

Galaxy Gaming, Inc.
Form 10-Q
August 14, 2014

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 June 30, 2014

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.)

6767 Spencer Street, Las Vegas, NV 89119

(Address of principal executive offices)

(702) 939-3254

(Issuer's telephone number)

Former address: 6980 O'Bannon Drive, Las Vegas, NV 89117

(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 issuer has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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: 38,560,591 common shares as of August 14, 2014.

Table of Contents

GALAXY GAMING, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2014

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>	20
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	<u>Balance Sheets as of June 30, 2014 and December 31, 2013 (unaudited);</u>
5	<u>Statements of Operations for the three and six months ended June 30, 2014 and 2013 (unaudited);</u>
6	<u>Statements of Comprehensive Income (Loss) for the six months ended June 30, 2014 and 2013 (unaudited);</u>
7	<u>Statements of Cash Flows for the six months ended June 30, 2014 and 2013 (unaudited);</u>
8-19	<u>Notes to Financial Statements (unaudited);</u>

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

	June 30, 2014 (Unaudited)	December 31, 2013 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$434,607	\$438,502
Restricted cash	264,916	244,416
Accounts receivables, net allowance for bad debts of \$34,887 and \$36,770	1,424,018	1,273,797
Prepaid expenses	94,777	34,973
Inventory	313,416	297,480
Note receivable – related party, current portion	18,765	18,212
Deferred tax asset	27,119	27,119
Other current assets	32,767	50,510
Total current assets	2,610,385	2,385,009
Property and equipment, net	271,883	44,952
Products leased and held for lease, net	106,018	85,883
Intangible assets, net	16,067,379	16,811,511
Goodwill	1,091,000	1,091,000
Note receivable – related party, net of current portion	364,533	365,086
Deferred tax assets, net of current portion	436,669	436,669
Other assets, net	47,228	7,245
Total assets	\$20,995,095	\$21,227,355
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$336,268	\$241,754
Accrued expenses	372,168	322,402
Income taxes payable	156,921	34,655
Deferred revenue	597,209	526,922
Jackpot liabilities	269,543	246,522
Current portion of capital lease obligations	61,305	—
Current portion of long-term debt	3,289,275	2,929,918
Total current liabilities	5,082,689	4,302,173
Deferred rent	52,724	—
Capital lease obligations, net of current portion	173,313	—
Long-term debt, net of debt discount, net of current portion	14,194,019	15,645,939
Total liabilities	19,502,745	19,948,112

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

Commitments and Contingencies (See Note 12)

Stockholders' equity		
Preferred stock, 10,000,000 shares, \$.001 par value preferred stock authorized; 0 shares issued and outstanding	—	—
Common stock, 65,000,000 shares authorized; \$.001 par value 38,560,591 and 38,310,591 shares issued and outstanding	38,560	38,311
Additional paid-in capital	2,586,135	2,330,676
Stock warrants	49,168	190,053
Accumulated deficit	(741,646)	(1,002,188)
Accumulated other comprehensive income (loss)	(439,867)	(277,609)
Total stockholders' equity	1,492,350	1,279,243
Total liabilities and stockholders' equity	\$20,995,095	\$21,227,355

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

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

(Unaudited)

