

Galaxy Gaming, Inc.  
Form 10-Q  
May 15, 2013

**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 March 31, 2013**

**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.)

**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 May 15, 2013.

Table of Contents

**GALAXY GAMING, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2013**

**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>	21
Item 3: <u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
Item 4T: <u>Controls and Procedures</u>	25

**PART II – OTHER INFORMATION**

Item 1: <u>Legal Proceedings</u>	26
Item 1A: <u>Risk Factors</u>	26
Item 2: <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
Item 3: <u>Defaults Upon Senior Securities</u>	26
Item 4: <u>Mine Safety Disclosures</u>	26
Item 5: <u>Other Information</u>	26
Item 6: <u>Exhibits</u>	26

Table of Contents

**PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

- 4 Balance Sheets as of March 31, 2013 and December 31, 2012 (unaudited);
- 5 Statements of Operations for the three months ended March 31, 2013 and 2012 (unaudited);
- 6 Statements of Cash Flows for the three months ended March 31, 2013 and 2012 (unaudited);
- 7 Statements of Comprehensive Income (Loss) for the three months ended March 31, 2013 and 2012 (unaudited);
- 8-20 Notes to Financial Statements (unaudited);

3

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

	March 31, 2013 (Unaudited)	December 31, 2012 (Unaudited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$290,743	\$398,424
Restricted cash	222,109	216,964
Accounts receivables, net allowance for bad debts of \$44,223 and \$44,223	995,449	1,026,768
Prepaid expenses	18,602	29,443
Inventory	316,320	217,772
Note receivable – related party, current portion	17,388	17,155
Deferred tax asset	172,286	221,049
Other current assets	48,639	42,375
Total current assets	2,081,536	2,169,950
Property and equipment, net	41,674	43,399
Products leased and held for lease, net	55,927	47,433
Intangible assets, net	18,153,190	18,550,416
Goodwill	1,091,000	1,091,000
Note receivable – related party, net of current portion	366,696	371,106
Deferred income taxes	120,774	120,774
Other assets, net	9,962	10,868
Total assets	\$21,920,759	\$22,404,946
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$263,848	\$286,983
Accrued expenses	193,910	251,734
Deferred revenue	444,365	440,342
Jackpot liabilities	235,881	222,109
Notes payable, current portion	2,390,183	2,360,930
Total current liabilities	3,528,187	3,562,098
Notes payable, net of debt discount, net of current portion	17,105,973	18,250,864
Deferred income taxes	72,337	—
Total liabilities	20,706,497	21,812,962
Commitments and Contingencies (See Note 11)		
Stockholders' equity		
Preferred stock, 10,000,000 shares, \$.001 par value preferred stock authorized; 0 shares issued and outstanding	—	—
	38,311	38,311

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

Common stock, 65,000,000 shares authorized; \$.001 par value 38,310,591 shares issued and outstanding		
Additional paid-in capital	2,114,548	2,113,097
Stock warrants	401,827	401,827
Accumulated deficit	(1,461,708 )	(1,565,505 )
Accumulated other comprehensive income (loss)	121,284	(395,746 )
Total stockholders' equity	1,214,262	591,984
Total liabilities and stockholders' equity	\$21,920,759	\$22,404,946

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

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>
Revenue:		
Product leases and royalties	\$ 1,889,430	\$ 1,628,320
Product sales and service	6,948	17,387
<b>Total revenue</b>	<b>1,896,378</b>	<b>1,645,707</b>
Costs and expenses:		
Costs of ancillary products and assembled components	27,251	8,634
Selling, general and administrative	957,583	1,102,788
Research and development	100,445	61,205
Depreciation	10,159	16,899
Amortization	397,226	406,713
Total costs and expenses	1,492,664	1,596,239
Income from operations	403,714	49,468
Other income (expenses)		
Interest income	5,863	6,061
Interest expense	(257,017 )	(226,747 )
<b>Total other income (expense)</b>	<b>(251,154 )</b>	<b>(220,686 )</b>
Income (loss) before provision for income taxes	152,560	(171,218 )
Benefit (provision) for income taxes	(48,763 )	—
Net income (loss)	\$ 103,797	\$(171,218 )
Basic income (loss) per share	\$0.00	\$(0.00 )
Diluted income (loss) per share	\$0.00	\$(0.00 )
Weighted average number of shares outstanding		
Basic	38,310,591	37,517,008
Diluted	38,310,591	37,517,008

