

COMPUTER SOFTWARE INNOVATIONS INC

Form 424B3

January 09, 2008

**PROSPECTUS SUPPLEMENT NO. 15**

To Prospectus dated May 14, 2007

**Filed Pursuant to Rule 424(b)(3)**

**Registration No. 333-129842**

## **Computer Software Innovations, Inc.**

**14,435,472 SHARES OF COMMON STOCK**

This Prospectus Supplement supplements the Prospectus dated May 14, 2007, as amended and supplemented, relating to the offer and sale by the selling stockholder identified in the Prospectus of up to 14,435,472 shares of common stock of Computer Software Innovations, Inc. (the Company ).

This Prospectus Supplement includes the Company s Form 8-K filed with the Securities and Exchange Commission on January 9, 2008.

The information contained in the report included in this Prospectus Supplement is dated as of the period of such report. This Prospectus Supplement should be read in conjunction with the Prospectus dated May 14, 2007, as supplemented on May 25, 2007, June 1, 2007, June 27, 2007, August 14, 2007, September 14, 2007, October 3, 2007, October 5, 2007, October 11, 2007, October 24, 2007, November 13, 2007, November 20, 2007, December 3, 2007 and December 5, 2007, which supplements are to be delivered with this Prospectus Supplement. This Prospectus Supplement is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement updates and supersedes the information contained in the Prospectus dated May 14, 2007, including any supplements or amendments thereto.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 15 is January 9, 2008.

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

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**FORM 8-K**

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**CURRENT REPORT PURSUANT  
TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**Date of report (Date of earliest event reported) January 2, 2008**

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**COMPUTER SOFTWARE INNOVATIONS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**

(State or other jurisdiction of incorporation)

**000-51758**  
(Commission File Number)

**98-0216911**  
(IRS Employer Identification No.)

**900 East Main Street, Suite T, Easley, South Carolina**  
(Address of principal executive offices)

**29640**  
(Zip Code)

**(864) 855-3900**

(Registrant's telephone number, including area code)

(Former name or former address, if changed since last report)

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Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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**Item 1.01. Entry into a Material Definitive Agreement.**

On January 2, 2008, Computer Software Innovations, Inc. ( CSI ) and Logical Choice Technologies, Inc. (Logical Choice ) entered into a Reseller Agreement dated to be effective October 18, 2007. The Reseller Agreement evidences an affiliate arrangement between CSI and Logical Choice, whereby CSI has been granted the right to sell Promethean and AudioGear products in 33 counties in central and southwestern Alabama. The term of the arrangement is one year, subject to renewal and termination for convenience upon 30-days advance written notice. The agreement also requires CSI to promote and sell only AudioGear-branded audio solutions from Logical Choice in Alabama.

Certain additional information on the Reseller Agreement is contained in a press release of CSI dated January 9, 2007, which is filed herewith as Exhibit 99.1 and incorporated into this item.

**Item 9.01. Financial Statements and Exhibits.**

(c) Exhibits.

The following exhibits are filed as part of this report:

<b>Exhibit Number</b>	<b>Description</b>
99.1	Press Release of CSI dated January 9, 2008.

**SIGNATURES**

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 hereunto duly authorized.

COMPUTER SOFTWARE INNOVATIONS, INC.

By: /s/ David B. Dechant  
David B. Dechant

Chief Financial Officer

Dated: January 9, 2008

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
99.1	Press Release of CSI dated January 9, 2008.

**COMPUTER SOFTWARE INNOVATIONS, INC. OFFERS INTERACTIVE CLASSROOM SOLUTIONS TO ALABAMA SCHOOLS; CSI ENTERS INTO AFFILIATE ARRANGEMENT WITH LOGICAL CHOICE TECHNOLOGIES**

**January 9, 2008 Easley, South Carolina** Computer Software Innovations, Inc. ( CSI ) (OTCBB: CSWI.OB), a leading provider of software and technology solutions primarily for the public sector, will be expanding its Interactive Classroom Technology Solutions into Alabama through an affiliate arrangement with Logical Choice Technologies (LCT), entered into on January 2, 2008. The affiliate arrangement with LCT allows CSI to sell Promethean and AudioGear products in thirty-three counties in Alabama, encompassing the central and southwestern portions of the state. This region of Alabama includes more than 600 schools and more than 20,000 classrooms. Currently, CSI is the exclusive reseller of Promethean s products for the South and North Carolina markets.

