

Galaxy Gaming, Inc.  
Form 10-Q  
November 14, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2012**

**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: 000-30653**

**Galaxy Gaming, Inc.**

(Exact name of small business issuer as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

20-8143439

(IRS Employer Identification No.)

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

6980 O'Bannon Drive, Las Vegas, Nevada 89117  
(Address of principal executive offices)

(702) 939-3254  
(Issuer's telephone number)

---

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the issuer (1) 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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 38,310,591 common shares as of November 7, 2012.

Table of Contents

**GALAXY GAMING, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2012**

**TABLE OF CONTENTS**

Page

**PART I – FINANCIAL INFORMATION**

Item 1:	<u>Financial Statements (unaudited)</u>	3
Item 2:	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	4
Item 3:	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	8
Item 4T:	<u>Controls and Procedures</u>	8

**PART II – OTHER INFORMATION**

Item 1:	<u>Legal Proceedings</u>	9
Item 1A:	<u>Risk Factors</u>	9
Item 2:	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	9
Item 3:	<u>Defaults Upon Senior Securities</u>	9
Item 4:	<u>Mine Safety Disclosures</u>	9
Item 5:	<u>Other Information</u>	9
Item 6:	<u>Exhibits</u>	9

Table of Contents

**PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

Our financial statements included in this Form 10-Q are as follows:

- F-1 Balance Sheets as of September 30, 2012 and December 31, 2011 (unaudited)
- F-2 Statements of Operations for the three and nine months ended September 30, 2012 and 2011 (unaudited)
- F-3 Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 (unaudited)
- F-4 – F-16 Notes to Financial Statements (unaudited)

Table of Contents**GALAXY GAMING, INC.**

## BALANCE SHEETS

**(Unaudited)**

ASSETS	September 30, 2012	December 31, 2011
Current Assets		
Cash and cash equivalents	\$346,954	\$200,128
Accounts receivable - trade, net of allowance for doubtful accounts of \$44,223 and \$20,865, respectively	1,082,665	843,328
Miscellaneous receivables	103,646	112,513
Prepaid expenses	27,666	57,650
Inventory	246,348	217,162
Related party note receivable, current portion	18,294	17,491
Total Current Assets	1,825,573	1,448,272
Property and Equipment, net	45,560	42,637
Other Assets		
Intellectual property and intangible assets, net	18,932,242	20,111,763
Related party note receivable, net of current portion	379,676	374,449
Goodwill	1,091,000	1,091,000
Other	13,106	47,290
Total Other Assets	20,416,024	21,624,502
<b>TOTAL ASSETS</b>	<b>\$22,287,157</b>	<b>\$23,115,411</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$328,821	\$274,576
Accrued expenses and taxes	481,315	358,860
Deferred revenue	437,063	336,048
Notes payable - related party	—	469
Notes payable - current portion	2,192,095	1,835,240
Total Current Liabilities	3,439,294	2,805,193
Long-Term Debt		
Notes payable, net of debt discount and net of current portion	18,463,539	20,035,366
<b>TOTAL LIABILITIES</b>	<b>21,902,833</b>	<b>22,840,559</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, 65,000,000 shares, \$.001 par value common stock authorized; 38,310,591 (37,508,091 – 2011) shares issued and outstanding	38,311	37,507
Additional paid in capital	2,004,208	1,915,311
Stock warrants	513,181	513,181

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

Stock subscription receivable	(3,916 )	(3,916 )
Accumulated deficit	(2,167,460 )	(2,187,231 )
TOTAL STOCKHOLDERS' EQUITY	384,324	274,852
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$22,287,157	\$23,115,411

The accompanying notes are an integral part of the financial statements.

F-1

Table of Contents**GALAXY GAMING, INC.****STATEMENTS OF OPERATIONS****(Unaudited)**

	FOR THE THREE MONTHS ENDED		FOR THE NINE MONTHS ENDED	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenue:				
Product leases and royalties	\$ 1,856,984	\$ 719,605	\$ 5,250,055	\$ 2,226,205
Product sales and service	16,544	14,278	59,396	37,874
Total revenue	1,873,528	733,883	5,309,451	2,264,079
Costs and expenses				
Cost of ancillary products and assembled components	18,001	16,449	77,106	61,628
Selling, general and administrative	994,537	826,878	3,155,617	2,351,569
Research and development	84,199	82,576	230,217	225,060
Depreciation	5,108	4,884	13,661	13,757
Amortization	424,641	8,165	1,210,988	24,496
Total costs and expenses	1,526,486	938,952	4,687,589	2,676,510
Income (loss) from operations	347,042	(205,069 )	621,862	(412,431 )
Other income (expense)				
Interest income	9,918	6,176	20,507	18,696
Interest expense	(227,484 )	(21,841 )	(672,598 )	(69,515 )
Gain on settlement	—	—	50,000	—
Total other income (expense)	(217,566 )	(15,665 )	(602,091 )	(50,819 )
Income (loss) before income taxes	129,476	(220,734 )	19,771	(463,250 )
Provision for income taxes	—	—	—	—
Net income (loss)	\$ 129,476	\$(220,734 )	\$ 19,771	\$(463,250 )
Net income (loss) per share:				
Basic	\$0.00	\$(0.01 )	\$0.00	\$(0.01 )
Diluted	\$0.00	\$(0.01 )	\$0.00	\$(0.01 )
Weighted average shares outstanding:				
Basic	38,310,591	35,508,091	38,052,008	35,399,449
Diluted	40,019,044	38,222,973	40,551,927	37,967,510

The accompanying notes are an integral part of the financial statements.

Table of Contents**GALAXY GAMING, INC.**

## STATEMENTS OF CASH FLOWS

**(Unaudited)**

	Nine Months Ended September 30,	
	2012	2011
<b>Cash Flows from Operating Activities:</b>		
Net income (loss) for the period	\$ 19,771	\$(463,250)
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Depreciation expense	13,661	13,757
Amortization expense	1,210,988	24,496
Provision for bad debts	30,000	27,000
Share-based compensation	89,701	20,000
Gain on settlement	(50,000 )	—
Amortization of debt discount	52,158	—
Changes in Assets and Liabilities		
(Increase) in accounts receivable	(269,337 )	(36,811 )
Decrease (Increase) in miscellaneous receivable	8,867	(44,606 )
Decrease (Increase) in prepaid expenses	29,984	(12,641 )
(Increase) in inventory	(29,186 )	(2,443 )
Increase (Decrease) in accounts payable	54,245	(14,630 )
Increase in accrued expenses and taxes	122,455	189,827
(Decrease) in accrued interest – related party	—	(25,973 )
Increase (Decrease) in deferred revenue	101,015	(3,186 )
Net Cash Provided By (Used in) Operating Activities	1,384,322	(328,460)
<b>Cash Flows from Investing Activities:</b>		
Acquisition of property and equipment	(16,584 )	(20,368 )
(Increase) in products leased and held for lease	—	(38,769 )
Decrease in other assets	52,717	2,717
(Increase) in note receivable	(7,330 )	—
Payments received on note receivable	1,300	34,627
Net Cash Provided By (Used in) Investing Activities	30,103	(21,793 )
<b>Cash Flows from Financing Activities:</b>		
Principal payments on notes payable – related party	(469 )	(105,037)
Collection of stock subscription receivable	—	6,604
Principal payments on note payable	(1,267,130)	(74,848 )
Proceeds from issuance of common stock	—	200,000
Net Cash (Used in) Provided By Financing Activities	(1,267,599)	26,719
Net Increase (Decrease) in Cash and Cash Equivalents	146,826	(323,534)
Cash and Cash Equivalents – Beginning of Period	200,128	444,434
Cash and Cash Equivalents – End of Period	\$ 346,954	\$ 120,900

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

Supplemental Cash Flow Information:

Cash paid for interest	\$505,083	\$94,809
Cash paid for income taxes	\$—	\$—

The accompanying notes are an integral part of the financial statements.