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

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

## STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2013 (Unaudited)	2012 (Restated) (Unaudited)
Cash flows from operating activities:		
Net income (loss) for the period	\$ 103,797	\$ (171,218 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation expense	10,159	17,806
Amortization expense	397,226	393,173
Amortization of debt discount	52,158	52,158
Provision for bad debts	—	15,000
Deferred income tax provision	48,763	—
Share-based compensation	1,451	80,250
Changes in operating assets and liabilities:		
Increase in restricted cash	(5,145 )	(11,488 )
Decrease (increase) in accounts receivable	31,325	(72,011 )
(Increase) decrease in other current assets	(6,264 )	105,566
Increase in inventory	(98,548 )	(18,344 )
Decrease (increase) in prepaid expenses	10,841	(28,204 )
(Decrease) increase in accounts payable	(23,048 )	32,471
Decrease in accrued expenses	(57,824 )	(54,070 )
Increase in deferred revenue	4,023	49,122
Increase in jackpot liabilities	13,772	10,191
Net cash provided by operating activities	482,686	400,402
Cash flows from investing activities:		
Acquisition of property and equipment	(2,791 )	—
Increase in note receivable	—	(6,060 )
Payments received on note receivable	4,177	—
Increase in products leased or held for lease	(13,231 )	—
Net cash used in investing activities	(11,845 )	(6,060 )
Cash flows from financing activities:		
Principal payments on notes payable – related party	—	(469 )
Principal payments on notes payable	(571,048)	(454,078 )
Net cash used in financing activities	(571,048)	(454,547 )
Effect of exchange rate changes on cash	(7,474 )	—
Net decrease in cash and cash equivalents	(107,681)	(60,205 )
Cash and cash equivalents – beginning of period	398,424	182,907
Cash and cash equivalents – end of period	\$ 290,743	\$ 122,702
Supplemental cash flow information:		



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

Cash paid for interest	\$257,017	\$ 111,748
Cash paid for income taxes	\$—	\$—
Effect of exchange rate on note payable in foreign currency	\$596,748	\$ 242,258

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

6

Table of Contents

**GALAXY GAMING, INC.**

**STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	Three Months Ended	
	March 31,	
	2013	2012
	(Unaudited)	(Unaudited)
Net income (loss)	\$ 103,797	\$ (171,218 )
Other comprehensive income (loss):		
Foreign currency translation adjustments	517,030	(242,258 )
Total comprehensive income (loss)	\$ 620,827	\$ (413,476 )

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

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 3,000 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. These recurring revenues generally have few direct costs thereby generating high gross profit margins. 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. 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 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.

***Enhanced Table Systems.*** Enhanced Table Systems are electronic enhancements used on casino table games to add to player appeal and 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 components known as the *Bet Tabulator System*, which is used to detect players’ wagers and *TableVision*, which is an electronic display attached to a gaming table. 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. Currently 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* allows up to 16 player positions and 6 betting positions per player. The *Andromeda Series* was the first of its kind, allowing for the most sensors to be placed on a single gaming table. Through the *TableVision* component, the *Andromeda Series* includes the ability to keep track of and display more than one jackpot.

### Table of Contents

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 player 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 placed a *MEGA-Share* qualifying wager. *MEGA-Share* rewards other players playing on other tables, other games, or even in other casinos with a share of a second jackpot simply for having a wager placed at the time another player won the main jackpot.

*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 15. The *TableMAX* e-Table system is a fully automated, multi-player electronic table game platform which does not need a human dealer. These platforms allow us to offer our Proprietary Table Game content in markets where live table games are not permitted. The e-Table product enables 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.

***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, 2012. 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.

**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 per account. To date, we have not experienced uninsured losses.

**Restricted cash.** We are required by gaming regulation to maintain sufficient reserves in restricted accounts to be used for the purpose of funding payments to winners of our jackpots offered. Compliance with restricted cash requirements for jackpot funding is reported to gaming authorities in various jurisdictions.

