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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 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	**20-8143439**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6767 Spencer Street, Las Vegas, NV 89119
(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 [X] 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 [X] 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 [X]

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

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 November 14, 2014.

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GALAXY GAMING, INC.

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

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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GALAXY GAMING, INC.

BALANCE SHEETS

(Unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$394,552	$438,502
Restricted cash	94,704	244,416
Accounts receivables, net allowance for bad debts of $34,887 and $36,770	1,432,705	1,273,797
Prepaid expenses	54,347	34,973
Inventory	306,955	297,480
Note receivable – related party, current portion	383,298	18,212
Deferred tax asset	27,119	27,119
Other current assets	34,819	50,510
Total current assets	2,728,499	2,385,009
Property and equipment, net	274,675	44,952
Products leased and held for lease, net	132,943	85,883
Intangible assets, net	15,676,130	16,811,511
Goodwill	1,091,000	1,091,000
Note receivable – related party, net of current portion	—	365,086
Deferred tax assets, net of current portion	436,669	436,669
Other assets, net	46,322	7,245
Total assets	$20,386,238	$21,227,355
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$383,560	$241,754
Accrued expenses	344,167	322,402
Income taxes payable	276,434	34,655
Deferred revenue	624,246	526,922
Jackpot liabilities	99,479	246,522
Current portion of capital lease obligations	64,926	—
Current portion of long-term debt	3,374,357	2,929,918
Total current liabilities	5,167,169	4,302,173
Deferred rent	54,477	—
Deferred taxes	124,053	—
Capital lease obligations, net of current portion	154,291	—
Long-term debt, net of debt discount, net of current portion	13,062,682	15,645,939
Total liabilities	18,562,672	19,948,112
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	38,561	38,311

Additional paid-in capital	2,610,689	2,330,676
Stock warrants	49,168	190,053
Accumulated deficit	(654,217)	(1,002,188)
Accumulated other comprehensive income (loss)	(220,635)	(277,609)
Total stockholders' equity	1,823,566	1,279,243
Total liabilities and stockholders' equity	$20,386,238	$21,227,355

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

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GALAXY GAMING, INC.

STATEMENTS OF OPERATIONS

(Unaudited)

	FOR THE THREE MONTHS ENDED		**FOR THE NINE MONTHS ENDED**	
	September 30, 2014	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Revenue:				
Product leases and royalties	$2,516,376	$2,025,665	$7,238,539	$5,846,471
Product sales and service	1,008	110,394	6,185	129,692
Total revenue	2,517,384	2,136,059	7,244,724	5,976,163
Costs and expenses:				
Cost of ancillary products and assembled components	19,362	14,322	56,302	73,805
Selling, general and administrative	1,480,957	1,217,376	4,108,235	3,161,441
Research and development	126,300	107,948	337,687	347,228
Depreciation	29,704	13,487	72,448	34,927
Amortization	391,249	397,226	1,170,381	1,191,678
Impairment of intangible assets	—	150,000	—	150,000
Total costs and expenses	2,047,572	1,900,359	5,745,053	4,959,079
Income from operations	469,812	235,700	1,499,671	1,017,084
Other income (expense):				
Interest income	5,387	5,722	16,841	17,395
Interest expense	(271,275)	(260,350)	(834,957)	(775,910)
Total other income (expense)	(265,888)	(254,628)	(818,116)	(758,515)
Income (loss) before provision for income taxes	203,924	(18,928)	681,555	258,569
Provision for income taxes	(116,495)	(2,055)	(333,584)	(90,565)
Net income (loss)	$87,429	$(20,983)	$347,971	$168,004
Basic income (loss) per share	$0.00	$(0.00)	$0.01	$0.00
Diluted income (loss) per share	$0.00	$(0.00)	$0.01	$0.00
Weighted average shares outstanding:				
Basic	38,560,591	38,310,591	38,493,955	38,310,591
Diluted	38,574,447	38,310,591	38,772,448	38,310,591

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

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GALAXY GAMING, INC.

STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2014	**2013**
Net income	$347,971	$168,004
Other comprehensive income:		
Foreign currency translation adjustments, net of tax	56,974	226,562
Total comprehensive income	$404,945	$394,566

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

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GALAXY GAMING, INC.