	FOR THE THREE MONTHS ENDED		FOR THE SIX MONTHS ENDED	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Revenue:				
Product leases and royalties	\$2,461,354	\$1,931,376	\$4,722,163	\$3,820,806
Product sales and service	1,175	12,350	5,177	19,298
Total revenue	2,462,529	1,943,726	4,727,340	3,840,104
Costs and expenses:				
Cost of ancillary products and assembled components	17,620	32,232	36,940	59,483
Selling, general and administrative	1,420,932	986,482	2,627,277	1,944,064
Research and development	98,051	138,835	211,387	239,280
Depreciation	28,451	11,280	42,744	21,440
Amortization	389,634	397,226	779,133	794,452
Total costs and expenses	1,954,688	1,566,055	3,697,481	3,058,719
Income from operations	507,841	377,671	1,029,859	781,385
Other income (expense):				
Interest income	5,827	5,809	11,454	11,672
Interest expense	(280,445)	(258,543)	(563,682)	(515,560)
Gain on settlement	—	—	—	—
Total other income (expense)	(274,618)	(252,734)	(552,228)	(503,888)
Income before provision for income taxes	233,223	124,937	477,631	277,497
Benefit (provision) for income taxes	(123,846)	(39,747)	(217,089)	(88,510)
Net income	\$109,377	\$85,190	\$260,542	\$188,987
Basic income per share	\$0.00	\$0.00	\$0.01	\$0.00
Diluted income per share	\$0.00	\$0.00	\$0.01	\$0.00
Weighted average shares outstanding:				
Basic	38,535,591	38,310,591	38,459,897	38,310,591
Diluted	38,626,603	38,410,591	38,537,558	38,410,591

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

Table of Contents

GALAXY GAMING, INC.

STATEMENTS OF COMPREHENSIVE INCOME

	FOR THE SIX MONTHS ENDED	
	JUNE 30,	
	2014	2013
		(Unaudited) (Unaudited)
Net income	\$260,542	\$ 188,987
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax	(162,258)	522,531
Total comprehensive income	\$98,284	\$ 711,518

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

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

STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS
ENDED JUNE 30,
2014 **2013**

	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net income for the period	\$260,542	\$188,987
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	42,744	21,440
Amortization expense	779,132	794,452
Amortization of debt discount	104,316	104,316
Deferred income tax provision	—	88,510
Share-based compensation	114,823	2,902
Changes in operating assets and liabilities:		
Increase in restricted cash	(20,500)	(18,253)
(Increase) decrease in accounts receivable	(150,414)	(22,902)
Decrease (increase) in other current assets	17,743	(4,481)
Increase in inventory	(52,079)	(132,507)
(Increase) decrease in prepaid expenses	(59,804)	(45,365)
(Increase) in other long-term assets	(40,889)	—
Increase (decrease) in accounts payable	94,346	4,583
Increase (decrease) in accrued expenses	49,695	(38,649)
Increase in income taxes payable	122,266	—
Increase in deferred revenue	70,287	40,370
Increase in jackpot liabilities	23,021	16,254
Increase in deferred rent	52,724	—
Net cash provided by operating activities	1,407,953	999,657
Cash flows from investing activities:		
Acquisition of property and equipment	(8,791)	(18,347)
Acquisition of intangible assets	(35,000)	—
Payments received on note receivable	—	4,177
Net cash (used in) provided by investing activities	(43,791)	(14,170)
Cash flows from financing activities:		
Principal payments on capital leases	(9,352)	—
Principal payments on notes payable	(1,360,143)	(1,135,014)
Net cash used in financing activities	(1,369,495)	(1,135,014)
Effect of exchange rate changes on cash	1,438	(5,728)
Net decrease in cash and cash equivalents	(3,895)	(155,255)
Cash and cash equivalents – beginning of period	438,502	398,424
Cash and cash equivalents – end of period	\$434,607	\$243,169

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

Supplemental cash flow information:		
Cash paid for interest	\$563,682	\$515,560
Inventory transferred to leased assets	\$36,550	\$27,898
Cash paid for income taxes	\$—	\$—
Supplemental non-cash financing activities information:		
Assets acquired by capital lease	\$243,970	\$—
Effect of exchange rate on note payable in foreign currency	\$74,935	\$603,774

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

7

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, Africa 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. 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*, *Emperor’s Challenge*, *High Card Flush* and *WPT Heads’Up Hold’em*. 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.

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.

Table of Contents

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 17. 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 unaudited 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 year ended December 31, 2013. 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.

Products leased and held for lease. We 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. Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the improvement or remaining lease term. Our policy is to capitalize expenditures that materially increase asset lives and expense ordinary repairs and maintenance as required.

