
Inventory	(2,765,910)	(1,116
Deposits - Inventory	(8,000)	(321
Deposits - merger	100,000	
Prepaid expenses and other current assets	(468,285)	(108
Accounts payable	357,685	101
Customer deposits	76,377	
Accrued liabilities	(616,833)	1
Cash used in operating activities	(8,948,422)	(4,138

Investing activities:		
Investment in certificates of deposits	(2,000,000)	
Proceeds from disposal of fixed assets	--	3
Additions of fixed assets	(4,777,874)	(158
Cash used in investing activities	(6,777,874)	(155
Financing activities:		
Sale of stock, net of expenses	4,515,988	5,291
Acquisition of subsidiary	--	(400
Repayments of notes payable	(31,998)	(1
Cash provided by financing activities	4,483,990	4,890
Increase in cash	(10,411,153)	596
Cash, beginning of period	10,712,858	1,482
Cash, end of period	$ 301,705	$ 2,079
Supplemental cash flow information:		
Interest paid	$ 8,388	$
Income taxes paid (refunded)	--	
Change in temporary equity	1,311,413	5,713
Non-cash investing activities:		
Stock issued and options granted for services	$ 1,395,790	$ 2,719

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

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SLS INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements at September 30, 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 September 30, 2005 and results of operations and cash flows for the nine months ended September 30, 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 there to included in our Form 10-KSB for the year ended December 31, 2004.

NOTE 2 - NOTES PAYABLE

At December 31, 2004 there is a note payable to an individual in the amount of $25,000. This note was paid in the quarter ended June 30, 2005. There is also a note payable for equipment in the amount of

$15,052 and $8,058 as of December 31, 2004 and September 30, 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 nine months ended September 30, 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 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 was recorded over the two-year period of the agreement beginning July 31, 2003 and ended June 30, 2005. Expense was 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. Factors used in the Black-Scholes pricing model included: risk-free interest rates of 3.65% to 3.73%; strike price of $0.25; market prices of $2.04 to $2.26; volatility rate of 22.13%; and a yield rate of 0.00%. Consulting expense relating to this agreement was $110,600 for the nine months ended September 30, 2005. As of September 30, 2005 all of the 1,100,000 options have been earned and expensed. There will be no further expense incurred in 2005.

In November 2003, an agreement was signed with William Fischbach for consulting services to be performed November 10, 2003 to November 2006. As compensation for consulting services we issued 400,000 shares of common stock on November 11, 2003. Using the market value on 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 $195,000 for the nine months ended September 30, 2005. On September 30, 2005 there was $288,671 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 September 30, 2005, Mr. Fischbach had earned no options based on his performance in the nine months ended September 30, 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 September 30, 2005, Mr. Fischbach had earned no cash fee in the nine months ended September 30, 2005.

In March 2004, we issued an option to purchase 100,000 shares of our common stock at $2.98 per share as part of an employment agreement signed with Joel Butler for consulting services. Using the market value on the date the agreement was signed, the shares were valued at $118,000 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 two-year period of the agreement. Consulting expense relating to this agreement was $88,500 for the nine months ended September 30, 2005. On September 30, 2005 there was $29,500 remaining in unamortized stock issued for services for this agreement.

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 an 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. Through September 30, 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 nine months ended September 30, 2005. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.93%; strike price of $2.11; market price of $2.30; volatility rate of 25.87%; and a yield rate of 0.00%. The agreement also calls for additional compensation to Hargis in the form of a cash fee of 2% based on payment received from the retailer. Through September 30, 2005, Hargis had earned $1,608 based on the value provided to us in the nine months ended September 30, 2005.

In February of 2005, an agreement was signed with 3CD Consulting, LLC for consulting services to be performed November 18, 2004 to November 17, 2007. As compensation for consulting services the Company issued 1,000,000 options for shares of common stock. The options have a term of 3 years and a strike price of $2. Using the Black-Scholes pricing model, the options were valued at $814,781 and recorded as a debit in the equity section of the balance sheet as unamortized cost of stock issued for services. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.08%; strike price of $2.00; market price of $2.45; volatility rate of 29.73%; and a yield rate of 0.00%. The expense is amortized over the three-year period of the agreement. Consulting expense relating to this agreement was $203,694 for the nine months ended September 30, 2005. On September 30, 2005, there was $579,091 remaining in unamortized cost of stock issued for services for this agreement.