F-3

Table of Contents

**GALAXY GAMING, INC.**

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

**NOTE 1. DESCRIPTION OF BUSINESS**

Unless the context indicates otherwise, references to “Galaxy Gaming, Inc.,” “we,” “us,” “our,” or the “Company,” refers to Galaxy Gaming, Inc., a Nevada corporation. “GGLLC” refers to Galaxy Gaming, LLC, a Nevada limited liability company that was a predecessor of the Company’s business but is not directly associated with Galaxy Gaming, Inc.

**Description of business.** We are engaged in the business of designing, developing, manufacturing and/or acquiring proprietary casino table games and associated technology, platforms and systems for the global gaming industry. Beginning in 2011, we expanded our product line with the addition of fully automated table games, known as e-Tables and separately, we entered into agreements to license our content for use by internet gaming operators. Casinos use our proprietary products to enhance their gaming floor operations and improve their profitability, productivity and security, as well as offer popular cutting-edge gaming entertainment content and technology to their players. We market our products to land-based, riverboat and cruise ship gaming establishments and to internet gaming companies. The game concepts and the intellectual property associated with these games are typically protected by patents, trademarks and/or copyrights. We market our products primarily via our internal sales force to casinos throughout North America, the Caribbean, the British Isles, Europe, Australia and to cruise ships and internet gaming sites worldwide. We currently have an installed base of our products on over 2,500 gaming tables located in over 500 casinos, which positions us as the second largest provider of proprietary table games in the world.

Revenues consist of primarily recurring royalties received from our clients for the licensing of our game content and other products. Historically, over 90% of our total revenues are recurring. In the year ending December 31, 2011, recurring revenues represented 99.2% of our total revenues. These recurring revenues generally have few direct costs thereby generating high gross profit margins in excess of 90%. In lieu of reporting as *gross profit*, this amount would be comparable to *revenues less cost of ancillary products and assembled components* on our financial statements. In the year ending December 31, 2011, revenues less cost of ancillary products and assembled components represented 97.4% of gross revenues. Additionally, we receive non-recurring revenue from the sale of associated products.

We group our products into three product categories we classify as “Proprietary Table Games,” “Enhanced Table Systems” and “e-Tables.” Our product categories are summarized below. Additional information regarding our products may be found on our web site, [www.galaxygaming.com](http://www.galaxygaming.com). Information found on the web site should not be considered part of this report.

***Proprietary Table Games.*** We design, develop and deliver our Proprietary Table Games to enhance our casino clients' table game operations. Casinos use our Proprietary Table Games in lieu of those games in the public domain (e.g. Blackjack, Craps, Roulette, etc.) because of their popularity with players and to increase profitability. Our Proprietary Table Games are grouped into two product types we call "Side Bets" and "Premium Games." Side Bets are proprietary features and wagering schemes typically added to public domain games such as poker, baccarat, pai gow poker, craps and blackjack table games. Examples of side bets include such popular titles as *Lucky Ladies*, *21+3* and *Bonus Craps*. Premium Games are unique stand-alone Proprietary Table Games with their own unique set of rules and strategies. Examples of Premium Games include such popular titles as *Texas Shootout*, *Three Card Poker* and *Emperor's Challenge*. Typically, Premium Games command a higher price point per unit than Side Bets.

F-4

Table of Contents

**Enhanced Table Systems.** Enhanced Table Systems are electronic enhancements used on casino table games to add to player appeal and to enhance game security. We include in this product category our *Bonus Jackpot System*, our *Inter-Casino Jackpot System* and our *MEGA-Share*. Our *Bonus Jackpot System* is designed to compete with our competitors' progressive jackpot systems and contains special features designed to further enhance the table game player's experience and in turn, the casino's profit. The *Bonus Jackpot System* consists of two independent sub-systems known as the *Bet Tabulator System*, which is an advanced system used to detect players' wagers and *TableVision*, which is an advanced electronic display system used on gaming tables. Our current version of the *Bonus Jackpot System* is known as the "*Andromeda Series*." Advancements in the *Andromeda Series* includes the ability for two-way communication between gaming tables located anywhere in the world and one or more data processing centers. Known as our *Inter-Casino Jackpot System*, we believe this achievement for casino table games was the first of its kind in the world. The availability of the data processing centers is the result of an agreement we entered into with Amazon Web Services, a unit of Amazon.com. In addition, our clients may use our *Andromeda Series* to communicate with their data center or internal server using their private network. The *Andromeda Series* increases the maximum number of player positions at a table from 7 to 16 and increases the number of betting positions per player from 1 to 6, both firsts within the casino table game industry. The *Andromeda Series* includes advanced player display options offered by the *TableVision* platform including the ability to keep track of and display more than one jackpot. This advancement, combined with the multiple sensor advancements, permits us to offer our *MEGA-Share* system to our casino clients.

Our *Inter-Casino Jackpot System* leverages the capabilities of our *Bonus Jackpot System* to connect and/or aggregate bonus or progressive jackpots from multiple casinos into a common network. This methodology often referred to as a "wide area progressive" has long been practiced in the slot machine industry, but was first introduced to table games in Nevada by us in April 2011.

*MEGA-Share* is a game play methodology invented by us that allows a player of one of our table games to share in the winnings of a jackpot together with other players. An example of this concept would be when multiple table game players are playing in a casino and one of them obtains a winning hand entitling them to a jackpot, the event also triggers a second *MEGA-Share* jackpot that is divided among all players who qualified for *MEGA-Share*. *MEGA-Share* rewards the other players playing on other tables, other games, or even other casinos with a share of the *MEGA-Share* jackpot, provided that they placed a qualifying *MEGA-Share* wager.

**e-Tables.** In February 2011, we entered into a definitive agreement to license the worldwide rights, excluding Oklahoma, Kentucky and the Caribbean, to the *TableMAX* e-Table system and simultaneously obtained the e-Table rights to the casino table games *Caribbean Stud*, *Caribbean Draw*, *Progressive Blackjack*, *Texas Hold'em Bonus* and *Blackjack Bullets*. See Note 18. The *TableMAX* e-Table system is a fully automated, dealer-less, multi-player electronic table game platform. These platforms allow us to offer our table game content in markets where live table games are not permitted, such as racinos, video lottery and arcade markets. Our e-Table product enables the automation of certain components of traditional table games such as data collection, placement of bets, collection of losing bets and payment of winning bets. This automation provides benefits to both casino operators and players, including greater security and faster speed of play, reduced labor and other game related costs and increased profitability.

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

This summary of our significant accounting policies is presented to assist in understanding our financial statements. The financial statements and notes are representations of our management team, who are responsible for their integrity and objectivity. These accounting policies conform to Generally Accepted Accounting Principles (“GAAP”) and have been consistently applied to the preparation of the financial statements. In the case of the TableMAX arrangement, since TableMAX currently reimburses us for all out-of-pocket operating losses, and monthly expenses have consistently exceeded revenues, we do not treat these revenues as normal revenues to us. On a monthly basis, we net the revenues against the expenses resulting in the difference which is used to invoice TableMAX for reimbursement.

***Basis of presentation.*** The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission (“SEC”), and should be read in conjunction with the audited financial statements and notes thereto contained herein and in our Form 10-K filed with the SEC as of and for the period ended December 31, 2011. In the opinion of management, all adjustments necessary in order for the financial statements to be not misleading have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

F-5

Table of Contents

**Basis of accounting.** The financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized as income when earned and expenses are recognized when they are incurred. We do not have significant categories of cost as our income is recurring with high margins. Expenses such as wages, consulting expenses, legal, regulatory and professional fees and rent are recorded when the expense is incurred.

**Cash and cash equivalents.** We consider cash on hand, cash in banks, certificates of deposit, and other short-term securities with maturities of three months or less when purchased, as cash and cash equivalents. Our bank accounts are deposited in insured institutions. The funds are insured up to \$250,000.

**Reclassifications.** Certain accounts and financial statement captions in the prior periods may have been reclassified to conform to the current period financial statements.