**Inventory.** Inventory consists of ancillary products such as signs, layouts, and bases for the various games and electronic devices and components to support our Enhanced Table Systems. Inventory value is determined by the average cost method and management maintains inventory levels based on historical and industry trends. We regularly assess inventory quantities for excess and obsolescence primarily based on forecasted product demand. See Note 5.

Table of Contents

**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. Since we retain title to the equipment, we classify these assets as “products leased and held for lease” and they are 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 three year period.

**Property and equipment.** Property and equipment are being depreciated over their estimated useful lives, 3 to 5 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 PTG 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.

**Impairment of long-lived assets.** We continually monitor events and changes in circumstances that could indicate carrying amounts of long-lived assets may not be recoverable. When such events or changes in circumstances are present, we assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell.

**Fair value of financial instruments.** The fair value of cash and cash equivalents, restricted cash, accounts receivable, prepaid expenses, other current assets, inventory, notes receivable-related party, deferred tax assets, accounts payable, accrued expenses, deferred revenue, jackpot liabilities 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.

**Concentration of risk.** We are exposed to risks associated with clients who represent a significant portion of total revenues. As of March 31, 2013 and 2012 we had revenues from one client account for 15.5% and 12.0% of total revenues, respectively. The amounts in accounts receivable related to this significant client at March 31, 2013 and 2012 was \$102,660 and \$112,980, respectively..

**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 negotiated terms, 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 begin earning revenue with the installation 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 (display of payouts), bases, layouts, signage and other items as they relate to support specific proprietary games in connection with the licensing of our games. Assembled components represent the cost of the equipment, devices and incorporated software used to support the *Bonus Jackpot System*.

**Research and development.** We incur research and development costs to develop our new and next-generation products. Our products reach technological feasibility shortly before the products are released and therefore R&D costs are expensed as incurred. Employee related costs associated with product development are included in R&D costs.

**Foreign currency translation.** For non-US functional accounts, assets and liabilities are translated at exchange rates in effect at the balance sheet date, and income and expense accounts at the average exchange rates for the year. Resulting currency translation adjustments are recorded as a separate component of shareholders' equity. We record foreign currency transactions at the exchange rate prevailing at the date of the transaction with resultant gains and losses being included in results of operations. Realized foreign currency transaction gains and losses have not been significant for any period presented.

***Income taxes.*** We record deferred tax assets and liabilities based on temporary differences between the financial reporting and tax bases of assets and liabilities, applying enacted tax rates expected to be in effect for the year in which the differences are expected to reverse. We reduce deferred tax assets by a valuation allowance when it is more likely than not that some or all of the deferred tax assets will not be realized.

Our provision for income taxes includes interest and penalties related to uncertain tax positions. We only recognize the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Table of Contents

**Basic income (loss) per share.** Basic earnings per share is calculated by dividing net income by the weighted average number of common shares issued and outstanding during the year. Diluted earnings per share is similar to basic, except that the weighted average number of shares outstanding is increased by the potentially dilutive effect of outstanding stock options and warrants, if applicable, during the year, using the treasury stock method.

**Stock-based compensation.** We measure and recognize all stock-based compensation, including restricted stock and stock-based awards to employees, under the fair value method. We measure the fair value of stock-based awards using the Black-Scholes model and restricted shares using the grant date fair value of the stock. Compensation is attributed to the periods of associated service and such expense is recognized on a straight-line basis over the vesting period of the awards. Forfeitures are estimated at the time of grant, with such estimate updated when the expected forfeiture rate changes.

**Use of estimates and assumptions.** We are required to make estimates, judgments and assumptions that we believe are reasonable based on our historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect reported amounts for assets, liabilities, revenues, expenses and related disclosures. Actual results may differ from initial estimates.