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 issued 300,000 shares of common stock. 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 $108,000 for the nine months ended September 30, 2005. On September 30, 2005 there was $612,000 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. Through September 30, 2005, New AV Ventures, LLC has earned no cash fee or options under this agreement.

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 with $900,000 plus 600,000 warrants, which were valued at $627,034 using the Black-Scholes pricing model. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.64%; strike price of $2.50; market price of $2.79; volatility rate of 29.73%; and a yield rate of 0.00%.

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 September 30, 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 September 30, 2005, the face value of the 14,450 outstanding shares is $15,098,371, of which $648,371 is premium. The face value of the preferred stock is convertible into common stock at $2.50 per share. As a result, on September 30, 2005, the 14,450 outstanding shares of preferred stock were convertible into 6,039,348 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. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.64%; strike price of $6.00; market price of $2.79; volatility rate of 29.73%; and a yield rate of 0.00%.

The provisions of the agreement pertaining to the Class D warrants provide for penalties if we fail to keep the registration statement effective for the resale of the common stock issuable upon exercise of the warrants. Since these provisions provide a settlement alternative that would be avoided by the company under other settlement alternatives, we are required by EITF 00-19 to record a liability in an amount equal to the market value of the Class D warrants. The initial

amount of this liability is the fair market value as determined by the Black-Scholes pricing model amounting to $1,506,112. Subsequent changes in the Black-Scholes based market value are to be reported in our statement of operations. As of September 30, 2005, using the Black-Scholes pricing model produced a value of $12,804. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.64% - 4.18%; strike price of $6.00; market price of $$1.91 - $2.79; volatility rate of 18.54% - 29.73%%; and a yield rate of 0.00%. Consequently the decrease in the original liability of $1,506,112 to the September 30, 2005 value of $12,804 resulted in recognition of a gain amounting to $1,493,308.

In the nine months ended September 30, 2005, 274,873 shares of preferred stock, series A, were converted to 2,748,730 shares of common stock. There are 76,000 shares of series A preferred stock outstanding as of September 30, 2005.

In the nine months ended September 30, 2005, 98,850 shares of preferred stock, series B, were converted to 988,500 shares of common stock. There are 97,200 shares of series B preferred stock outstanding as of September 30, 2005.

In the nine months ended September 30, 2005, 550 shares of preferred stock, series C, were converted into 220,000 shares of common stock. There are 14,450 shares of series C preferred stock outstanding as of September 30, 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 September 30, 2005 and are therefore shown in these financial statements as stock not issued but owed.

In the nine months ended September 30, 2005, 90,000 options were granted from time to time to Ryan Schinmann for consulting services. The options have strike prices equal to the market price on their respective grant dates, ranging from $2.04 to $2.51. Using the Black-Scholes pricing model, the options were valued at $86,269 and recorded as consulting expense. Factors used in the Black-Scholes pricing model included: risk-free interest rates of 3.94% to 4.50%; strike prices of $2.04 to $2.51; market prices of $2.04 to $2.51; volatility rate of 25.87%; and a yield rate of 0.00%. 10,000 additional options are to be granted every month until the contract is terminated, and the contract is terminable by the Company at will.

In the nine months ended September 30, 2005, 930,000 options were granted to directors of the Company. Using the Black-Scholes pricing model, the options were valued at $686,868 and recorded as compensation expense. Factors used in the Black-Scholes pricing model included: risk-free interest rates of 3.71% to 4.06%; strike prices of $2.27 to $2.50; market prices of $2.27 to $2.38; volatility rate of 22.13%; and a yield rate of 0.00%. In the second quarter of 2005, 730,000 options issued in the first quarter automatically expired upon resignation of two directors. Therefore, compensation expense for the nine months ended September 30, 2005 was reduced by $490,868 in credits from the expiration of such options, resulting in a net expense of $196,000 for the nine months ended September 30, 2005.