We are excited about this opportunity to bring our interactive classroom expertise to Alabama, said Nancy Hedrick, CEO and President of CSI. We have a very strong partnership with Promethean in both North Carolina and South Carolina and look forward to offering these technology solutions in additional states. LCT has also been a strong Promethean partner and we feel our affiliate arrangement will work well in Alabama.

Interactive classroom implementations have been a significant part of CSI s growth in 2007 as schools in North Carolina and South Carolina have increasingly adopted this instructional technology. In addition to selling the Promethean solutions, which include Activboards, Activotes and Activlates, and the AudioGear audio enhancement products, CSI will be providing installation services, staff development and ongoing support for interactive classroom installations in Alabama. CSI s recent acquisition of McAleer Computer Associates located in Mobile, Alabama provides relationships with more than 90% of the finance officers within Alabama school districts. CSI will now be able to offer this technology to many of those districts.

The true impact of this instructional technology has yet to be fully realized. The transformation of the classroom has set the stage for the development of engaged life-long learners, states Keone Trask, Chief Technology Officer of CSI.

**About Computer Software Innovations, Inc.**

Computer Software Innovations, Inc. is a full service company providing software and technology solutions primarily to public sector organizations. The software solutions include financial management, billing and revenue management, school activity accounting, lesson planning and automated workflow. The technology solutions include IP telephony, IP video surveillance, visual communications, interactive classrooms, network security and traffic monitoring, infrastructure design, wireless solutions, network management, engineering services and hardware solutions. CSI s client base includes school districts, higher education, municipalities, county governments, and other non-profit organizations. Currently, more than 600 public sector organizations utilize CSI s software systems and network integration services. Additional information on CSI can be obtained through its website at [www.csioutfitters.com](http://www.csioutfitters.com).

**About Logical Choice Technologies, Inc.**

Logical Choice Technologies was founded in 1994 with a vision to utilize technology to enhance education and continues to do so to this day. The 130 + employees strive to make a difference not only in Education, but in Government as well. ClassroomTechnology Integration is the company s main area of expertise as it strictly serves the education and government marketplace. The company is best known today for working with public/private school systems to design and implement 21st Century Model Classroom solutions. Additional information on LCT can be obtained through its website at [www.logicalchoice.com](http://www.logicalchoice.com).

**About Promethean**

Promethean is a global leader in interactive learning technology that empowers teachers to engage, educate, assess and motivate learners. Developed by and for educators, its award-winning products help teachers to prepare digital lessons quickly and with greater ease. The technology enables them to create, customize and integrate text, web, video and audio content, so they can more easily capture students attention and accommodate different learning styles.

Promethean Activclassroom solutions are helping educators teach and students learn worldwide with Activboard, the world s most durable interactive whiteboard technology; Activstudio, a software platform for secondary teaching; and Activprimary, the only product designed specifically for use in primary schools and kindergarten. It also offers wireless hand-held Activotes that permit instantaneous assessment

of pupils' comprehension of lessons. Beyond the classroom, Promethean offers training and support to ensure maximum results and return on investment.

Promethean is headquartered in the United Kingdom. Its products are distributed through a network of partners and inspire millions of learners in more than 70 countries.

For more information, please visit [www.prometheanworld.com](http://www.prometheanworld.com)

### **Forward-Looking and Cautionary Statements**

This release contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Among other things, these statements relate to our financial condition, results of operations and future business plans, operations, opportunities and prospects. In addition, we and our representatives may from time to time make written or oral forward-looking statements, including statements contained in other filings with the Securities and Exchange Commission and in our reports to stockholders. These forward-looking statements are generally identified by the words or phrases may, could, should, expect, anticipate, plan, believe, seek, estimate, predict, project or words of similar import. These forward-looking statements are based upon our current knowledge, assumptions about future events and involve risks and uncertainties that could cause our actual results, performance or achievements to be materially different from any anticipated results, prospects, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are not guarantees of future performance. Many factors are beyond our ability to control or predict. You are accordingly cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date that we make them. We do not undertake to update any forward-looking statement that may be made from time to time by or on our behalf.