**Inventory.** Inventory consists of products designed to enhance table games, such as signs, layouts, bases for the various signs and electronic devices to support our enhanced bonus platforms. The inventory value is determined by the average cost method and management maintains inventory levels based on historical and industry trends. Signs and layouts do not change when table games change. We do not allocate overhead to inventory and as such costs are not significant. We track inventory internally in the following categories: raw materials, finished components (sub-units used to complete full units), and finished inventory of full units.

**Products leased and held for lease.** In 2011, we began to provide products whereby we maintain ownership and charge a fee for the use of the product. Such fees may be a flat monthly fee and/or a fee associated with the performance of the product. Since we retain title to the equipment, we classify these assets as “products leased and held for lease” and are included in the “Other” assets account shown on the accompanying balance sheets. These assets are stated at cost, net of depreciation. Depreciation on leased products is calculated using the straight-line method over a one-year period.

**Fair value of financial instruments.** The fair value of cash and cash equivalents, accounts receivable, miscellaneous receivables, prepaid expenses, inventory, notes receivable-related party, accounts payable, accrued expenses, taxes, deferred revenue, notes payable-related party and notes payable approximates the carrying amount of these financial instruments due to their short-term nature. The fair value of long-term debt, which approximates its carrying value, is based on current rates at which we could borrow funds with similar remaining maturities.

**Property and equipment.** The capital assets are being depreciated over their estimated useful lives generally ranging from three to five years using the straight-line method of depreciation for book purposes.

**Intellectual property and intangible assets.** These intellectual property and intangible assets have finite lives and are being amortized using the straight-line method over their economic useful lives, five to thirty years. Material assets added over the past several years are as follows:

Client installation base	60 months
Patents	87 - 132 months
Trademarks	144 – 360 months
Client relationships	264 months

The intangible assets are analyzed for potential impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

**Goodwill.** A goodwill balance of \$1,091,000 was created as a result of the Prime Table Games asset acquisition. This asset will be assessed for impairment at least annually and if found to be impaired, its carrying amount will be reduced and an impairment loss will be recognized.

**Revenue recognition.** Revenue is primarily derived from the licensing of our products and intellectual property. Consistent with our strategy, revenue is generated from negotiated month-to-month recurring licensing fees or the performance of our products or both. We also, occasionally, receive a one-time sale of certain products and/or reimbursement of our manufactured equipment.

Table of Contents

Substantially, all revenue is recognized when it is earned. Depending upon the product and geographic location, our clients may be invoiced monthly in advance, monthly in arrears or quarterly in arrears for the licensing of our products. If billed in advance, the advance billings are recorded as deferred revenue on our balance sheet. If billed in arrears, we recognize the corresponding preceding period's revenue upon invoicing at the subsequent date. Generally, we earn royalty revenue beginning with the start or "go live" date of the associated product in our clients' establishment. The monthly recurring invoices are based on executed agreements with each client.

Additionally, clients may be invoiced for product sales at the time of shipment or delivery of the product. Revenue from the sale of our associated products is recognized when the following criteria are met:

- (1) Persuasive evidence of an arrangement between us and our client exists;
- (2) Shipment has occurred;
- (3) The price is fixed and or determinable; and
- (4) Collectability is reasonably assured or probable.

The combination of hardware and software included in our Enhanced Table Systems and e-Tables are essential to the operation of the respective systems. As such, we do not segregate the portion of revenue between manufactured equipment and any software or electronic devices needed to use the equipment when the system is provided. We do not market the software separately from the equipment.

**Costs of ancillary products and assembled components.** Ancillary products include paytables, bases, layouts, signage and other items as they relate to support specific proprietary games that our clients have purchased in connection with the licensing of said game. Assembled components represent the cost of the equipment, devices and incorporated software used to support the *Bonus Jackpot System*.

**Research and development.** Research and development costs are charged to expense when incurred and are included in our statement of operations. These costs include salaries, benefits, and other internal costs allocated to software and hardware development efforts, as well as purchased components.

**Deferred income taxes.** Deferred income taxes are recognized by applying enacted statutory rates, applicable to future years, to temporary differences between the tax bases and financial statement carrying values of our assets and liabilities. Valuation allowances are recorded to reduce deferred tax assets to amounts that are more likely than not to be realized.

**Basic income (loss) per share.** Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of our company.

**Stock-based compensation.** Stock-based compensation is accounted for at fair value in accordance with ASC Topic 718. On March 29, 2012, our Board of Directors approved an issuance of fully paid common stock to certain employees. See Note 12.

**Management estimates.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions have been made in determining the depreciable lives of such assets and the allowance for doubtful accounts receivable. Actual results could differ from those estimates.

**Recently issued accounting guidance.** We do not expect the adoption of recently issued accounting pronouncements to have a significant impact on our results of operations, financial position or cash flow.

Table of Contents**NOTE 3. RELATED PARTY NOTE RECEIVABLE**

The related party note receivable at September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
Related party note receivable	\$ 397,970	\$ 391,940
Less: current portion	(18,294 )	(17,491 )
	\$ 379,676	\$ 374,449

We acquired, with an asset purchase agreement from GGLLC, the note receivable stated above, as part of the purchase of the remaining intellectual property including patents, patent applications, trademarks, trademark applications, copyrights, know-how and trade secrets related to the casino gaming services including but not limited to games, side bets, inventions and ideas. The related party note receivable is a ten year unsecured note with a 6% fixed interest rate, monthly principal and interest payments of \$6,598 with the unpaid principal and interest due in February 2017. Interest income associated with this note receivable was \$18,985 and \$18,696 for the nine months ended September 30, 2012 and 2011, respectively. The terms of the note were amended in September 2010 whereby the monthly principal and interest payment was reduced to \$3,332 and the unpaid principal and interest is due August 2015.

Management evaluates collectability on a regular basis and will set up reserves for uncollectible amounts when it has determined that some or all of this receivable may be uncollectible. At September 30, 2012 management believed that 100% of the notes receivable principal and interest amounts are collectable.

**NOTE 4. PREPAID EXPENSES**

Prepaid expenses consist of the following as of:

	September 30, 2012	December 31, 2011
IT system	\$ 15,844	\$ 6,129
Trade show expenses	8,505	13,557
Other	2,770	1,145
Rent	547	10,360
Insurance	—	18,371

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

Legal	—	7,500
Property taxes	—	588
	\$ 27,666	\$ 57,650

**NOTE 5. PROPERTY AND EQUIPMENT**

Property and equipment, recorded at cost, consisted of the following as of:

	September 30, 2012	December 31, 2011
Computer equipment	\$49,634	\$43,845
Furniture and fixtures	73,771	62,976
Office equipment	10,320	10,320
Leasehold improvements	6,367	6,367
	140,092	123,508
Less: accumulated depreciation	(94,532 )	(80,871 )
	\$45,560	\$42,637

Depreciation expense was \$13,661 and \$13,757 for the nine months ended September 30, 2012 and 2011, respectively.

F-8

Table of Contents**NOTE 6. INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS**

Intellectual property and intangible assets consisted of the following as of:

	September 30, 2012	December 31, 2011
Intellectual property	\$16,355,967	\$16,355,967
Territory	150,000	150,000
Non-compete	660,000	660,000
Customer relationships	3,400,000	3,400,000
	20,565,967	20,565,967
Less: Accumulated amortization	(1,633,725 )	(454,204 )
	\$18,932,242	\$20,111,763

Amortization expense was \$1,210,988 and \$24,496 for the nine months ended September 30, 2012 and 2011, respectively. Included in amortization expense are amounts related to the amortization of other assets totaling \$31,467 and \$6,436 for the nine months ended September 30, 2012 and 2011, respectively.

In 2007, we acquired intellectual property including patents, patent applications, trademarks, trademark applications, copyrights, know-how and trade secrets related to the casino gaming services, including but not limited to, games, side bets, inventions and ideas, valued at \$140,967 from a related party.