In June of 2005, an agreement was signed with JMBP, Inc. and Mark Burnett for consulting services. As compensation for consulting services the Company agreed to issue 1,000,000 options for shares of common stock and 1,000,000 warrants for shares of common stock. The options have a term of five years and a strike price of $2.05. The warrants have a term of five years and a strike price of $6.50. 400,000 options and 400,000 warrants vested on the date the agreement was signed. The remaining options and warrants vest upon various events as set forth in the agreement. Through September 30, 2005, 100,000 additional warrants and 100,000 additional options vested. Using the Black-Scholes pricing model, these options and warrants were valued at $283,740 and recorded as consulting expense for the nine months ended September 30, 2005. Factors used in the Black-Scholes pricing model included: risk-free interest rate of 3.61% - 3.89%; strike price of $2.05 - $2.51 for the options and $6.50 for the warrants; market price of $1.91 - $2.05; volatility rate of 19.36% - 22.13%; and a yield rate of 0.00%. Expenses to be recorded in future quarters are unknown at this time because the value of the vesting options and warrants will be partly based on the market price on the date the vesting events take place.

In June of 2005, we entered into employment agreements with Michael Maples, Steven Lamar, and John Gott. Each agreement has a term of three years. In the agreements we agreed to pay an aggregate of $150,000 in signing bonuses, agreed to issue an aggregate of 1,125,000 shares of common stock, and agreed to issue an aggregate of 1,250,000 options. The signing bonuses were paid and capitalized as a prepaid expense, which will be amortized monthly over the three-year term of each agreement. In the nine months ended September 30, 2005, $14,132 was recorded in compensation expense. There is $135,868 remaining in prepaid expense as of September 30, 2005. The 1,125,000 shares of common stock are required to be issued in January 2006 and are therefore shown in these financial statements as "stock not issued but owed". The shares were valued at $2,418,750, using the market price on the date the agreement was signed, and recorded as unamortized cost of stock issued for compensation in the equity section of these financial statements. The cost will be amortized over the three-year term of the agreements. For the nine months ended September 30, 2005, $230,279 was amortized into compensation expense. Unamortized cost of stock issued for compensation was $2,188,471 as of September 30, 2005. The 1,250,000 options will be earned evenly over the three-year term of each agreement. Each option is convertible into one share of common stock at a strike price of $2.50 and is exercisable for a period of ten years. Expense associated with the options will be recorded over the three-year period of the agreement at fair market value, using the Black-Scholes pricing model. Compensation expense relating to options earned for the nine months ended September 30, 2005 was $116,038. Factors used in the Black-Scholes pricing model included; risk-free

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interest rates of 3.75% - 4.09%; strike price of $2.50; market prices of $1.91 - $2.15; volatility rates of 22.13% - 26.73%; and a yield rate of 0.00%. Through September 30, 2005, 49,562 of the 1,250,000 options have been earned and expensed. Expenses to be recorded in future quarters are unknown at this time because the value of the earned options will be partly based on the month-end market price.

In the quarter ended June 30, 2005, the company's CEO transferred 55,000 shares of his personal common stock to various individuals for consulting services. For accounting and tax purposes, these transfers are deemed to have been made by the Company. The shares were valued using the market price at the date the stock was transferred. The stock price ranged from $2.15 - $2.40. The shares were valued at $128,250 and recorded as consulting expense for the nine months ended September 30, 2005.

In the quarter ended June 30, 2005, the company's CEO granted 500,000 options to a consultant from his own personal stock. For accounting and tax purposes, these transfers are deemed to have been made by the Company. Using the Black-Scholes pricing model included: risk free interest rate of 3.19%; strike price of $.05; market price of $2.04; volatility rate of 22.13%; and a yield rate of 0%. The options were recorded as consulting expense for the nine months ended September 30, 2005.

NOTE 4 - UNAMORTIZED COST OF STOCK ISSUED FOR SERVICES AND COMPENSATION

As detailed in Note 3, 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 nine months ended September 30, 2005, $1,145,202 was amortized into consulting expense. Unamortized cost of stock issued for services was $1,482,266 as of September 30, 2005.