Table of Contents

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
Licensing agreements	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 assess 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. For the six months ended June 30, 2014 and 2013, we had the following client revenue concentrations:

Location	2014 Revenue	2013 Revenue
Client A North America	15.3%	12.5%
Client B United Kingdom	12.3%	6.6%

Client C United Kingdom 8.4% 8.4%

We are also exposed to risks associated with the expiration of our patents. In 2015, domestic and international patents will expire on two of our products, which account for approximately \$2,675,793 or 56.6% of our revenue for the six months ended June 30, 2014.

Leases. We recognize rent expense for operating leases on a straight-line basis (including the effect of reduced or free rent and rent escalations) over the applicable lease term. The difference between the cash paid to the landlord and the amount recognized as rent expense on a straight-line basis is included in deferred rent. The landlord of our corporate headquarters financed leasehold improvements in the amount of \$150,000. See Note 12. These improvements have been recorded as a capital lease and amortized over the life of the lease.

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. Revenue from the sale of lifetime licenses, under which we have no continuing obligation, is recorded on the effective date of the license agreement. Revenue from the sale of equipment or ancillary products is recorded in accordance with the contractual shipping terms.

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.

Table of Contents

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.

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

In March 2013, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update (“ASU”) requiring the release of cumulative translation adjustment into net income when an entity either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a foreign subsidiary. We adopted this ASU in 2014 and it has not had a material impact on our financial statements.

In February 2013, the FASB issued new accounting guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, including debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning on or

after December 15, 2013. We adopted this guidance in 2014 and do not believe it has a significant impact on its consolidated results of operations, financial condition and cash flows.

Table of Contents***Recently adopted accounting standards – not adopted***

We believe there is no additional new accounting guidance adopted, but not yet effective, which is relevant to the readers of our financial statements. However, there are numerous new proposals under development which, if and when enacted, may have a significant impact on its financial reporting.

NOTE 3. NOTE RECEIVABLE – RELATED PARTY

The note receivable balance was as follows:

	June 30, 2014	December 31, 2013
Note receivable	\$383,298	\$383,298
Less: current portion	(18,765)	(18,212)
Long-term note receivable	\$364,533	\$365,086

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 \$11,022 and \$11,560 for the six months ended June 30, 2014 and 2013, respectively. At June 30, 2014, there was an interest receivable balance of \$28,720 which is included in other current assets.

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 June 30, 2014 and December 31, 2013, management believed that 100% of the note receivable principal and interest amounts are collectible.

NOTE 4. PREPAID EXPENSES

Prepaid expenses consisted of the following at:

	June 30, 2014	December 31, 2013
Professional services	\$31,023	\$5,436
IT systems	24,057	8,923
Rent	17,162	175
Insurance	12,702	12,579
Dues & subscriptions	3,290	—
Other prepaid expenses	2,623	147
Inventory costs	2,520	2,520
Trade show expense	1,400	—
Property taxes	—	3,325
Regulatory compliance expenses	—	1,868
Prepaid expenses	\$94,777	\$34,973

Table of Contents**NOTE 5. INVENTORY**

Inventory consisted of the following at:

	June 30, 2014	December 31, 2013
Raw materials and component parts	\$203,685	\$182,351
Finished goods	92,494	95,579
Work-in-process	50,132	52,445
	346,311	330,375
Less: inventory reserve	(32,895)	(32,895)
Inventory	\$313,416	\$297,480

NOTE 6. PROPERTY AND EQUIPMENT

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

	June 30, 2014	December 31, 2013
Leasehold improvements	\$150,000	\$6,367
Furniture and fixtures	139,471	76,031
Computer equipment	78,770	69,960
Office equipment	12,270	12,270
	380,511	164,628
Less: accumulated depreciation	(108,628)	(119,676)
Property and equipment, net	\$271,883	\$44,952

Property and equipment includes \$243,970 of leasehold improvements, furniture and fixtures under capital leases as of June 30, 2014. Accumulated depreciation of assets under capital leases totaled \$13,669 as of June 30, 2014.