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

**Recently adopted accounting standards - adopted**

**Comprehensive income.** In June 2011, the FASB issued an Accounting Standards Update (“ASU”) that eliminates the option to present components of other comprehensive income as part of the statement of changes in equity and now requires an entity to present items of net income and other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance also required companies to present on the face of the financial statements reclassification adjustments from other comprehensive income to net income, but in December 2011, the FASB issued an ASU that deferred this requirement. The guidance became effective for fiscal years beginning after December 15, 2011. We adopted the provisions of the guidance in 2012 and elected to present items of net income and other comprehensive income in two separate but consecutive statements.

**Qualitative impairment assessment for goodwill and other indefinite-lived intangibles.** In July 2012, the FASB issued an ASU that gives an entity the option to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. This guidance was effective for annual and interim impairment tests performed

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

for fiscal years beginning after September 15, 2012. We adopted the provisions of the guidance on January 1, 2013. The adoption of the guidance did not have a material impact on our financial statements.

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

The note receivable balance was as follows:

	March 31, 2013	December 31, 2012
Note receivable	\$384,084	\$388,261
Less: current portion	(17,388 )	(17,155 )
Total long-term note receivable	\$366,696	\$371,106

A note receivable was acquired as part of the 2007 asset purchase agreement with GLLC. The 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. 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.

Interest income associated with this note receivable was \$5,820 and \$6,061 for the periods ended March 31, 2013 and 2012, respectively.

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 March 31, 2013 and December 31, 2012, management believed that 100% of the note receivable principal and interest amounts are collectable.

**NOTE 4. PREPAID EXPENSES**

Prepaid expenses consist of the following at:

	March 31, 2013	December 31, 2012
Trade show expense	\$5,880	\$4,520
Insurance	4,053	8,096
Professional services	3,000	3,000
IT system	2,285	9,065
Property taxes	1,769	—

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

Other prepaid expenses	1,090	2,757
Rent	525	—
Inventory costs	—	2,005
Total prepaid expenses	\$ 18,602	\$ 29,443

**NOTE 5. INVENTORY**

Inventory consists of the following as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
Raw materials and component parts	\$ 168,570	\$ 109,637
Finished goods	86,968	80,291
Work-in-process	93,677	60,739
Subtotal	349,215	250,667
Less: inventory reserve	(32,895 )	(32,895 )
Total inventory	\$316,320	\$217,772

Table of Contents**NOTE 6. PROPERTY AND EQUIPMENT**

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

	March 31, 2013	December 31, 2012
Computer equipment	\$54,308	\$51,516
Furniture and fixtures	73,771	73,772
Office equipment	10,320	10,320
Leasehold improvements	6,367	6,367
	144,766	141,975
Less: accumulated depreciation	(103,092)	(98,576)
	\$41,674	\$43,399

Included in depreciation expense was \$4,516 and \$4,265 for the three months ended March 31, 2013 and 2012, respectively.

**NOTE 7. PRODUCTS LEASED AND HELD FOR LEASE**

Products leased and held for lease consisted of the following at:

	March 31, 2013	December 31, 2012
Enhanced table systems	\$111,804	\$98,573
Less: accumulated depreciation	(55,877)	(51,140)
Products leased and held for lease, net	\$55,927	\$47,433

Included in depreciation expense was \$4,737 and \$12,634 related to products leased and held for lease for the three months ended March 31, 2013 and 2012, respectively.

**NOTE 8. INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS**

Intellectual property and intangible assets consisted of the following at:

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

	March 31, 2013	December 31, 2012
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	(2,412,777 )	(2,015,551 )
	\$18,153,190	\$18,550,416

Amortization expense was \$397,226 and \$406,713 for the three months ended March 31, 2013 and 2012, respectively.

Included in intangible assets at March 31, 2013 and December 31, 2012 are other intangible assets of \$150,000. This amount relates to the 2008 purchase of a regional territory from an outside sales representative. The total value of this agreement was \$150,000 and the resulting intangible asset has an infinite life.