In our most recent Form 10-KSB, we have included risk factors and uncertainties that might cause differences between anticipated and actual future results. We have attempted to identify, in context, some of the factors that we currently believe may cause actual future experience and results to differ from our current expectations regarding the relevant matter or subject area. The operations and results of our software and systems integration businesses also may be subject to the effects of other risks and uncertainties, including, but not limited to:

- a reduction in anticipated sales;
- an inability to perform customer contracts at anticipated cost levels;
- Our ability to otherwise meet the operating goals established by our business plan;
- market acceptance of our new software, technology and services offerings;
- an economic downturn; and
- changes in the competitive marketplace and/or customer requirements.

For More Information Contact:

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[www.csioutfitters.com](http://www.csioutfitters.com)

Or

Investor Contact:

Alliance Advisors, LLC

Mark McPartland, 910-221-1827



consulting services. The options have a strike price equal to the market price on their grant date, ranging from \$2.73 to \$3.10. Using the Black-Scholes pricing model, the options were valued at \$161,900 and recorded as consulting expense. NOTE 5 - UNAMORTIZED COST OF STOCK ISSUED FOR SERVICES During the years ended December 31, 2003 and 2002, we issued or agreed to issue 3,215,452 shares of common stock, granted 500,000 options for common stock, and 100,000 options for preferred stock, series A, as part of consulting agreements. The value of stock issued and options granted totaled \$913,036 and \$1,599,213 for the years ended December 31, 2003 and 2002. This cost is 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 six months ended June 30, 2004, \$140,008 was amortized into consulting expense. Unamortized cost of stock issued for services was \$641,196 as of June 30, 2004. NOTE 6 - CONSULTING, PROMOTIONAL AND INVESTOR RELATIONS SERVICES Consulting and investor relation services expense was \$3,118,036 for the six months ended June 30, 2004. Consulting and investor relation expenses incurred are detailed below: Consulting expenses relating to stock issued for consulting agreements was \$140,008 (See Note 5) in the six months ended June 30, 2004. Consulting expenses relating to options issued for services was \$2,575,033 (See Note 4) for the six months ended June 30, 2004. 10 In the six months ended June 30, 2004, we settled a lawsuit brought by a former consultant. The former consultant returned 100,000 shares of common stock for cancellation in exchange for \$250,000 paid in March and April of 2004. This settlement was expensed as consulting expense in the six months ended June 30, 2004. Various individuals and corporations performed consulting services and investor relation services for us during the six months ended June 30, 2004 and were paid \$152,995. NOTE 7 - ACQUISITIONS 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, approximately \$467,000. We paid 50,000 euros, 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. \$109,165 has been recorded as acquisitions expense in the six months ended June 30, 2004 in relation to the option price and related legal fees for this acquisition attempt. On March 12, 2004, we acquired Evenstar, Inc., by a merger with and into our newly formed, wholly owned subsidiary, Evenstar Mergersub, Inc. (Mergersub). In consideration for Evenstar, Inc., we paid \$300,000 in cash and issued 300,000 shares of common stock to the stockholders of Evenstar, Inc. Using the market value of the common stock on the day of the acquisition and the amount of cash given, the total acquisition price was \$1,161,000. An asset was recorded on these financial statements in the amount of \$12,498 for a patent acquired in the merger. Evenstar had no other assets or liabilities, therefore, the remaining \$1,148,502 was recorded as goodwill on these financial statements. On March 12, 2004 we performed an impairment test on the goodwill recorded in the merger with Evenstar, Inc. We determined that the goodwill was impaired and an impairment charge of \$1,148,502 was recorded. This charge is shown on the condensed consolidated statement of operations in the general and administrative expenses. 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 will 11 grant 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. NOTE 8 - EMPLOYEE STOCK OPTIONS During the second quarter of 2003, the Company adopted the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based