As detailed in Note 3, we have agreed to issue common stock as part of various employment 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 compensation. The balance is amortized into compensation expense over the three-year lives of the employment agreements. For the nine months ended September 30, 2005, $230,279 was amortized into compensation expense. Unamortized cost of stock issued for compensation was $2,217,971 as of September 30, 2005.

NOTE 5 - CONSULTING, PROMOTIONAL AND INVESTOR RELATIONS SERVICES

Consulting and investor relation services expense was $2,199,234 for the nine months ended September 30, 2005. Consulting and investor relation expenses incurred are detailed below:

Consulting expenses relating to stock issued for services were $398,012 (See Note 4) in the nine months ended September 30, 2005. Consulting expenses relating to options issued for services was $747,190 (See Note 3) for the nine months ended September 30, 2005.

Various individuals and corporations performed consulting services and investor relation services for us during the nine months ended September 30, 2005 and were paid $1,054,032 in cash.

NOTE 6 - BUILDING AND RELATED PARTY TRANSACTIONS

We paid rent of $18,750 for January of 2005 to a company 50% owned by John Gott, our Chief Executive Officer.

In February of 2005, we exercised an option to purchase a building from a company 50% owned by John Gott, our Chief Executive Officer. The purchase price was $3,500,000.

NOTE 7 - TEMPORARY EQUITY - RESCISSION OFFERS

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 repurchase shares of common stock issued upon exercise of 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. 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 nine months ended September 30, 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 22,600 Class B warrants were issued in the 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. 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 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. We intend to make a rescission offer during 2005 to the holders of all outstanding shares of Convertible Preferred Stock, but we do not intend to offer rescission to holders who have converted their Convertible Preferred Stock to common stock. If all holders of the 76,000 shares of Convertible Preferred Stock remaining outstanding on September 30, 2005 elected rescission at their original purchase price of $2.50 per share, the Company would be required to pay an aggregate of $190,000 plus interest. Because the current stock price is well above the conversion price, no adjustments to these financial statements have been recorded.

Pending the completion of the rescission offer, the right of shareholders to seek rescission and receive the rescission amount is not completely within the control of the Company. As a result, the shares subject to rescission rights are considered and treated as temporary common and preferred stock for financial accounting purposes until such time as the rescission rights lapse or are exercised. Therefore the rescission amount and related shares were removed from the Shareholder Equity and are currently classified as Temporary Equity. The restatement was made solely to reflect this reclassification and did not affect the Company's previously reported net income, net income per share, assets or liabilities.

NOTE 8 - SUBSEQUENT EVENTS

From October 1, 2005 through November 7, 2005, 10,000 shares of preferred stock, series A, were converted to 100,000 shares of common stock.

From October 1, 2005 through November 7, 2005, 7,500 shares of preferred stock, series B, were converted to 75,000 shares of common stock.

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 sales representatives and our own internal sales force, for our following lines: Pro, Cinema, Home Theatre, Studio, Universal Series, RLA and the PRD series. Recently we have consolidated all our foreign distribution with one sales representative organization who will work between the Company and all foreign distributors. We have also begun 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 September 30, 2005
as compared to the quarter ended September 30, 2004.

For the quarter ended September 30, 2005, revenue increased to $1,209,076 from $576,336 in the 2004 period, a 110% increase, resulting primarily from the positive results of a marketing program we started in January 2004 and our increased production capabilities resulting from facility expansions completed

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in 2004 and 2005. Compared to the same quarter of 2004, the most significant sales increases have occurred in our "core" Pro products which accounted for 44% of our sales in the quarter ended September 30, 2005. Sales to the Cinema industry, a new line for 2005, have been very strong exceeding $280,000 for the third quarter of 2005. During September of 2005 we shipped our new "home theater in a box, the Q Line Silver to a Fortune 50 Retailer. While we believe this channel exposure will be significant to our future sales growth, the initial order was for 400 units to be distributed to 100 test stores throughout the US. Our quarterly gross profit percentage decreased to approximately 30% in the 2005 period from margins of approximately 42% in the 2004 period, primarily due to unusually high profit margins in the 2004 period.