In October 2011, we acquired the following intangible assets related to the asset purchase with Prime Table Games:

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



Table of Contents**NOTE 9. ACCRUED EXPENSES**

Accrued expenses, consisted of the following at:

	March 31, 2013	December 31, 2012
Salaries & payroll taxes	\$67,534	\$65,052
Commissions	56,762	67,026
Vacation	56,503	50,949
Trade show expenses	5,927	—
Professional fees	4,356	63,510
Accrued interest	2,572	2,505
Other accrued expenses	256	2,692
Total accrued expenses	\$193,910	\$251,734

**NOTE 10. LONG-TERM DEBT**

Long - term debt consists of the following at:

	March 31, 2013	December 31, 2012
Note payable – related party	\$1,115,893	\$1,122,915
Notes payable, net of debt discount - PTG	18,380,263	19,488,879
	19,496,156	20,611,794
Less: Current portion	(2,390,183 )	(2,360,930 )
	\$17,105,973	\$18,250,864

The note payable – related party requires monthly principal and interest payments of \$9,159, at a fixed interest rate of 7.3% through February 2017, at which time there is a balloon payment due of \$1,003,000. This note payable is a result of the asset purchase agreement with GLLC and under the direction of GLLC, the payments are to be made on GLLC's behalf directly to Bank of America. The note agreement remains in the name of GLLC and we have no direct obligation to Bank of America. The note payable – related party is currently being litigated. Note 11 in Item 8. "Financial Statements and Supplementary Data" included in our annual report on Form 10-K for the year ended December 31, 2012

In October 2011, we closed an asset acquisition with Prime Table Games. Included within the structure of the \$23 million acquisition was a \$22.2 million component consisting of two promissory notes: 1) a note payable for \$12.2 million, and 2) a note payable for £6.4 million (\$10.0 million USD) note. 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 March 31,	Total
2014	\$2,390,183
2015	2,931,514
2016	3,569,803
2017	5,152,841
2018	4,377,258
Thereafter	2,291,609
Total long term debt	\$20,713,208
Less: debt discount	(1,217,052 )
Long-term debt, net of debt discount	\$19,496,156

Table of Contents**NOTE 11. COMMITMENTS AND CONTINGENCIES**

**Operating lease obligations.** 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. Our lease expired at the end of August 2012 and is currently on a term of month-to-month. In addition to our offices, we rent various temporary storage facilities in the range of \$150 to \$460 a month. All temporary facilities have rental agreements with a monthly term. Rent expense was \$40,456 and \$40,034 for the three months ended March 31, 2013 and 2012, respectively.

Based upon our current growth projections, we anticipate either renewing our existing lease agreement and/or expanding our operations with a lease of a second office, or in the alternative, we may elect to not renew our existing lease and seek an entirely new facility sometime in 2013. The amounts shown in the accompanying table reflect our estimates of lease obligations for the twelve months ending 2013 through 2018 and are based upon our current estimates of our projected needs and our forecast of the commercial real estate market in Las Vegas. These estimates are summarized as follows:

Twelve Months Ended March 31,	Annual Obligation (Estimate)
2014	\$ 177,456
2015	221,400
2016	232,470
2017	244,092
2018	253,170
Thereafter	873,786
Total Estimated Lease Obligations	\$ 2,002,374

**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 topic ASC Topic 450, 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 11 in Item 8. "Financial Statements and Supplementary Data" included in our annual report on Form 10-K for the year ended December 31, 2012. There are no material updates to matters previously reported on Form 10-K for the year ended December 31, 2012, except:

*California administrative licensing action* – In 2003, Galaxy Gaming of California, LLC (“GGCA”), submitted an application to the California Gambling Control Commission (“Commission”) for a determination of suitability for licensure to do business with tribal gaming operations in California. At the time, our CEO was a member of GGCA. We acquired GGCA in 2008, through it, operated in 2008 and 2009, transferred all of its operations to us in 2009 and dissolved it in 2011. The Division of Gambling Control of the California Department of Justice (“Division”) processed GGCA's application and in 2005 made a recommendation to the Commission alleging GGCA and our CEO were unsuitable. In 2006, the Commission assigned the matter to the Office of Administrative Hearings (“OAH”) to further adjudicate the process. In April 2013, the OAH released a proposed decision, finding some of the allegations without merit, affirmed others and returned the matter to the Commission upholding the Division's prior recommendation. In February 2009, we independently applied to the Commission for a finding of suitability. Since our CEO was named in the GGCA case, our application with the Commission remains in a pending status. Until such time the Commission acts on our application, we are authorized and continue to conduct business with California tribes, subject to each tribe's gaming agency's requirements. In the event the Commission reaches an adverse decision in the GGCA action, it could potentially prevent us from conducting future business in California and may influence other gaming regulatory agencies thereby negatively affecting our ability to conduct business in those jurisdictions. We believe the remaining allegations against GGCA and our CEO are inaccurate, moot, immaterial and/or do not apply to us. None of the allegations pertain to any operations performed by us within or outside of California. The matter is now, or will soon be, before the Commission, who has the authority to determine our suitability, subject to judicial review.