In 2009, we purchased back a regional territory license from an outside sales representative. The total value of this agreement was \$150,000 and the resulting intangible asset has an infinite life.

We executed an asset purchase agreement in April 2010, with T&P Gaming, Inc., and its majority owners whereby we acquired the client installation base, intellectual property, territorial license and related inventory associated with the “*Deuces Wild Hold'em Fold'em*” game (“*Deuces Wild*”) and related “*Random Wild*” game for \$216,000.

On October 1, 2011, we entered into an asset purchase agreement with Prime Table Games, LLC and Prime Table Games UK. A subsequent valuation report performed by a national business valuation firm concluded the following valuation of the purchase:

Asset	Fair Value
Trademarks	\$2,740,000

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

Patents	13,259,000
Goodwill	1,091,000
Non-compete agreement	660,000
Customer relationships	3,400,000
Total	\$21,150,000

The intellectual property and intangible assets are analyzed for potential impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The regional territorial license has an infinite life.

F-9

Table of Contents**NOTE 7. ACCRUED EXPENSES AND TAXES**

Accrued expenses and taxes consisted of the following as of:

	September 30, 2012	December 31, 2011
Accrued expenses and taxes	\$355,278	\$106,539
Wages and related costs	108,537	124,821
Accrued legal settlement	17,500	127,500
	\$481,315	\$358,860

**NOTE 8. LONG-TERM DEBT**

Long - term debt consists of the following as of:

	September 30, 2012	December 31, 2011
Note payable - commercial bank	\$1,129,590	\$1,148,448
Notes payable, net of debt discount - asset acquisition	19,526,044	20,722,158
	20,655,634	21,870,606
Less: Current portion	(2,192,095 )	(1,835,240 )
	\$18,463,539	\$20,035,366

The note payable is paid to a commercial bank in monthly installments of \$9,159 including fixed interest of 7.3%, for ten years, through February 2017, at which time there is a balloon payment of \$1,003,230. This liability was assumed with the asset purchase agreement from GLLC. The note payable financed the purchase of the intellectual property including patents, patent applications, trademarks, trademark applications, copyrights, know-how and trade secrets related to the casino gaming services including but not limited to games, side bets, inventions and ideas. The note agreement with the commercial bank remains in the name of GLLC and we have no direct obligation to the commercial bank, but rather to GLLC, a related party. The commercial bank filed a civil action against us pertaining to this promissory note. See Note 10.

In October 2011 we closed an asset acquisition from Prime Table Games LLC and Prime Table Games UK. Included within the structure of the \$23 million acquisition was a \$22.2 million component consisting of two promissory notes, with one of the notes due in the amount of \$12.2 million, payable in U.S. funds and a second note in the amount of £6.4 million, payable in British Sterling, which has been converted to \$10 million U.S. dollars in our financial presentations at the rate of one (1) U.S. dollar is equal to 0.64 British pounds. The notes were recorded at fair value,

net of a debt discount of \$1,530,000.

Maturities of our long-term debt are as follows:

Maturities as of September 30,	Total
2013	2,192,095
2014	2,716,312
2015	3,314,257
2016	4,006,170
2017	5,327,774
Thereafter	4,420,362
Total notes payable	21,976,970
Less:	
Debt discount	(1,321,336 )
Current portion	(2,192,095 )
Long-term debt, net of debt discount	\$ 18,463,539

F-10

Table of Contents**NOTE 9. NOTE PAYABLES – RELATED PARTY**

We received working capital loans from GLLC, a related party, in 2008 and 2007. The loans included interest at 9% and were due 90 days after demand. The terms of the loan called for interest to be accrued on interest if payments were not made. Interest expense associated with these loans was \$0 and \$3,573 for the nine months ended September 30, 2012 and 2011, respectively. The notes were paid in full in July 2011.

GLLC, a related party, is the holder of the long-term promissory note paid to the commercial bank. See Note 8.

**NOTE 10. COMMITMENTS AND CONTINGENCIES**

**Operating lease obligation.** We lease our offices from a related party that is connected with our CEO. We entered into a lease effective September 1, 2010 for a period of two years with a monthly rental payment of \$10,359. Rent expense was \$98,455 and \$93,240 for the nine months ended September 30, 2012 and 2011, respectively. Our lease expired at the end of August 2012 and is currently on a term of month-to-month. Based upon our current growth projections, we anticipate either renewing our existing lease agreement and expanding our operations with a lease of a second facility or in the alternative, may elect to not renew our existing lease and seek an entirely new facility sometime in late 2012 or 2013. We may also elect to purchase a future facility. The amounts shown in the accompanying table reflect our estimates of lease obligations for the twelve months ending 2013 through 2017 and are based upon our current estimates of our projected needs and our forecast of the commercial real estate market in Las Vegas, including a 5% cost of living increase. These estimates are summarized as follows:

Twelve Months ended September 30,	Annual obligation (Estimate)
2013	\$ 139,130
2014	146,087
2015	153,391
2016	161,061
2017	169,114
Total lease obligation	\$ 768,783

**Legal proceedings.** In the ordinary course of conducting our business, we are, from time to time, involved in various legal proceedings, administrative proceedings, regulatory government investigations and other matters, including those in which we are a plaintiff, that are complex in nature and have outcomes that are difficult to predict. In accordance with SFAS 5, "Accounting for Contingencies," we record accruals for such contingencies to the extent that we conclude that it is probable that a liability will be incurred and the amount of the related loss can be reasonably estimated. Our assessment of each matter may change based on future unexpected events. An unexpected adverse judgment in any pending litigation could cause a material impact on our business operations, intellectual property,

results of operations or financial position. Unless otherwise expressly stated, we believe costs associated with litigation will not have a material impact on our financial position or liquidity, but may be material to the results of operations in any given period. We assume no obligation to update the status of pending litigation, except as may be required by applicable law, statute or regulation. For a complete description of the facts and circumstances surrounding material litigation to which we are a party, see Note 10 in Item 8. "Financial Statements and Supplementary Data" included in our annual report on Form 10-K for the year ended December 31, 2011. There are no material updates to matters previously reported on Form 10-K for the year ended December 31, 2011, except:

*Unax Gaming settlement.* In May 2012, we entered into a settlement agreement ("UNAX Settlement") with UNAX Service, LLC ("Unax Gaming"). As a result of the UNAX Settlement, Unax Gaming assigned all of its rights and interest in the games "Double Action Blackjack" and "Squeezit Blackjack" which were deemed to have infringed on several patents held by us. The UNAX Settlement also called for Unax Gaming to reimburse us \$20,000 for court costs and attorney fees. Additionally, we received a note receivable from Unax Gaming in the amount of \$50,000. The note receivable bore annual interest of 6% and payments of interest only were to be made monthly, starting on June 1, 2012. The note receivable required payments of principal in the amount of \$25,000 to be paid on or before December 31, 2012 and \$25,000 on or before June 30, 2014. The note receivable had a provision whereby the second principal payment due in June 2014 would be forgiven if Unax Gaming complied with all terms of the UNAX Settlement and makes all other interest and principal payments timely. In the event Unax Gaming failed to make any of the foregoing payments on the dates specified, all remaining payments would have become immediately due and subject to payment of interest beginning immediately at an annual rate of 10%. As of September 30, 2012 Unax Gaming paid in full the outstanding balance.

Table of Contents

*Sherron Associates settlement.* On October 25, 2011, we and our CEO entered into a settlement agreement (“Sherron Settlement”) with Sherron Associates, Inc. (“Sherron”). In connection with the Sherron Settlement we agreed to pay Sherron the sum of \$150,000 in monthly installments in the amount of \$7,500 per month commencing November 1, 2011 and with scheduled increases in phases over the course of one year to a maximum of \$17,500 per month. The obligation was memorialized by a promissory note, at zero percent interest. We recorded a provision for litigation settlement of \$150,000 during the quarter ended September 30, 2011. In addition, the Sherron Settlement required our CEO to pay either the sum of \$350,000 by June 1, 2012 or \$375,000 by November 1, 2012. If our CEO failed to comply with the required payment on the corresponding due date, we would have been required to make payment in the amount of \$375,000 by November 15, 2012. We and our CEO separately complied with our respective obligations contained within the Sherron Settlement and the matter is now concluded.