General and administrative expenses for the 2005 third quarter increased to $3,313,312 from $1,569,381 in the 2004 third quarter, an increase of $1,743,931. As shown in the table below, the increase resulted primarily from non-cash charges for options and stock transactions of the new directors and executives and continuing increased cash costs to support our new facility, new management structure, and advertising programs. Advertising and promotion expense increased in the 2005 period due to image and branding programs directed at the retail market in connection with planned product launches in retail outlets in late 2005 and early 2006 (approximately $429,000 in the 2005 period) and demo and promotional equipment costs ($237,000 in the 2005 period). Other cash G&A expense include increases in labor and related costs (approximately $321,000), trade show and travel ($101,000), and increased operating costs at our new facility ($78,000).

	Three Months Ended	
	September 30, 2005	September 30, 2004
NON-CASH G&A EXPENSE ITEMS:		
Charges for stock and options issued for consulting and investor relation services	$ 246,661	$ 373,412
Charges for options and stock issued and sold to directors/employees	394,229	--
Total non-cash G&A expense	640,890	373,412
CASH G&A EXPENSE ITEMS:		
Consulting and investor relation services	866,549	574,481
Advertising and promotion	796,625	120,268
Other cash G&A expenses	1,009,248	501,220
Total cash G&A expense	2,672,422	1,195,969
Total G&A expense	$3,313,312	$1,569,381

Other income (expense) increased to a net income of $294,744 in the 2005 third quarter as compared to net other income of $8,044 in the 2004 third quarter, primarily due to $69,893 in interest earned on cash and certificates of deposit related to cash received from our private placement of Series C Convertible Preferred Stock and a $224,858 non-cash gain on the change in valuation of the "D warrants" as explained further in Note 3 to the financial statements.

Due principally to the increase in general and administrative expense, offset to a small degree by an increase in gross profit, and the other income items above, our net loss increased to $2,657,280 in the third quarter of 2005 as compared to a net loss of $1,318,048 in the comparable quarter of 2004.

Nine months ended September 30, 2005
as compared to the nine months ended September 30, 2004.

Revenue increased to $2,889,149 from $1,502,559 in the first nine months of 2005, a 92% increase, resulting primarily from the positive results of a new marketing program we started in January 2004 and our increased production capabilities resulting from facility expansions completed in 2004 and 2005. Most significant sales increases have occurred in our "core" Pro and RLA products which accounted for over 50% of our sales in the nine months ended September 30, 2004 and 2005. Sales to the Cinema industry, a new line for 2005, have been strong, exceeding $500,000 for the first nine months of 2005. During September of 2005 we shipped our new "home theater in a box, the Q Line Silver to a Fortune 50 Retailer. Our gross profit percentage decreased to approximately 32% in the 2005 period from approximately 46% in the 2004 period, primarily due to unusually high profit margins in the 2004 period.

General and administrative expenses for the first nine months of 2005 increased to $8,981,827 from $7,438,310 in the 2004 period. The increase resulted primarily from increased advertising expenses as well as increases in costs to support our new facility and new management structure. The costs for the nine months of 2004 includes a one-time impairment charge of $1,148,502 recognized in the first half of 2004 related to the Evenstar, Inc. acquisition.

	Nine Months Ended	
	September 30, 2005	September 30, 2004
NON-CASH G&A EXPENSE ITEMS:		
Charges for stock and options issued for consulting and investor relation services	$2,268,802	$3,153,453
Charges for options and stock issued and sold to directors/employees	630,817	87,786
Impairment charge - Evenstar, Inc.	--	848,502
Total non-cash G&A expense	2,899,619	4,089,741
CASH G&A EXPENSE ITEMS:		
Consulting and investor relation services	1,053,871	912,476
Advertising and promotion	1,466,379	226,396
Acquisitions - SA Sound	--	109,165
Acquisitions - BG deal expired	100,000	--
Impairment charge - Evenstar, Inc.	--	300,000
Other cash G&A expenses	3,461,958	1,800,532
Total cash G&A expense	6,082,208	3,348,569
Total G&A expense	$8,981,827	$7,438,310