Table of Contents

**Note 12. STOCKHOLDERS' EQUITY**

We had 65,000,000 shares of \$.001 par value common stock and 10,000,000 shares of \$.001 par value preferred stock authorized as of March 31, 2013.

In March 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 no preferred shares issued and outstanding at March 31, 2013.

**Note 13. Related Party Transactions**

We lease our offices from a related party that is related to our CEO. The lease was entered into effective September 1, 2010 for a period of two years requiring a monthly rental payment of \$10,359. Our lease expired at the end of August 2012 and is currently on a term of month-to-month.

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

We have a note payable to a related party. See Note 9.

Certain administrative, accounting and legal support services are performed by a related party of the CEO. We accrued or paid fees to the related party in the amount of \$2,610 and \$5,600 for the three months ended March 31, 2013 and 2012, respectively.

**NOTE 14. INCOME TAXES**

Our forecasted effective tax rate at March 31, 2013 is 37.1%, a 37.1% increase from the 0.0% effective tax rate recorded at March 31, 2012. After discrete benefit of 5.1%, the effective tax rate for the quarter ending March 31, 2013 is 32.0%. The discrete benefit is primarily attributable to the recognition of state net operating losses.

**Note 15. Stock Warrants and Options**

**Warrant activity.** We have accounted for 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*. In prior years, we estimated the fair value of the warrants using the Black-Scholes option pricing model based on assumptions at the time of issuance.

A summary of current warrant activity 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 – December 31, 2012	1,330,953	0.45
Issued	—	—
Exercised	—	—
Expired	—	—
Outstanding – March 31, 2013	1,330,953	\$ 0.45
Exercisable – March 31, 2013	—	—

Table of Contents

**Stock options.** For the three months ended March 31, 2013 and 2012, we issued -0- and 92,500 stock options, respectively. Stock options issued to members of our Board of Directors were -0- and 92,500 for the three months ended March 31, 2013 and 2012, 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 for the three months ended March 31, 2012.

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:

	Options issued year ended December 31, 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 three months ended March 31, 2013 and 2012, respectively.

A summary of stock option activity is as follows:

	Common Stock Options	Weighted Average Exercise Price
Outstanding – January 1, 2012	615,000	\$ 0.43
Issued	285,000	0.40
Exercised	—	—
Expired	(800,000)	—
Outstanding – December 31, 2012	100,000	0.45
Issued	—	—
Exercised	—	—
Expired	—	—
Outstanding – March 31, 2013	100,000	\$ 0.45
Exercisable – March 31, 2013	—	—

**Note 16. Asset AcquisitionS AND SIGNIFICANT TRANSACTIONS**

*Acquisition of Prime Table Games' assets.* In October 2011, we executed an asset purchase agreement (the "PTG Agreement") with Prime Table Games LLC and Prime Table Games UK (collectively "Prime Table Games"). Under the terms of the PTG 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.

We accounted for the asset purchase as a business combination using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the purchase date and be recorded on the balance sheet regardless of the likelihood of success of the related product or technology. The process for estimating the fair values of identifiable intangible assets involves the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. Transaction costs are not included as a component of consideration transferred and were expensed as incurred.



Table of Contents

*Consideration transferred.* The acquisition-date fair value of the consideration transferred consisted of the following items:

Common stock – 2,000,000 shares	\$480,000
Note payable – Prime Table Games LLC	12,200,000
Note payable – Prime Table Games UK	10,000,000
Total	\$22,680,000

The note payable to Prime Table Games UK is 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 2% per annum for the duration of the note or until the standard payment schedule resumes.