*Reel Games, Inc. dismissal.* On November 10, 2011, we were served with a complaint by Reel Games, Inc. (“Reel Games”) in the United States District Court Southern District of Florida, alleging amongst other things, misappropriations of trade secrets, breach of confidence, fraud and intentional interference with contract. Reel Games claimed that the value of the information misappropriated alone was in excess of \$1 million. The allegations stemmed from a mutual non-disclosure and non-circumvention agreement executed by the parties in May 2010, in connection with us evaluating the acquisition of certain assets of Reel Games. In December 2011, we filed a Motion for Dismissal and on October 30, 2012, the District Court dismissed the action with prejudice. Other than the attorney fees incurred by us in the litigation, we paid no consideration to Reel Games or any other party.

*Washington administrative notice.* On March 19, 2012, we received a notice of administrative charges from the Washington State Gambling Commission (“Commission”) as a result of a routine audit conducted by them in 2010. The notice involves alleged untimely notifications, predominantly by predecessor companies. We continue to communicate with Commission officials and the matter remains pending. Our executive leadership team believes the matter will be resolved without material effect to our business operations in Washington. If unresolved, we could be subject to fines, reimbursement of the commission's investigative costs or harsher sanctions. For the nine-month period ended September 30, 2012, Washington revenues were \$851,126. For 2011, Washington revenues were \$1,154,925.

*Bank of America action.* On October 16, 2012, we were served with a complaint by Bank of America (“BofA”) regarding a promissory note payable between GGLLC and BofA. See Note 8. The complaint alleges we received valuable assets from GGLLC in 2007 for little or no consideration. We obtained these assets as a part of the asset purchase agreement from GGLLC for fair and just compensation and have at all times been fully compliant with our obligations to GGLLC. We have never been a party to any agreement with BofA and deny any and all liability to them. On November 12, 2012, we filed our answer to their complaint and additionally, we filed a counter-lawsuit against BofA claiming Slander of Business, Abuse of Process and Detrimental Promissory Reliance. We intend to vigorously defend ourselves in this matter and to pursue all available remedies against BofA, including but not limited to, recovery of damages caused by them. Our executive leadership team believes the matter will be resolved favorably and without material effect to our business, however, we could be subject to penalty interest and acceleration of the outstanding amount if unsuccessful.

**Note 11. Allowance for Doubtful Accounts**

We record an allowance for doubtful accounts based on periodic reviews of accounts receivable. As of September 30, 2012 and December 31, 2011, we had an allowance for doubtful accounts of \$44,223 and \$20,865, respectively.

**Note 12. STOCKHOLDERS' EQUITY**

We have 65,000,000 shares of \$.001 par value common stock and 10,000,000 shares of \$.001 par value preferred stock authorized as of September 30, 2012 and December 31, 2011. As of December 31, 2011, there were 37,508,091 shares of common stock and -0- preferred shares outstanding. During the nine months ended September 30, 2012, we did not sell any additional shares of common stock to the public. On March 29, 2012, our Board of Directors approved a stock grant for a small group of employees that granted 802,500 shares of restricted common stock valued at \$0.10 per share. There were 38,310,591 common shares and -0- preferred shares issued and outstanding at September 30, 2012.

F-12

Table of Contents

**Note 13. Related Party Transactions**

We lease our offices from a party that is related to our CEO. See Note 10.

We have a note receivable from a related party. See Note 3.

We have a note payable to a related party. See Notes 8 and 9.

Certain administrative, accounting and legal support services are performed by the wife of our CEO. Her services are provided through a company that is a related party to our CEO. We accrued or paid fees in the amount of \$24,175 and \$13,950 in the nine months ended September 30, 2012 and the year ended December 31, 2011, respectively.

**Note 14. Other Income (Expenses)**

Other income (expenses) consists of the following for the nine months ended:

	September 30, 2012	September 30, 2011
Interest income	\$20,507	\$18,696
Interest expense – PTG	(447,412)	—
Interest expense – debt discount	(156,474)	—
Interest expense – commercial bank	(68,712 )	(69,515 )
Gain on settlement	50,000	—
Total other income (expenses)	\$(602,091)	\$(50,819)

Interest expense – PTG refers to the debt (two promissory notes) entered into through the acquisition of Prime Table Games in late 2011. See Note 8. Interest expense – debt discount refers to a present value calculation of the Prime Table Games debt by the valuation company at a discount rate of 6.61% taking multiple factors into account such as a) our income metrics and repayment risks, b) bond market data, and c) credit analysis and metrics from S&P.

**Note 15. Income Taxes**

## Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

For the nine months ended September 30, 2012 and year ended December 31, 2011, we have recognized a net profit. However, since we have a previous net operating loss carry-forward of in excess of net income of approximately \$1,160,000, no tax liability has been recorded. The losses will be carried forward and can be used through the year 2028 to offset future taxable income up to a cumulative total of approximately \$1,514,000. The cumulative net operating loss carry-forward for income tax purposes may differ from the cumulative financial statement loss due to permanent differences and timing differences between book and tax reporting. Additionally, we have a foreign tax credit carry-forward of approximately \$215,644 that can be used in the future to offset federal income tax owed.

We periodically review the need for a valuation allowance against deferred tax assets based upon earnings history and trends. We believe that the valuation allowances provided are appropriate.

The cumulative tax effect at the expected rate of 34% of significant items comprising our net deferred tax amount is as follows:

Deferred tax asset attributable to:	September 30, 2012	December 31, 2011
Net operating loss carryover	\$548,612	\$555,334
Valuation allowance	(548,612)	(555,334)
Net deferred tax asset	\$0	\$0

Table of Contents**Note 16. Non-Cash Investing and Financing Cash Flow Disclosures**

During the year ended December 31, 2009, we sold 101,250 shares of common stock to employees in exchange for various notes receivable totaling \$40,500. As of September 30, 2012 and December 31, 2011, \$3,916 and \$10,520, respectively, were still outstanding and recorded as a stock subscription receivable.

**Note 17. Stock Warrants and Options**

**Warrant activity.** We issued 266,667 warrants in connection with the sale of common stock during the quarter ended June 30, 2011, respectively. We have accounted for these warrants as equity instruments in accordance with EITF 00-19 (ASC 815-40), Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, and as such, will be classified in stockholders' equity as they meet the definition of "...indexed to the issuer's stock" in EITF 01-06 (ASC 815-40) The Meaning of Indexed to a Company's Own Stock. We have estimated the fair value of the warrants issued in connection with the sale of common stock at \$42,549 for the year ended December 31, 2011, using the Black-Scholes option pricing model with the following assumptions:

	Warrants issued year ended December 31, 2011
Expected volatility	146 %
Expected dividend yield	0.00 %
Risk-free rate over the estimated expected life of the warrants	0.0066 %
Expected term (in years)	3.0

A summary of changes in share purchase warrants during the nine months ended September 30, 2012 is as follows:

	Common Stock Warrants	Weighted Average Exercise Price
Outstanding, January 1, 2012	2,017,382	\$ 0.43
Issued	—	—
Exercised	—	—
Expired	(686,429 )	0.40
Outstanding, September 30, 2012	1,330,953	\$ 0.45

**Stock options.** For the nine months ended September 30, 2012 and 2011, we issued 285,000 and 323,750 stock options, respectively. Stock options issued to members of our Board of Directors were 185,000 and 323,750 for the nine months ended September 30, 2012 and 2011, respectively. For our Board of Directors, the stock options were valued at the fair market value of the services performed that resulted in an expense of \$8,000 and \$12,000 for each nine months ended September 30, 2012 and 2011, respectively.