As shown in the preceding table, our non-cash G&A expenses have decreased $1,190,122. Cash G&A costs increased significantly due to a number of branding and advertising programs, increased promotional costs, and consulting costs due to infrastructure development and compliance issues. The increased advertising costs included expenses for image and branding programs directed at the retail market in connection with planned product launches in retail outlets in late 2005 and early 2006 (approximately $523,000 in the 2005 period), demo and promotional equipment costs ($237,000 in the 2005 period), and preparation and videos and collateral materials explaining our technology ($100,000 in the 2005 period). The increase in other cash G&A costs include increased labor and related costs (approximately $592,000), trade shows and travel ($397,000), and increased operating costs at our new facility ($487,000).

The combined factors of increased revenue offset by the increase in general and administrative costs resulted in a Loss from Operations for the nine months ended September of 2005 amounting to $8,059,343 compared to $6,749,980 loss for the same period of 2004.

Other income (expense) amounted to $1,394,937 of income for the nine months of 2005 compared to $26,729 other income for the same period during 2004. Major components of the 2005 other income amount are a loss of $234,158 due to the disposal of leasehold improvements made to our previous office and factory facility, a gain of $136,232 from interest income resulting from the proceeds for our Series C Preferred stock offering, and a non-cash gain of $1,493,308 from the change in valuation of our D warrants that were issued as part of the Series C Preferred offering.

The increase in other income and gross profit more than offset the increase in our general and administrative costs to result in a net loss for the nine months of 2005 amounting to a $6,015,806 loss compared to a loss of $6,723,252 for the same period of 2004.

FINANCIAL CONDITION

On September 30, 2005, our current assets exceeded current liabilities by $7,190,356 compared to an excess of $12,229,108, on December 31, 2004. Total assets exceeded total liabilities by $12,108,060, 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 January 2005 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 nine months of 2005, we also invested $231,284 for new vehicles, $661,230 for improvements to the new headquarters and manufacturing facility, and $385,360 for new equipment.

Our operations used cash of $10,411,153 for the first nine months of 2005 which was primarily attributable to the net loss of $6,664,406 recognized during the period; an increase in inventory of $2,765,910; a reduction of accrued liabilities by $616,833, 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; and an increase in prepaid expenses and other current assets of $468,285 primarily related to prepaid advertising associated with our national branding campaign, deposits and prepaid insurance. We wrote off the $100,000 paid to Bohlender-Graebener Corporation upon expiration of our agreement. On September 30,2005, we had a backlog of orders of approximately $108,698 compared to a backlog of $200,000 at this same time last year.

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.

On June 17, 2005, we entered into employment agreements with John M. Gott, our Chairman and Chief Executive Officer; Steven M. Lamar, our newly hired President; and Michael L. Maples, our newly hired Chief Operating Officer and Chief Financial Officer. Each employment agreement has a term of three years and severance payments equal to six months of base salary following a termination by us without "cause" or a termination by the executive for "good reason." Mr. Gott's agreement provides for an annual salary of $180,000, an increase from his previous salary of $96,000; a grant of options to purchase up to 500,000 shares of our common stock at $2.50 per share; and an agreement to grant 500,000 shares of our common stock to Mr. Gott in January 2006.

Mr. Lamar's agreement provides for an annual salary of $120,000, a signing bonus of $100,000, a grant of options to purchase up to 500,000 shares of our common stock at $2.50 per share, and an agreement to grant 500,000 shares of our common stock to Mr. Lamar in January 2006.

Mr. Maples' agreement provides for an annual salary of $250,000, a signing bonus of $50,000, a grant of options to purchase up to 250,000 shares of our common stock at $2.50 per share, and an agreement to grant 125,000 shares of our common stock to Mr. Maples in January 2006.

Each of the options described above were granted on June 21, 2005 and have a term of ten years. The options vest in one-third increments on each of the first, second and third anniversaries of the date of the option grant. The options vest in full upon a "change of control" or termination of the executive's employment by us without "cause."