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

*Fair value estimate of assets acquired and liabilities assumed.* The total purchase consideration is allocated to Prime Table Games intangible assets based on their estimated fair values as of the closing date. The allocation of the total purchase price to the net assets acquired is as follows:

Patents	\$13,259,000
Customer relationships	3,400,000
Trademarks	2,740,000
Debt discount	1,530,000
Goodwill	1,091,000
Non-compete agreement	660,000
Total	\$22,680,000

**TableMAX agreement.** In February 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”) for the purpose of conducting 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.

Table of Contents

TMAX assigned, for the term of the TMAX Agreement, all of its existing gaming installations 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 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 through December 31, 2012. 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. While TMAX has not agreed to reimbursement of losses subsequent to December 31, 2012, we have not experienced significant losses attributable to the TableMAX Division.

Included in other current assets at March 31, 2013 is \$38,925, representing reimbursement due from TMAX.

**Note 17. Subsequent Events**

*California administrative licensing action update* – In April 2013, the Office of Administrative Hearings released a proposed decision, finding some of the allegations without merit, affirmed others and returned the matter to the Commission. See Note 11 *California administrative licensing action*.

In accordance with ASC 855-10, we have analyzed our operations subsequent to March 31, 2013 to the date these financial statements were issued, and have determined that we do not have any material subsequent events to disclose in these financial statements, other than the events discussed above.

**NOTE 18. CORRECTION OF ERRORS AND RESTATEMENTS**

We have restated our ending balances for March 31, 2012, as well as the balance sheet and statement of cash flows for March 31, 2012 to correct an error in our accounting. The error relates to an adjustment for foreign currency translation of the notes payable balance to Prime Table Games UK, which is recorded in the functional currency pound sterling. The adjustment records an unrealized translation adjustment to the accumulated other comprehensive income (loss) account. There was no effect on the statement of operations.

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

The following are the previous and corrected balances for the period ended March 31, 2012:

March 31, 2012 Financial Statements	Line Item	Corrected	Previously Stated
Balance Sheet	Notes payable, current portion	1,976,553	1,835,240
Balance Sheet	Notes payable, net of debt discount, net of current portion	19,734,391	20,035,366
Balance Sheet	Total liabilities	22,718,141	22,840,599
Balance Sheet	Accumulated other comprehensive (loss)	(242,258 )	—
Balance Sheet	Total shareholders' (deficit) equity	(58,374 )	274,852
Statement of Cash Flows	Non-cash investing and financing activities:		
	Effect of exchange rate on note payable in foreign currency	242,258	—

20

Table of Contents

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains statements that do not relate to historical or current facts, but are “forward looking” statements. These statements relate to analyses and other information based on forecasts of future results and estimates of amounts not yet determinable. These statements may also relate to future events or trends, our future prospects and proposed new products, services, developments, or business strategies, among other things. These statements can generally (although not always) be identified by their use of terms and phrases such as anticipate, appear, believe, could, would, estimate, expect, indicate, intent, may, plan, predict, project, pursue, will, continue and other similar terms and phrases, as well as the use of the future tense.

Actual results could differ materially from those expressed or implied in our forward looking statements. Our future financial condition and results of operations, as well as any forward looking statements, are subject to change and to inherent known and unknown risks and uncertainties. You should not assume at any point in the future that the forward looking statements in this report are still valid. We do not intend, and undertake no obligation, to update our forward looking statements to reflect future events or circumstances.

**OVERVIEW**

We develop, acquire, manufacture and market technology and entertainment-based products for the gaming industry for placement on the casino floor. Our products primarily relate to licensed casino operators’ table games activities and focus on either increasing their profitability, productivity and security or expanding their gaming entertainment offerings in the form of proprietary table games, electronically enhanced table game platforms or fully-automated electronic tables. Our products are offered in highly regulated markets throughout the world. Our products are manufactured at our headquarters and manufacturing facility in Las Vegas, Nevada, as well as outsourced for certain sub-assemblies in the United States.