Included in depreciation expense was \$24,926 and \$9,378 related to property and equipment for the six months ended June 30, 2014 and 2013, respectively.

NOTE 7. PRODUCTS LEASED AND HELD FOR LEASE

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

	June 30, 2014	December 31, 2013
Enhanced table systems	\$ 193,575	\$ 157,861
Less: accumulated depreciation	(87,557)	(71,978)
Products leased and held for lease, net	\$ 106,018	\$ 85,883

Included in depreciation expense was \$16,008 and \$10,251 related to products leased and held for lease for the six months ended June 30, 2014 and 2013, respectively.

NOTE 8. INTANGIBLE ASSETS

Intellectual property and intangible assets consisted of the following at:

	June 30, 2014	December 31, 2013
Patents	\$ 13,615,967	\$ 13,615,967
Customer relationships	3,400,000	3,400,000
Trademarks	2,740,000	2,740,000
Non-compete agreements	660,000	660,000
Licensing agreements	35,000	—
	20,450,967	20,415,967
Less: accumulated amortization	(4,383,588)	(3,604,456)
Intangible assets, net	\$ 16,067,379	\$ 16,811,511

Amortization expense was \$779,133 and \$794,452 for the six months ended June 30, 2014 and 2013, respectively.

Table of Contents

In October 2011, we acquired the following intangible assets related to the asset purchase with Prime Table Games LLC and Prime Table Games UK (collectively “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 acquired intangible assets	\$21,150,000

NOTE 9. ACCRUED EXPENSES

Accrued expenses, consisted of the following at:

	June 30, 2014	December 31, 2013
Commissions	\$ 111,520	\$ 92,744
Salaries & payroll taxes	64,039	59,266
Vacation	58,806	41,216
Trade show expenses	53,995	48,718
Professional fees	44,133	75,000
TableMAX reimbursement	31,490	—
Royalties	4,250	—
Accrued interest	3,170	2,443
Other accrued expenses	765	3,015
Accrued expenses	\$ 372,168	\$ 322,402

NOTE 10. CAPITAL LEASE OBLIGATIONS

Capital lease obligations consisted of the following at:

	June 30, 2014
Capital lease obligation – office furniture	\$ 86,118
Capital lease obligation – leasehold improvements	148,500

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

	234,618
Less: Current portion	(61,305)
Capital lease obligations	\$ 173,313

The capital lease obligation – office furniture requires 30 monthly payments of \$3,641, including interest at 10.2%, through September 2016.

The capital lease obligation – leasehold improvements requires 60 monthly payments of \$2,879, including 5.5% interest, through May 2019.

The capital leases cover furniture and leasehold improvements located at our corporate headquarters in Las Vegas, NV. Annual requirements for capital leases obligations are as follows:

June 30,	Total
2015	\$78,237
2016	78,237
2017	43,769
2018	34,545
2019	31,663
Total minimum lease payments	\$266,451
Less: amount representing interest	(31,833)
Present value of net minimum lease payments	\$234,618

Table of Contents**NOTE 11. NOTES PAYABLE**

Notes payable consisted of the following at:

	June 30, 2014	December 31, 2013
Note payable – related party	\$ 1,080,418	\$ 1,095,181
Notes payable, net of debt discount - PTG	16,402,876	17,480,676
	17,483,294	18,575,857
Less: Current portion	(3,289,275)	(2,929,918)
Notes payable	\$ 14,194,019	\$ 15,645,939

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 GGLLC. The note payable between GGLLC and Bank of America was the subject of litigation and was settled in February 2014. See Note 12 for further details.

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 GBP (\$10.0 million USD) note. The notes were recorded at fair value, net of a debt discount of \$1,530,000. See Note 17 for further details.