In July 2012, we issued our Chief Financial Officer 100,000 stock options at an exercise price equal to the closing price of our common stock on the trading day prior to the grant date (\$0.25). The stock options granted were calculated to have a fair value of \$17,415 using the Black-Scholes option pricing model with the following assumptions:

	Nine-months ended September 30, 2012	
Dividend yield	0	%
Expected volatility	118	%
Risk free interest rate	0.33	%
Expected life (years)	3.00	

The cost of the options issued to the members of our Board of Directors and our Chief Financial Officer have been classified as share based compensation for the nine months ended September 30, 2012 and 2011, respectively.

Table of Contents

A summary of changes in stock options during the nine months ended September 30, 2012 is as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding, January 1, 2012	615,000	\$ 0.36
Issued	285,000	0.23
Exercised	—	—
Expired	(522,500)	0.37
Outstanding, September 30, 2012	377,500	\$ 0.25

**Note 18. Asset AcquisitionS AND SIGNIFICANT TRANSACTIONS**

**Acquisition of Prime Table Games' assets.** On October 4, 2011 we executed an asset purchase agreement ("Prime Agreement") with Prime Table Games LLC and Prime Table Games UK (collectively "Prime Table Games"). Under the terms of the Prime Agreement we acquired over 20 different table games, including *21+3*, *Two-way Hold'em* and *Three Card Poker*, which are currently played on approximately 500 tables in 200 casinos in the United States, the United Kingdom and in the Caribbean (*Three Card Poker* rights are limited to the British Isles). The intellectual property portfolio includes 36 patents, 11 patents pending, 96 worldwide trademark and design registrations and 47 domain name registrations. The two principals of Prime Table Games also executed with us a non-compete agreement.

The acquisition was accounted for using the acquisition method of accounting. The allocation of fair value of the purchase price, based on an independent valuation, is as follows:

Asset	Fair Value
Trademarks	\$2,740,000
Patents	13,259,000
Goodwill	1,091,000
Non-compete agreement	660,000
Customer relationships	3,400,000
	\$21,150,000

Terms of the purchase included a down payment of \$480,000, payable in the form of 2,000,000 shares of our common stock with the balance due in the form of two promissory notes. One of the notes is payable to Prime Table Games LLC in the amount of \$12,200,000 (USD) and the other is payable to Prime Table Games UK in the amount of £6,400,000 (GBP). At the closing of the acquisition, the parties agreed to a conversion rate of one United States Dollar is equal to 64/100 British Pound Sterling, (\$1.00USD = £0.64GBP). Interest on the promissory notes was 0% in 2011. The fair value of the notes, net of the debt discount was \$20,670,000. The rate increases to 3% in 2012 and increases

at 1% per year thereafter to maximum of 9%. Payments on each of the notes are as follows:

*Prime Table Games LLC.* Monthly payments are due under this note, commencing with \$100,000 due on or before January 28, 2012. Subsequent payments are due on the 28th day of each month and the payment amount shall increase to \$130,000 per month beginning 16 months after the closing, \$160,000 per month beginning in 28 months, \$190,000 per month beginning in 40 months and \$220,000 beginning in 52 months until fully paid.

*Prime Table Games UK.* Monthly payments are due under this note, commencing with £64,000 due on or before January 28, 2012. Subsequent payments are due on the 28th day of each month and the payment amount shall increase to £76,800 per month beginning 16 months after the closing, £89,600 per month beginning in 28 months, £102,400 per month beginning in 40 months, £115,200 per month in 52 months until fully paid.

In the event future monthly revenue received by us from the “Assets,” as defined in the Prime Agreement is less than 90% of the notes monthly payment due to Prime Table Games, then the note payments may, at our option, be adjusted to the higher of \$100,000 per month (for the Prime Table Games LLC note) and £64,000 per month (for the Prime Table Games UK note) or 90% of the monthly revenue amount. If we engage in this payment adjustment election, the note shall not be deemed in default and the interest rate of the note will increase an additional 2% above the annual interest rate or until the standard payment schedule resumes.

F-15

Table of Contents

The notes are collateralized by the all of the assets acquired from Prime Table Games LLC and Prime Table Games UK.

**TableMAX agreement.** On February 21, 2011, we entered into a definitive agreement (“TMAX Agreement”) with TableMAX Corporation (“TMAX”) a provider of electronic table games and platforms headquartered in Las Vegas, Nevada and a principal investor in TMAX. Under the terms of the TMAX Agreement, we have exclusive worldwide rights (excluding one international territory and two U.S. states) to the TMAX electronic gaming platform and certain game titles. We created an operating division (the “TableMAX Division”) which conducts sales, distribution, marketing, engineering, sub-licensing and manufacturing related to the TMAX products and related intellectual property. The TableMAX Division is wholly owned by us and is not considered owned by, related to, a joint venture partner of or an agent of TMAX in any manner. The term of the TMAX Agreement is five years. At any time during the term of the TMAX Agreement, either TMAX or we may make a written offer to purchase the sole ownership of the TableMAX Division. Such offer shall be subject to the parties’ mutual agreement and neither party shall be under any obligation to accept such an offer. If such an agreement has not been consummated within six months of the expiration of the TMAX Agreement, then each party must indicate to the other party no later than six months from the scheduled expiration of the TMAX Agreement, their intent to renew the TMAX Agreement for a term of at least one year, or terminate.

TMAX agreed to assign, for the term of the TMAX Agreement, all of its existing gaming installations and usable inventory to the TableMAX Division. We agreed to furnish our intellectual property relating to our table game content for use by the TableMAX Division, royalty-free for the term of the TMAX Agreement. The TMAX Agreement specifies annual performance targets whereby we are required, on a cumulative basis, to have minimum table placements. If we fail to meet the performance criteria as defined in the TMAX Agreement, we will be required to pay TMAX the difference between TMAX’s share of the actual profit obtained by the TableMAX Division and the estimated profit that would have been obtained if the minimum performance criteria had been obtained.

We are responsible for the losses of the TableMAX Division however, TMAX has agreed to reimburse us during the first 12 months from the date of the TMAX Agreement for operating expenses of the TableMAX Division up to a maximum of \$600,000. Subsequent to the 12 months anniversary of the TMAX Agreement, TMAX notified us that they would continue to reimburse us for the losses attributed with the TableMAX Division. Net profits from the TableMAX Division will be split between TMAX and us on a sliding scale basis dependent upon the number of TableMAX Division table installations and profit results as defined in the TMAX Agreement.

Included in Miscellaneous receivables is \$103,646 representing reimbursement due from TMAX at September 30, 2012. Included in cash and cash equivalents at September 30, 2012 is \$204,744 related to the TMAX progressive jackpot.

**Acquisition of Lakes Entertainment’s assets.** In November 2011, we entered into an asset purchase agreement (the “Lakes Agreement”) with Lakes Entertainment, Inc., a Minnesota corporation (“Lakes”). Under the Lakes Agreement, we acquired certain business assets from Lakes. The acquisition includes a portfolio of patented casino table games,

including *Bonus Craps*, *Four The Money*, *Rainbow Poker*, and *Roulette Craps*, together with an assignment of the Lakes' rights under existing licensing agreements with various casinos throughout the United States.

***Acquisition of Unax Gaming assets.*** As indicated in Note 10, in May 2012 we entered into a Settlement Agreement with Unax Gaming. As a result of the Settlement Agreement, Unax Gaming assigned all of its rights and interest in the games "Double Action Blackjack" and "Squeezit Blackjack" which were deemed to infringe on several patents held by us.

#### **Note 19. Subsequent Events**

On October 16, 2012, we were served with a complaint by BofA. We answered their complaint and filed a counter-lawsuit against them on November 12, 2012. See Notes 8 and 10.

On or about November 5, 2012, all of our obligations and that of our CEO pertaining to the Sherron Settlement were fully satisfied. See Note 10.

On October 30, 2012, the action filed by Reel Games against us was dismissed with prejudice. See Note 10.