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.

Table of Contents

*Expand our inventory of products and technologies to attain a fully comprehensive portfolio.* Historically, only one company in the table game industry, SHFL Entertainment, 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.

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.



Table of Contents

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 TMAX e-Tables are developed for us by TableMAX Corporation. Having installed the majority of TMAX e-Tables we received last year, we are awaiting the next major release of the TMAX 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 expect to offer this product to gaming operators in 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.

*Results of operations for the three months ended March 31, 2013.* For the quarter ended March 31, 2013, our continuing operations generated gross revenues of \$1,896,378 compared to gross revenues of \$1,645,707 for the previous year’s comparable quarter, representing an increase of \$250,671 or 15%. 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 TMAX Agreement in February 2011. Selling, general and administrative expenses for the quarter ended March 31, 2013, were \$957,583 compared to \$1,102,788 for the previous year’s first quarter, representing a \$145,205 decrease, or 13%. The significant year-over-year changes in selling, general and administrative was comprised of the following items:

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

	Three months ended	
	March 31,	
	2013	2012
TMAX SG&A expenses	\$91,729	\$83,070
Legal expenses	89,321	188,367
Sales commissions	68,577	138,9798
Investor relations expense	32,973	6,816
Trade show expenses	31,048	15,794
Employee benefit expense	27,629	7,359
Share based compensation expense	1,451	80,250

The increase in TMAX expenses was primarily related to increased activity and ongoing maintenance of units in service. Legal expenses decreased due to the decreased activity in regulatory, compliance and litigation issues which arose during the latter half of 2011 and carried into 2012. Sales commissions decreased due to fewer new client bonuses being awarded. Investor relations expense has increased due to our investor visibility strategy. Employee benefit expense increased due to a larger participation rate in benefit programs by employees. Share based compensation expense in 2012 included a one-time grant of stock to employees, which was not repeated in 2013.

Table of Contents

During the three months ended March 31, 2013, we accrued income taxes at the expected annualized rate of 37.1% as compared to annualized rate of 0.0% for the same period 2012. The increase in the expected annualized rate in 2013 was primarily due to recognition of net operating loss carryforwards recognized in 2012. In addition, a discrete tax benefit related to state net operating losses was recognized in the first quarter of 2013.

**Liquidity and capital resources.** As of March 31, 2013, we had total current assets of \$2,081,536 and total assets of \$21,920,759. This compares to \$2,169,950 and \$22,404,946, respectively for the period ended December 31, 2012. The decrease in current assets for the period ended March 31, 2013 reflects a lower accounts receivable balance and lower current deferred tax asset balance. Our total current liabilities as of March 31, 2013 were \$3,528,187 versus \$3,562,098 as of December 31, 2012. This decrease was primarily attributed to payment of trade payables and accrued expenses, which was offset by an increase in the current portion of notes payable, due to the expected increase in principal payments come 2014. Deferred revenue of \$444,365 remained consistent at March 31, 2013 compared to \$440,342 at December 31, 2012 due to flat sales revenues between the quarters.

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 March 31, 2013, other than the commitment from the major shareholder of TMAX to provide a line of credit specific to acquiring inventory for the TMAX 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 three months ended March 31, 2013, were net income of \$103,797 and decreases in accounts receivable of \$31,325 offset by increases in inventory of \$98,548, increases in accounts payable of \$23,048 and increases in accrued expenses of \$57,824, for a total operating activities impact of an additional \$482,686 of cash.

Cash flows used in investing activities for the three months ended March 31, 2013 were \$11,845, primarily due to an increase in products leased or held for lease of \$13,231. Cash used in financing activities during the three months ended March 31, 2013 was \$571,048 which was completely comprised of principal payments 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, 2012. 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, 2012, our disclosure controls and procedures were 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 11 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**

None.

**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>
26	

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: May 15, 2013

By: /s/ Robert Saucier

Robert Saucier

Chief Executive Officer

**Galaxy Gaming, Inc.**

Date: May 15, 2013

By: /s/ Gary A. Vecchiarelli

Gary A. Vecchiarelli

Chief Financial Officer