On June 14, 2005, we entered into a Promotion Agreement with JMBP, Inc. and Mark Burnett. In connection with the Promotion Agreement, we entered into an Option Agreement and Warrant Certificate on June 14, 2005 with Mr. Burnett. Under the Option Agreement, SLS granted Mr. Burnett 1,000,000 options for shares of our common stock at an exercise price of $2.05 per share, subject to certain adjustments specified in the Option Agreement. Under the Warrant Certificate, we granted to Mr. Burnett warrants to purchase 1,000,000 shares of our common stock at an exercise price of $6.50 per share, subject to certain adjustments specified in the Warrant Certificate. Forty percent of the options and warrants vested as of June 14, 2005 and the remainder of the options and warrants vest, if at all, incrementally based on the achievement of specified milestones. The vested options and warrants are exercisable at any time, and from time to time, during the term beginning on June 14, 2005 and ending on June 14, 2010. SLS issued the options and warrants as part of the consideration for the consulting and other services SLS is entitled to receive under the Promotion Agreement. Through September 30, 2005, 100,000 additional options and 100,000 additional warrants vested based on performance under our agreement.

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 holders to exercise them) and may require holders to convert the preferred stock to common stock if certain conditions are met. Through September 30, 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 was for one year and could 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 was required to work with us, diligently and in good faith, to consummate a merger. During the first six months of the agreement, BG was not permitted to solicit any offer to purchase BG, and was not permitted to respond to any unsolicited offer. In addition to the above, BG granted us exclusive sales and marketing rights to certain BG products and we committed to purchase certain minimum quantities of various BG products at agreed-upon prices. Those purchase commitments were 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. We satisfied all of these purchase commitments. In the event no agreement to merge the companies on mutually acceptable terms could be reached before termination of the agreement, BG would 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 additional 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. We are currently in negotiations with BG to extend the agreement.

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 September 30, 2005, we had $301,705 in cash, and a certificate of deposit for $2,000,000 maturing on December 10, 2005. With more than $5 million in receivables and inventory free of any debt we have entered into discussions with commercial banking sources for a stand by line of credit based on those assets.

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. We expect that we will need to obtain some amount of additional financing before the end of the first quarter of 2006 or earlier. However, we cannot be certain that we will be able to successfully obtain such financing. If we fail to do so, we may be unable to continue as a viable business, or we may be unable to proceed with our initiatives to increase our retail sales and our other initiatives.

CRITICAL ACCOUNTING POLICIES

Our discussion of results of operations and financial condition relies on our consolidated financial statements that are prepared based on certain critical accounting policies that require management to make judgments and estimates that are subject to varying degrees of uncertainty. We believe that investors need to be aware of these policies and how they impact our financial reporting to gain a more complete understanding of our financial statements as a whole, as well as our related discussion and analysis presented herein. While we believe that these accounting policies are grounded on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates or judgments. The accounting policies and related risks described in the notes to our financial statements for the year ended December 31, 2004 are those that depend most heavily on these judgments and estimates.

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 a note payable on equipment in the principal amount of $7,293 at September 30, 2005, which bears interest at a fixed rate of 5.16% and matures in September 2008.

We have invested $2,000,000 of current excess cash in one $2,000,000 certificate of deposit. The CD earns interest at 3.34% per annum and matures on December 10, 2005. The selection of this investment was made with the primary goal of preservation of principal, while obtaining a fixed yield. On October 14, 2005, we cashed the CD prior to maturity. We have no other investments that are subject to market risk.

ITEM 4. CONTROLS AND PROCEDURES.

As of September 30, 2005, our Chief Executive Officer and our 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 each concluded that our disclosure controls and procedures were effective as of September 30, 2005.

In recent years, we have been required to make restatements and reclassifications of our financial statements. 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. In 2005, we have hired three new personnel - a Chief Financial Officer, a Controller, and an Information Technology Director - whose functions will include improving our controls and procedures.

We have made no changes in our internal control over financial reporting during the quarter ended September 30, 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
31.1	Rule 13a-14(a) / 15d-14(a) Certifications of Chief Executive Officer
31.2	Rule 13a-14(a) / 15d-14(a) Certifications of Chief Financial Officer
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: September 20, 2006

By: /s/ Michael L. Maples

Michael L. Maples
Chief Financial Officer
(Principal Financial Officer)