Maturities of our notes payable are as follows:

Maturities as of June 30,	Total
2015	\$ 3,135,743
2016	4,133,834
2017	5,453,591
2018	4,720,001
2019	996,387
Total notes payable	\$ 18,439,556
Less: debt discount	(956,262)
Notes payable, net	\$ 17,483,294

of debt
discount

NOTE 12. COMMITMENTS AND CONTINGENCIES

Operating lease obligations. In February 2014, we entered into a lease (the “Lease”) for a new corporate office with an unrelated third party. The 5-year Lease is for a building approximately 24,000 square feet, which is comprised of approximately 16,000 square feet office space and 8,000 square feet warehouse. The property is located in Las Vegas, Nevada.

The initial term of the Lease commenced on April 1, 2014. We are obligated to pay approximately \$153,000 in annual base rent in the first year, which shall increase by approximately 4% each year. We are also obligated to pay real estate taxes and other building operating costs. Subject to certain conditions, we have certain rights under the Lease, including rights of first offer to purchase the premises if the landlord elects to sell. We also have an option to extend the term of the Lease for two consecutive terms of three years each, at the then current fair market value rental rate determined in accordance with the terms of the Lease.

In connection with the Lease, the landlord has agreed to finance tenant improvements (“Tenant Improvements”) of \$150,000. The base rent is increased by an amount sufficient to fully amortize the Tenant Improvements through the Lease term upon equal monthly payments of principal and interest, with interest imputed on the outstanding principal balance at the rate of 5.5% per annum. See Note 10.

Pursuant to the lease, we have the option to terminate the Lease effective at the end of the 36th month (“Termination Date”). We must deliver written notice of our intention to terminate the Lease to the landlord at least six months before the Termination Date. In the event we exercise our option to terminate, we shall pay the landlord a termination fee (the “Termination Fee”) equal to the sum of (i) all unamortized TI Allowance amounts, plus (ii) all unamortized leasing commissions paid by the landlord with respect to the lease, plus (iii) all unamortized rental abatement amounts.

Table of Contents

For the period September 2010 to April 2014, we leased our offices from a related party that is connected with our CEO. The rental agreement was on a month-to-month basis and monthly rent payments were \$10,359. Through April 2014, we rented various temporary storage facilities in the range of \$150 to \$460 a month. Our new corporate offices include approximately 8,000 square feet of warehouse space and as of May 2014, virtually all of our external storage rental contracts have been eliminated.

Total rent expense was \$127,865 and \$81,746 for the six months ended June 30, 2014 and 2013, respectively.

Future minimum lease payments are as follows:

Twelve Months Ended June 30,	Annual Obligation
2015	\$209,568
2016	218,304
2017	227,052
2018	235,788
2019	244,524
Total Estimated Lease Obligations	\$ 1,135,236

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, 2013. There are no material updates to matters previously reported on Form 10-K for the year ended December 31, 2013, except:

Bank of America action. In October 2012, we were served with a complaint by Bank of America (“BofA”) regarding a promissory note payable between GGLLC and BofA. The complaint, filed in the Eighth Judicial District Court in the State of Nevada, alleged that we received valuable assets from GGLLC in 2007 for little or no consideration. In the complaint, BofA sought to collect in full the outstanding principal and any accrued interest owed under the promissory note. On February 21, 2014, we reached a full settlement of all claims alleged by BofA. Pursuant to the settlement, BofA and we agreed to dismiss its legal actions against each other and enter into a mutual release of

claims. Furthermore, we agreed to vacate the building located at 6980 O'Bannon Drive no later than April 30, 2014. The complaint was dismissed by the court on April 10, 2014 and we vacated the building as of April 18, 2014.

Note 13. 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 June 30, 2014.

In February 2014, an independent contractor (the "Contractor") was granted 150,000 shares of the Company's restricted common stock. Of this amount, 75,000 vested and transferred immediately, with the remaining 75,000 vesting in equal installments through (and transferring on) January 1, 2015.