In accordance with ASC Topic 855-10, we have analyzed our operations subsequent to September 30, 2012 and up to the date these financial statements were issued, and have determined that there are not any material subsequent events to disclose in these financial statements other than the events described above.

Table of Contents

**Item 2. Management’s Discussion and Analysis OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-looking statements.** Certain statements, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements.” These forward-looking statements generally are identified by the words “believes,” “project,” “expects,” “anticipates,” “estimates,” “intends,” “strategy,” “plan,” “may,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially from the forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and future prospects on a consolidated basis include, but are not limited to: changes in economic conditions, legislative/regulatory changes, availability of capital, interest rates, competition, and generally accepted accounting principles. These risks and uncertainties should also be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning our business, including additional factors that could materially affect our financial results, is included herein and in our other filings with the SEC.

**Overview.** We are engaged in the business of developing proprietary casino table games and associated technology and systems for the casino gaming industry. We receive fees in the form of recurring revenues for our intellectual property, technology and services that we provide to land-based, riverboat and cruise ship casinos in the United States and internationally. We group our products into three product categories we classify as “Proprietary Table Games,” “Enhanced Table Systems” and “e-Tables.” Additional information regarding our products and product categories may be found in Note 1 “Description of Business” in Item 1 “Financial Statements” included in this Form 10-Q and on our web site, [www.galaxygaming.com](http://www.galaxygaming.com). Information found on the web site should not be considered part of this report.

**Strategy.** Our long-term business strategy is designed to capitalize on the opportunities we perceive within the gaming industry. We are an experienced developer of proprietary table games but a relative newcomer to developing and providing advanced electronic table game platforms and e-Tables. Throughout our history, we have been focused on creating and expanding our base of recurring revenues that we earn on a monthly basis. Our plan is to continue to increase the recurring revenues we receive by employing the following strategies:

1. Expand our inventory of products and technologies to attain a fully comprehensive portfolio;
2. Increase our per unit price point by leveraging our Enhanced Table Systems; and
3. Grow our e-Table business.

*Expand our inventory of products and technologies to attain a fully comprehensive portfolio.* Historically, only one company in the table game industry, Shuffle Master Gaming, Inc., has had the ability to offer casinos nearly all of the

table game products they require. Their unique ability to offer numerous products both in terms of game content and what they term as “utility” products (e.g. card shufflers, smart dealing shoes, baccarat displays, etc.), has stifled competition from other companies, including us, who are disadvantaged without a complete product line offering. Our strategy is to be an alternative for casino operators by offering a complete and comprehensive portfolio of games, products, systems, technologies and methodologies for casino table games. If we achieve this objective, we intend to offer complete turn-key systems rather than compete solely as a purveyor of individual products only. We intend to continuously develop and/or seek to acquire new proprietary table games to complement our existing offerings and to extend our penetration of proprietary table games on the casino floor. We expect to accomplish this strategic shift through internal development of products as well as continued acquisitions from others.

Our first preference is to develop internally our products and intellectual property. Our CEO works closely with our engineering team to develop new cutting-edge table game content and ancillary products. Together they have been responsible for the continued development of our Proprietary Table Games and Enhanced Table Systems. We intend to further expand our product line including so-called “utility” products now offered by our competitors through our continued research, design, development and engineering efforts.

### Table of Contents

In addition, we are constantly seeking to acquire marketable products developed by others. In 2010, we acquired the *Deuces Wild Hold'em Fold'em* and *Random Wild* games and associated intellectual property from T&P Gaming, Inc. In October 2011 we acquired over 20 different table games, including *21+3*, *Two-way Hold'em* and *Three Card Poker* from Prime Table Games. Those games are currently played on approximately 500 tables in 200 casinos in the United States, the United Kingdom and in the Caribbean. Prime Table Games' intellectual property portfolio included 47 patents and patents pending, 96 worldwide trademark and design registrations and 47 domain name registrations. In November 2011, we acquired the table games *Bonus Craps*, *Four The Money*, *Rainbow Poker* and *Roulette Craps* together with nine patents, various trademarks and an assignment of existing licensing agreements with various casinos throughout the United States from Lakes Entertainment, Inc. In September 2012, we acquired the table game *High Card Flush* and all related patents and trademarks from Red Card Gaming, Inc.

We anticipate the continued acquisition and/or development of additional new proprietary table games and associated intellectual property, which when combined with our existing portfolio, will give us the complete inventory of proprietary games to offer casinos a complete solution, thereby increasing our competitiveness in the marketplace.

*Increase our per unit price point by leveraging our Enhanced Table Systems.* Our Enhanced Table Systems permit us the opportunity to significantly increase the amount of recurring revenue we receive from each table game placement. Accordingly, our goal is to concentrate on installing new game placement using one or more of our Enhanced Table Systems and to convert our existing Proprietary Table Game placements that currently do not incorporate our Enhanced Table Systems. We have modified most of our Premium Table Games and many of our Side Bets to benefit from the economics this new system affords us. In the future, we intend to be able to offer this platform for all games.

Additionally, we expect that most or all of our new Proprietary Table Games will include the *Bonus Jackpot System* component. The technology developed with the *Bonus Jackpot System* has allowed us to offer not only bonus jackpots and progressive jackpots, but also provides us the infrastructure to offer our *Inter-Casino Jackpot System* and *MEGA-Share*, which we believe will be a popular option for casinos seeking to increase their game play activity. We have identified jurisdictions where we may have the ability to offer this program and have commenced seeking the requisite approvals. In jurisdictions where our *Inter-Casino Jackpot System* is approved, we intend to increase our sales efforts towards connecting casinos together into a common jackpot system.

We invented the concept called *MEGA-Share*, which we first installed in December 2011. *MEGA-Share* and our *Inter-Casino Jackpot System* are unrelated but can be combined if so desired by our clients. A casino could operate either one, or operate both simultaneously. We believe *MEGA-Share* has the ability to become a "must-have" product for casinos and as a result could be a significant contributor to our future revenue growth. Accordingly, we also intend to intensify our sales efforts on obtaining *MEGA-Share* placements.

*Grow our e-Table business.* Our *TableMAX* product line is developed for us by TableMAX Corporation. Having installed the majority of TableMAX e-Tables we received last year, we are awaiting the next major release of the *TableMAX* e-Table, referred to as the "Model E." We have been informed by TableMAX Corporation that the majority of the Model E's development is complete and it has been submitted for regulatory approval with Gaming Labs

International, an independent testing organization. We anticipate the requisite approval for the Model E in late 2012 and expect to offer this product to gaming operators in early 2013.

**Sources of revenue.** We derive recurring revenues from the licensing of our products and intellectual property. Consistent with our strategy, these revenues are generated from negotiated recurring licensing fee agreements, which typically, are month-to-month in nature. We also receive revenues in the form of a one-time sale of certain products and/or reimbursement of our manufactured equipment.

**Financing.** Additional funding may be necessary to facilitate our current aggressive growth plans and acquisition strategy, as well as the investments in our infrastructure. If we determine that additional funding is required and we are unsuccessful in raising capital, we will still pursue acquisitions and growth, however, our acquisition opportunities could be limited and our growth strategy could be negatively impacted.

**Expected changes in number of employees, plant and equipment.** As we continue to grow, we anticipate the purchasing of inventory and equipment and possibly the leasing of additional space to accommodate research, development, manufacturing and assembly operations. We will also evaluate the necessary increases to our employee base over the course of the year.