Compensation, effective as of the beginning of the year. There were no previous granting of options to employees prior to the second quarter of 2003 and therefore this adoption has no effect on previous financial statements. No method of reporting the change in accounting principle has been used. The board of directors approved 75,000 options for directors in the six months ended June 30, 2004. The options have a strike price of \$2.21, expire in 10 years, and vest immediately. 25,000 options were approved for each of three board members for their roles as directors of the company. Using the Black-Scholes pricing model, in accordance with the fair value recognition provision of FASB Statement No. 123, the options were valued at \$87,786 and recorded as compensation expense in the six months ended June 30, 2004. NOTE 9 - SUBSEQUENT EVENTS From July 1 to July 28, 2004, we sold 15,000 shares of preferred stock, series B, for \$300,000. On July 28, 2004 the private placement offering was closed. On July 1, 2004, we issued 37,500 shares of preferred stock, series B that were owed to buyers as of June 30, 2004. From July 1 to July 29, 2004, 240,860 shares of preferred stock, series A, were converted to 2,408,600 shares 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. We are doing this because the registration statement 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 our most recent audited financial statements. The former warrant holders will be entitled to 12 rescind their purchases. Once made, the rescission offer is open for 30 days. The rescission offer would require us to purchase warrants back at their original exercise price, \$.50 for the Class A warrants and \$3.00 for the Class B warrants, at each warrant holder's option. The current market price is well above the \$.50 exercise price of the Class A warrants so no adjustment to the financial statements for the year ended December 31, 2003 and the six months ended June 30, 2004 have been made for the rescission offer. The current market price is below the \$3.00 exercise price of the Class B warrants. 22,600 Class B warrants were exercised during the rescission offer period, so the rescission offer would not have a material liability effect on these financial statements. Therefore, no adjustment has been made. 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 of these financial statements.

13 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, and a line of in-wall, in-ceiling and outdoor loudspeakers. From the early 1970'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 new custom-designed loudspeaker systems, we ceased these historical operations and began focusing all efforts towards becoming a loudspeaker manufacturer and selling to dealers and contractors on a wholesale basis. As a result, we have been essentially in a development stage, as we are bringing to market products that we introduced in 2000 and 2001 and designing and bringing to market additional products. In June 2000, we asked dealers and distributors to sell our Professional Line of products. These dealers and distributors started to form our current network of approximately 50 dealers and 7 foreign distributors and we began shipping to them. However, most of the Professional Line required new ribbon drivers that we completed and implemented into the product line in early 2001. In September 2000, we introduced our Home Theatre systems, and sales for those systems began immediately. From September through December 2000, we added 20 new Home Theatre dealers in the US and began marketing efforts to establish distributors and dealers outside the US. In June 2001, we introduced a Commercial Line of loudspeakers that use our PRD500 Ribbon Driver and, in September 2001, we finished the development of our PRD1000 Ribbon Driver and began implementing it into our Professional Line. Our PRD drivers, which we manufacture, upgraded the previous drivers that we purchased from third-party manufacturers; and our cost is approximately one-sixth of the price that we had been paying for the previous drivers. 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.