In March 2014, Norm DesRosiers, Director, was granted 100,000 shares of the Company's restricted common stock as condition of his Board of Directors Director Service Agreement. The restricted stock grant vested immediately.

In April 2014, William A. Zender was appointed to serve as a member of our Board of Directors effective May 1, 2014. As a condition of his Board of Directors Director Service Agreement, Mr. Zender was granted 75,000 shares of our restricted common stock which vested immediately.

There were 38,560,591 common shares and no preferred shares issued and outstanding at June 30, 2014.

Table of Contents

Note 14. Related Party Transactions

We leased our offices from the Saucier Business Trust, an entity that is related to our CEO through April 2014. The lease was entered into effective September 1, 2010 for a period of two years requiring a monthly rental payment of \$10,359. Total payments made to this related party was \$31,077 and \$61,259 for each six month period ended June 30, 2014 and 2013.

We have a note receivable from Abyss Group, LLC, an entity that is related to our CEO. This 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 whereby the monthly principal and interest payment was reduced to \$3,332 and the unpaid principal and interest is due August 2015. The balance as of June 30, 2014 and December 31, 2013 was \$383,298 and \$383,298, respectively. Interest income associated with this note receivable was \$11,022 and \$11,560 for the six month periods ended June 30, 2014 and 2013, respectively.

We have a note payable to a related party, GLLC, an entity that is controlled by our CEO. The note payable required 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. The balance as of June 30, 2014 and December 31, 2013 was \$1,080,418 and \$1,095,181, respectively. This note payable is a result of the asset purchase agreement with GLLC. The note payable between GLLC and Bank of America was the subject of litigation and was settled in March 2014. See Note 12 for further details.

Certain administrative, accounting and legal support services are performed by Carpathia Associates, LLC, an entity related to our CEO. We accrued or paid fees to the related party in the amount of \$0 and \$2,610 for the six months ended June 30, 2014 and 2013, respectively.

NOTE 15. INCOME TAXES

Our forecasted effective tax rate at June 30, 2014 is 45.5%, a 7.9% increase from the 37.6% effective tax rate recorded at June 30, 2013. The increase in the expected annual rate in 2014 was primarily due to the non-availability of the Federal R&D tax credit, since Congress has not extended this benefit yet for 2014. No discrete items were recorded for the six months ending June 30, 2014.

Note 16. Stock Warrants, Options AND GRANTS

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, 2013	1,330,953	\$ 0.45
Issued	—	—
Exercised	—	—
Expired	(714,286)	0.40
Outstanding – December 31, 2013	616,667	0.51
Issued	—	—
Exercised	—	—
Expired	(441,667)	0.40
Outstanding – June 30, 2014	175,000	\$ 0.80
Exercisable – June 30, 2014	—	—

Table of Contents

Stock options. For the six months ended June 30, 2014 and 2013, we issued 106,250 and -0- stock options, respectively. Stock options issued to members of our Board of Directors were 50,000 and -0- for the six months ended June 30, 2014 and 2013, respectively. Stock options issued to independent contractors were 56,250 and -0- for the six months ended June 30, 2014 and 2013, respectively. The stock options granted for the six months ended June 30, 2014 were calculated to have a fair value of \$30,672 using the Black-Scholes option pricing model with the following assumptions:

	Options Issued
	Six Months Ended
	June 30, 2014
Dividend yield	0%
Expected volatility	86% to 90%
Risk free interest rate	1.62% to 1.73%
Expected life (years)	5.00

A summary of stock option activity is as follows:

	Common Stock Options	Weighted Average Exercise Price
Outstanding – January 1, 2013	100,000	\$ 0.25
Issued	—	—
Exercised	—	—
Expired	—	—
Outstanding – December 31, 2013	100,000	0.25
Issued	106,250	0.42
Exercised	—	—
Expired	—	—
Outstanding – June 30, 2014	206,250	\$ 0.34
Exercisable – June 30, 2014	172,916	\$ 0.36

Stock grants. For the six months ended June 30, 2014 and 2013, we granted 275,000 and -0- shares of common stock, respectively. Stock granted to our Board of Directors was 175,000 and -0- shares for the six months ended June 30, 2014 and 2013. Stock granted to independent contractors was 100,000 and -0- shares for the six months ended June 30, 2014 and 2013.