Table of Contents

**Results of operations for the three months ended September 30, 2012.** For quarter ended September 30, 2012, our continuing operations generated gross revenues of \$1,873,528 compared to gross revenues of \$733,883 for the previous year's comparable quarter, representing an increase of \$1,139,645 or 155%. This material increase was due primarily to the performances of the Prime Table Game assets added to our portfolio in October 2011 and the addition of e-Tables resulting from the TableMAX transaction in February 2011. Selling, general and administrative expenses for the quarter ended September 30, 2012, were \$994,537 compared to \$826,878 for the previous year's third quarter, representing a \$167,659 increase, or 20%. The material year-over-year expense increases were in the following areas as shown:

	Three months ended	
	September 30,	
	2012	2011
Sales commissions	\$206,833	\$102,489
Legal	139,518	90,820
TableMAX SG&A expenses	71,384	—
Trade show expense	58,922	24,618
Outside consultant expense	42,478	14,441
Distributor fees	36,784	6,026
Settlement expense	—	150,000

The increase in sales commissions was related primarily to increased sales. Legal expense increased due to a number of number of regulatory, compliance, and litigation issues which arose during the latter half of 2011 and carried into 2012. The increase in TableMAX SG&A expense was due to the active marketing and selling of TableMAX products. Trade show expense increase due to an expanded presence at G2E and additional Native Indian gaming events. Outside consultant expense was due primarily to the use of contract personnel used to assist our Interim Chief Financial Officer and one-time accounting requirements related to the Prime Table Games acquisition. Distributor fees increased due to the use of distributors in jurisdictions the company was not directly licensed. The settlement expense in 2011 was related to the settlement agreement with Sherron Associates, Inc.

Comparing the quarter ended September 30, 2012 with the immediately preceding quarter ended June 30, 2012 our revenue grew \$83,312 to \$1,873,528 from \$1,790,216 representing a 4.7% increase. Our selling, general and administrative expenses decreased \$38,396 to \$994,537 from \$1,032,933, or a 3.8% decrease. We recognized a gain on the settlement with Unax Gaming of \$50,000 for the quarter ended June 30, 2012. These and other factors resulted in the net income of \$129,476 for the quarter ended September 30, 2012 compared to net income of \$61,504 for the quarter ended June 30, 2012.

**Liquidity and capital resources.** As of September 30, 2012, we had total current assets of \$1,825,573 and total assets of \$22,287,157. This compares to \$1,448,272 and \$23,115,411, respectively for the period ended December 31, 2011. The material increase in current assets for the period ended September 30, 2012 is reflective of the performance of the Prime Table Games asset acquisition which occurred in October 2011. Our total current liabilities as of September 30, 2012 were \$3,439,294 versus \$2,805,193 as of December 31, 2011. This increase is primarily due to the increase in current portion of the PTG debt obligation, whose payments increase from \$200,000 to \$250,000 starting January 1, 2013. Deferred revenue increased \$101,015 to \$437,063 at September 30, 2012 from \$336,048 at December 31, 2011

Edgar Filing: Galaxy Gaming, Inc. - Form 10-Q

due to increased sales. Additionally, accrued expenses and taxes increased \$122,455 to \$481,315 at September 30, 2012 from \$358,860 at December 31, 2011 primarily due to an increase in the TMAX progressive jackpot liability. Total current liabilities are as follows for periods ending September 30, 2012 and December 31, 2011:

Account	2012	2011
Accounts payable	\$328,821	\$274,576
Accrued expenses	481,315	358,860
Deferred revenue	437,063	336,048
Notes payable – related party	—	469
Notes payable – current portion	2,192,095	1,835,240
Total current liabilities	\$3,439,294	\$2,805,193

6

Table of Contents

When compared to the quarter ending June 30, 2012 current assets increased by \$278,305 or 18%. This increase was made up mostly by an increase in cash of \$139,806 and accounts receivable of \$132,399. Total assets decreased by \$164,695 or 1%. This decrease was largely attributable to increasing amortization of the Prime Table Games assets. Current liabilities grew by \$233,538 or 7%. Much of this growth came from an increase in the current portion of the PTG debt obligation, whose payments increase from \$200,000 to \$250,000 starting January 1, 2013. This increase of \$121,015 accounts for 52% of the current liability growth, with the other major growth being in accrued expenses, which grew \$79,692 from \$401,623 to \$481,315 or 34%. Despite increases in accrued expenses (\$79,692) and current portions of the PTG notes payable (\$121,015), our working capital increased by \$44,767 from the quarter ending June 30, 2012 due to increases in cash (\$139,806) and accounts receivable (\$132,399).

We have undertaken certain growth initiatives to expand our recurring revenue base. As such we have made investments in personnel, inventory and research related to the development of our enhanced table systems. Additionally, we hired sales and marketing personnel and spent monies on regulatory efforts for the purpose of expanding our distribution network.

It is our intention to continue these initiatives. To the extent we are not able to achieve our growth objectives or raise additional capital we will need to evaluate the reduction of operating expenses.

At September 30, 2012, other than the commitment from the major shareholder of TableMAX to provide a line of credit specific to acquiring inventory for the TableMAX system, we do not have any available third-party lines or letters of credit. Furthermore, we do not have any written or oral commitments from officers or shareholders to provide us with loans or advances to support our operations or fund potential acquisitions.

The primary components of our operating cash flow for the nine months ended September 30, 2012, were net income from operations of \$19,771, increases in accounts receivable (\$269,337) and inventory (\$29,186) offset by increases in accounts payable (\$54,245), accrued expenses and taxes (\$122,455) and deferred revenue (\$101,015), for a total operating activities impact of an additional \$1,384,322 of cash.

Cash flows provided by investing activities for the nine months ended September 30, 2012 were \$30,103, primarily due to note receivable of \$50,000 as a result of the Unax Gaming settlement. Cash used in financing activities during the nine months ended September 30, 2012 was \$1,267,599 almost completely comprising principal payments of \$1,267,130 towards long-term debt.

We intend to fund our continuing operations through increased sales. Additionally the issuance of debt or equity financing arrangements may be required to fund expenditures or other cash requirements. Despite this funding there is no assurance that we will be successful in raising additional funding, if necessary. If we are not able to secure additional funding, the implementation of our business plan could be impaired. There can be no assurance that such additional financing will be available to us on acceptable terms or at all. In addition, we may incur higher capital

expenditures in the future to expand our operations. We may from time to time acquire products and businesses complementary to our business. As a public entity, we may issue shares of our common stock and preferred stock in private or public offerings to obtain financing, capital or to acquire other businesses that can improve our performance and growth. To the extent that we seek to acquire other businesses in exchange for our common stock, fluctuations in our stock price could have a material adverse effect on our ability to complete acquisitions.

***Critical accounting policies.*** In December 2001, the SEC requested that all registrants list their most “critical accounting policies” in the Management Discussion and Analysis. The SEC indicated that a “critical accounting policy” is one which is both important to the portrayal of a company’s financial condition and results, and requires management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Currently, we do not believe that we have any accounting policies that fit this definition.

***Recently issued accounting pronouncements.*** We do not expect the adoption of recently issued accounting pronouncements to have a significant impact on our results of operations, financial position or cash flow.

Table of Contents

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

A smaller reporting company is not required to provide the information required by this Item.

**Item 4T. Controls and Procedures**

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2011. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2011, our disclosure controls and procedures are effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

***Limitations on the effectiveness of internal controls.*** Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material error. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving our objectives and our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at that reasonable assurance level. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

Table of Contents

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings**

(See Note 10 of Item 1 Financial Statements regarding current litigation.)

**Item 1A. Risk Factors**

A smaller reporting company is not required to provide the information required by this Item.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In February 2011, we sold a total of 533,333 shares of common stock and 266,667 warrants for total cash proceeds of \$200,000. The offering and sale of the shares was exempt from registration under Rule 506 of Regulation D. The shares were offered exclusively to accredited and/or sophisticated investors and there was no general solicitation or advertising.

**Item 3. Defaults upon Senior Securities**

None

**Item 4. MINE SAFETY DISCLOSURES**

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

<b><u>Exhibit Number</u></b>	<b><u>Description of Exhibit</u></b>
31.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002</u>
9	

Table of Contents

**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 thereunto duly authorized.

Galaxy Gaming, Inc.

Date: November 14, 2012

By: /s/ Robert Saucier

Robert Saucier

Chief Executive Officer

Galaxy Gaming, Inc.

Date: November 14, 2012

By: /s/ Gary A. Vecchiarelli

Gary A. Vecchiarelli

Chief Financial Officer