14 RESULTS OF OPERATIONS QUARTER ENDED JUNE 30, 2004 AS COMPARED TO THE QUARTER ENDED JUNE 30, 2003. For the quarter ended June 30, 2004, revenue increased to \$505,306 from \$277,244 in the 2003 period, an 82% increase, resulting primarily from the positive results of a new 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 decreased to approximately 55% in the 2004 period from approximately 65% in the 2003 period, primarily as a result of new personnel that were in training and sales of several large systems at a high promotional discount, as well as the unusually high historical gross profit percentage in the 2003 period. General and administrative expenses for the 2004 second quarter increased to \$2,912,239 from \$606,386 in the 2003 second quarter, an increase of \$2,305,853. The increase resulted primarily from \$2,102,093 in consulting and investor relation services expenses (as further described in Note 6 to the financial statements), \$1,680,698 of which were non-cash charges for the amortization of stock and options issued under consulting agreements; \$87,786 in compensation expense for the non-cash charge for issuances of stock options (as further described in Note 8 to the financial statements); and a cash payment of \$250,000 pursuant to a promotion agreement with the recording artist Quincy Jones through Global Drumz, Inc. Due to the increase in general and administrative expenses, partially offset by the revenue increase, our net loss increased to \$2,621,385 in the second quarter of 2004 as compared to a net loss of \$401,270 in the comparable quarter of 2003. Other income (expense) decreased to net other income of \$13,813 in the 2004 second quarter as compared to net other income of \$25,997 in the 2003 second quarter, primarily due to other income recognized in the 2003 period from the write-off of accounts payable. SIX MONTHS ENDED JUNE 30, 2004 AS COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2003. For the first six months of 2004, revenue increased to \$926,222 from \$382,021 in the first six months of 2003, a 142% increase, resulting primarily from the positive results of a new 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 decreased to approximately 48% in the 2004 period from approximately 59% in the 2003 period, primarily as a result of new personnel that were in training and sales of several large systems at a high promotional discount, as well as the unusually high historical gross profit percentage in the 2003 period. Due primarily to the increase in general and administrative expenses, as discussed below, and partially offset by the revenue increase, our net loss increased to \$5,405,203 in the first half of 2004 as compared to a net loss of \$855,715 in the first half of 2003. General and administrative expenses for the first six months of 2004 increased to \$5,868,928 from \$1,108,535 in the 2003 period, primarily as a result of consulting and investor relations services expenses of \$3,118,036 in the 2004 period (\$2,335,041 of which were non-cash charges), compared to \$511,027 in the 2003 period. 15 Other income decreased to net other income of \$18,684 in the 2004 period as compared to net other income of \$26,360 in the 2003 period, primarily due to other income recognized in the 2003 period from the write-off of accounts payable. FINANCIAL CONDITION On June 30, 2004, our current assets exceeded current liabilities by \$4,760,770, compared to an excess of \$1,945,227, on December 31, 2003. Total assets exceeded total liabilities by \$5,190,213, compared to an excess of total assets over total liabilities of \$2,249,489 on December 31, 2003. The increased working capital was primarily due to the sale of 257,100 shares of Series B Preferred Stock for net proceeds of \$4,815,750 in the first half of 2004. In addition to funding operations, the proceeds from such sales of stock allowed us to increase cash by \$1,891,876, increase inventory by \$427,969, increase net fixed assets by \$123,149, decrease accounts payable by \$101,130, increase accounts receivable by \$77,975, and pay deposits totaling \$320,457 for inventory and a potential merger. On June 30, 2004, we had a backlog of orders of approximately \$125,000. 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 substantial 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, we commenced a new private placement of Series B Preferred Stock in the first quarter of 2004 to raise capital. As discussed above, through June 30, 2004, we sold 257,100 shares of Series B Preferred Stock for net proceeds of \$4,815,750. Each share 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 the first half of 2004, we also received an aggregate of \$115,600 in cash in payment of the exercise price for the exercise of outstanding warrants. 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, since May 1, 2002, 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 (the date that an amendment to the registration statement was declared effective, making the registration statement "current"). Once made, the rescission offer is expected to remain open for 30 16 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. 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 has been granted and is expected to be issued in the near future. 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. 17 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. On June 30, 2004, we had \$3,374,662 in cash. We believe this cash is more than sufficient to fund our planned operations for at least the next twelve months. In the past, we have been able to privately borrow money from individuals by the issuance of notes, and we have been able to raise money by the issuance of preferred stock and common stock. We intend to continue to do so as needed. However, we cannot be certain that we will continue to be able to successfully obtain such financing. If we fail to do so, we may be unable to continue as a viable business. FORWARD-LOOKING INFORMATION This report, as well as our other reports filed with the SEC and our press releases and other communications, contain forward-looking

statements made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995.