Share based compensation. The cost of all stock options and stock grants issued have been classified as share based compensation for the six months ended June 30, 2014 and 2013, respectively. Total share based compensation was \$114,823 and \$2,902 for the six months ended June 30, 2014 and 2013, respectively. The share based compensation is included in selling, general & administrative expenses on the statement of operations.

Note 17. 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. 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.

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

Table of Contents

The note payable to Prime Table Games UK is in the amount of £6,400,000 (GBP). 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 increased 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 purchase price allocation	\$ 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. 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 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 accrued expenses at June 30, 2014 is \$31,490, representing reimbursement due to TMAX.

Note 18. Subsequent Events

In accordance with ASC 855-10, we have analyzed our operations subsequent to June 30, 2014 to the date of 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.

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.

Table of Contents

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. 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 and provider of proprietary table games, 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, Bally Technologies, inc. (formerly 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.

Table of Contents

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 TMAX e-Tables are developed for us by TableMAX Corporation. Having installed the majority of TMAX e-Tables we received in prior years, we are now offering the latest version of the TMAX e-Table, referred to as the “Model E.” Currently, there are several Model E’s in the field generating revenue and we have been informed by TableMAX Corporation that there will be delivery of additional units in mid-2014. We expect to expand placements of the TMAX product and increase our revenues in 2014.

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 June 30, 2014. For the three months ended June 30, 2014, our continuing operations generated gross revenues of \$2,462,529 compared to gross revenues of \$1,943,726 for the previous year's comparable quarter, representing an increase of \$518,803 or 26.7%. This increase was primarily attributable to our continued focus on premium games, which command a higher price point than side bets. Additionally, revenues in the United Kingdom also saw a substantial increase due to the increased utilization of products. Selling, general and administrative expenses for the quarter ended June 30, 2014, were \$1,420,932 compared to \$986,482 for the previous year's second quarter, representing an increase of \$434,450, or 44.0%. The significant year-over-year changes in selling, general and administrative was comprised of the following categories:

	Three months ended June 30,	
	2014	2013
Compensation and related	\$789,054	\$532,632
Professional and compliance	206,245	97,973
Office related expenses	158,014	72,861

The increase in compensation and related expenses was due to salaries, wages and payroll taxes related to expanded staff. We experienced higher commissions in 2014 due to increased sales. Also included in compensation and related is stock compensation expense, which saw increased activity in 2014 due to the addition of new directors to our board and the hiring of an independent consultant. Professional and compliance expenses increased due to expansion into new territories and fees related to intellectual property incurred in 2014. Office related expenses increased due to the moving our corporate headquarters, which is four times larger than our previous location.

During the three months ended June 30, 2014, we accrued income taxes at the estimated annualized rate of 45.5% as compared to the annualized rate of 37.6% for the same period 2013. The increase in the expected annual rate in 2014 was primarily due to the non-availability of the Federal R&D tax credit, since Congress has not extended this benefit yet for 2014.

Results of operations for the six months ended June 30, 2014. For the six months ended June 30, 2014, our continuing operations generated gross revenues of \$4,727,340 compared to gross revenues of \$3,840,104 for the previous year's comparable period, representing an increase of \$887,236 or 23.1%. This increase was primarily attributable to our continued focus on premium games, which command a higher price point than side bets. Additionally, revenues in the United Kingdom also saw a substantial increase due to the increased utilization of products. Selling, general and administrative expenses for the six months ended June 30, 2014, were \$2,627,277 compared to \$1,944,064 for the same period 2013, representing an increase of \$683,213, or 35.1%. The significant year-over-year changes in selling, general and administrative was comprised of the following categories:

	Six months ended June 30,	
	2014	2013
Compensation and related	\$1,472,754	\$1,071,270

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

Professional and compliance	365,463	222,943
Office related expenses	245,451	146,095

The increase in compensation and related expenses was due to salaries, wages and payroll taxes related to expanded staff. We experienced higher commissions in 2014 due to increased sales. Also included in compensation and related is stock compensation expense, which saw increased activity in 2014 due to the addition of new directors to our board and the hiring of an independent consultant. Professional and compliance expenses increased due to expansion into new territories and fees related to intellectual property incurred in 2014. Office related expenses increased due to the moving our corporate headquarters, which is four times larger than our previous location.

Liquidity and capital resources. As of June 30, 2014 we had total current assets of \$2,610,385 and total assets of \$20,995,095. This compares to \$2,385,009 and \$21,227,355, respectively as of December 31, 2013. The increase in current assets as of June 30, 2014 was primarily impacted by an increase in accounts receivable, which is a result of increased revenues. Our total current liabilities as of June 30, 2014 were \$5,082,689 versus \$4,302,173 as of December 31, 2013. This increase was primarily attributed to an increase in income taxes payable and our current portion of notes payable, due to our scheduled monthly debt payment increase to Prime Table Games in January 2015.

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 have increased our sales and marketing budget and spent monies on regulatory efforts for the purpose of expanding our distribution network. We are also subject to several regulatory investigations and proceedings which may result in significant future legal and regulatory expenses. A significant increase in such expenses may require us to postpone growth initiatives or investments in personnel, inventory and research and development of our products. It is our intention to continue such initiatives and investments. However, 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.

Table of Contents

At June 30, 2014, 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 six months ended June 30, 2014, were net income of \$260,542, increases in accounts receivable of \$150,414, inventory of \$52,079 and prepaid expenses of \$59,804, offset by increases in income taxes payable of \$122,266, accounts payable of \$94,346 and deferred revenue of \$70,287 for a total operating activities impact of an additional \$1,407,953 of cash.

Cash flows used in investing activities for the six months ended June 30, 2014 were \$43,791, due to the acquisition of intangible assets and increases in our property and equipment. Cash used in financing activities during the six months ended June 30, 2014 was \$1,369,495 which was completely comprised of principal payments towards long-term debt and capital leases.

We incur unrealized gains and losses related to foreign currency translation adjustments, which is recorded as other comprehensive income or loss. For the six months ended June 30, 2014 we incurred other comprehensive loss of \$162,258, net of tax. This amount is primarily due to the unrealized translation adjustment on the note payable due Prime Table Games – UK, which is due in British Sterling currency. The remaining translation adjustments relate to insignificant amounts in accounts receivable, accounts payable and accrued expenses recorded in foreign currencies. So as long as we have balance sheet items recorded in foreign currencies, such as the note payable, we will be subject to fluctuations against the U.S. Dollar. Additionally, as transactions are settled, the foreign currency translations are realized and recorded as selling, general & administrative expenses on the statement of operations. Such realized translation adjustments are de minimus for the six months ended June 30, 2014.

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. We may also incur significant expenses when applying for new licenses or in complying with current jurisdictional requirements. 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, 2013. 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 June 30, 2014 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 12 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

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
31.1	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
31.2	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
32.1	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
101**	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 formatted in Extensible Business Reporting Language (XBRL).

**Provided herewith

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: August 14, 2014

By: /s/ ROBERT B. SAUCIER

Robert B. Saucier

Chief Executive Officer

Galaxy Gaming, Inc.

Date: August 14, 2014

By: : /s/ GARY A. VECCHIARELLI

Gary A. Vecchiarelli

Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature Title Date

/s/ ROBERT B. SAUCIER Chief Executive Officer (Principal Executive Officer) August 14, 2014

Robert B. Saucier

/s/ GARY A. VECCHIARELLI Chief Financial Officer (Principal Financial and Accounting Officer) August 14, 2014

Gary A. Vecchiarelli