Forward-looking statements include all statements regarding our expected financial position, results of operations, cash flows, dividends, financing plans, strategy, budgets, capital and other expenditures, competitive positions, growth opportunities, benefits from new technology, plans and objectives of management, and markets for stock. These forward-looking statements are based largely on our expectations and, like any other business, are subject to a number of risks and uncertainties, many of which are beyond our control. The risks include those stated in the "Risk Factors" section of our Annual Report on Form 10-KSB and economic, competitive and other factors affecting our operations, markets, products and services, expansion strategies and other factors discussed elsewhere in this report, our Annual Report on Form 10-KSB and the other documents we have filed with the Securities and Exchange Commission. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this report will in fact prove accurate, and our actual results may differ materially from the forward-looking statements.

ITEM 3. CONTROLS AND PROCEDURES. As of June 30, 2004, our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2004. 18 As a result of the audit of our financial statements for the year ended December 31, 2002, we were required to make restatements and reclassifications of our unaudited financial statements filed for the quarters ended March 31, June 30 and September 30, 2002. Such restatements and reclassifications call into question the effectiveness of our disclosure controls and procedures. We are currently considering enhancements to such controls and procedures. We have made no changes in our internal control over financial reporting during the quarter ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. 19 PART II - OTHER INFORMATION ITEM 2. CHANGES IN SECURITIES. In the quarter ended June 30, 2004, the Company sold 113,600 shares of Series B Preferred Stock for \$2,251,500 in net cash proceeds. All sales were made to accredited investors. Each share of preferred stock is convertible into ten shares of common stock after six months. 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 sales were made in reliance on Section 4(2) of the Securities Act of 1933, as amended. The net proceeds from the sale of preferred stock in the second quarter of 2004 are to be used for sales, marketing and advertising expenses, increases in inventory, and working capital purposes. All of the foregoing uses of proceeds were direct or indirect payments to nonaffiliates. In June 2004, we entered into an endorsement / consulting agreement with the recording artist Quincy Jones through Global Drumz, Inc., pursuant to which we granted options to purchase 1,000,000 shares of common stock, at an exercise price of \$2.00 per share, in exchange for future endorsements of our products and various other consulting services. Each option is exercisable for a period of five years. Pursuant to the agreement, we also issued a warrant, with a five-year term, for 1,000,000 additional shares of common stock at an exercise price of \$7.00 per share. The options automatically vest as to 50% of the options upon the effective date of the agreement and as to one-sixth of the remaining options monthly thereafter. The issuances to Global Drumz were made in reliance on Section 4(2) of the Securities Act of 1933, as amended. 20 ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K. (a)

Exhibits. The following are being filed as exhibits to this Report: Exhibit No. Description of Exhibit -----  
 ----- 4.1 Certificate of Designations for Series B Preferred Stock 4.2 Form of Class C Warrant 10.1  
 Promotion Agreement, dated June 2, 2004, between SLS International, Inc. and Global Drumz, Inc. 10.2 Option  
 Agreement, dated June 2, 2004, between SLS International, Inc. and Global Drumz, Inc. 10.3 Redeemable Warrant,  
 dated June 2, 2004, issued by SLS International, Inc. in favor of Global Drumz, Inc. 10.4 Redeemable Warrant, dated  
 March 23, 2004, issued by SLS International, Inc. in favor of Kenny Securities Corp. 31 Rule 13a-14(a) / 15d-14(a)  
 Certifications\* 32 Section 1350 Certifications (b) Reports on Form 8-K. We filed a Report on Form 8-K/A on May  
 20, 2004 to file financial statements and pro forma financial information relating to our acquisition of Evenstar, Inc.  
 21 SIGNATURE ----- Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly  
 caused this report to be signed on its behalf by the undersigned thereunto duly authorized. SLS INTERNATIONAL,  
 INC. (Registrant) Date: August 6, 2004 By /s/ John Gott ----- John Gott President and Chief Financial  
 Officer (Principal Financial Officer) 22