STATEMENTS OF CASH FLOWS

(Unaudited)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2014	**2013**
Cash flows from operating activities:		
Net income for the period	$347,971	$168,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	72,450	34,927
Amortization expense	1,170,381	1,191,678
Amortization of debt discount	156,474	156,474
Deferred income tax provision	333,584	90,565
Share-based compensation	139,378	4,354
Impairment of intangible assets	—	150,000
Changes in operating assets and liabilities:		
Decrease (increase) in restricted cash	149,712	(25,123)
(Increase) in accounts receivable	(159,478)	(193,608)
Decrease (increase) in other current assets	15,691	(42,550)
(Increase) in inventory	(80,678)	(164,136)
(Increase) in prepaid expenses	(19,374)	(7,744)
(Increase) in other long-term assets	(41,794)	—
Increase in accounts payable	141,885	48,841
Increase in accrued expenses	22,582	16,990
Increase in deferred revenue	97,324	55,993
(Decrease) increase in jackpot liabilities	(147,043)	28,002
Increase in deferred rent	54,477	—
Net cash provided by operating activities	2,253,542	1,512,667
Cash flows from investing activities:		
Acquisition of property and equipment	(31,343)	(21,735)
Acquisition of intangible assets	(35,000)	—
Payments received on note receivable	—	4,963
Net cash used in investing activities	(66,343)	(16,772)
Cash flows from financing activities:		
Principal payments on capital leases	(24,753)	—
Principal payments on notes payable	(2,199,935)	(1,702,937)
Net cash used in financing activities	(2,224,688)	(1,702,937)
Effect of exchange rate changes on cash	(6,461)	3,613
Net decrease in cash and cash equivalents	(43,950)	(203,429)
Cash and cash equivalents – beginning of period	438,502	398,424
Cash and cash equivalents – end of period	$394,552	$194,995
Supplemental cash flow information:		
Cash paid for interest	$678,483	$515,560
Cash paid for income taxes	$—	$—

Supplemental non-cash financing activities information:		
Assets acquired by capital lease	$243,970	$—
Inventory transferred to leased assets	$71,203	$31,876
Effect of exchange rate on note payable in foreign currency	$190,180	$124,400

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

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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.

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.

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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 any 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.

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 nine months ended September 30, 2014 and 2013, we had the following client revenue concentrations:

	Location	2014 Revenue	2013 Revenue
Client A	North America	15.2 %	15.3 %
Client B	United Kingdom	8.0 %	7.3 %
Client C	United Kingdom	5.7 %	5.2 %

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 $4,086,000 or 56.4% of our revenue for the nine months ended September 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.

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*.

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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.

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.

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NOTE 3. NOTE RECEIVABLE – RELATED PARTY

The note receivable balance was as follows:

	September 30, 2014	December 31, 2013
Note receivable	$383,298	$383,298
Less: current portion	(383,298)	(18,212)
Long-term note receivable	$—	$365,086

A note receivable was acquired as part of the 2007 asset purchase agreement with GGLLC. 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 $16,432 and $17,114 for the nine months ended September 30, 2014 and 2013, respectively. At September 30, 2014, there was an interest receivable balance of $34,006 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 September 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:

	September 30, 2014	December 31, 2013
Professional services	$ 18,351	$ 5,436

Trade show expense	17,000	—
IT systems	16,681	8,923
Other prepaid expenses	1,161	147
Dues & subscriptions	495	—
Insurance	484	12,579
Rent	175	175
Inventory costs	—	2,520
Property taxes	—	3,325
Regulatory compliance expenses	—	1,868
Prepaid expenses	$ 54,347	$ 34,973

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NOTE 5. INVENTORY

Inventory consisted of the following at:

	September 30, 2014	December 31, 2013
Raw materials and component parts	$184,913	$182,351
Finished goods	95,859	95,579
Work-in-process	59,078	52,445
	339,850	330,375
Less: inventory reserve	(32,895)	(32,895)
Inventory	$306,955	$297,480

NOTE 6. PROPERTY AND EQUIPMENT

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

	September 30, 2014	December 31, 2013
Leasehold improvements	$150,000	$6,367
Furniture and fixtures	162,293	76,031
Computer equipment	78,770	69,960
Office equipment	12,903	12,270
	403,966	164,628
Less: accumulated depreciation	(129,291)	(119,676)
Property and equipment, net	$274,675	$44,952

Included in depreciation expense was $45,590 and $15,520 related to property and equipment for the nine months ended September 30, 2014 and 2013, respectively.

Property and equipment includes $243,970 of leasehold improvements, furniture and fixtures under capital leases as of September 30, 2014. Accumulated depreciation of assets under capital leases totaled $28,642 as of September 30, 2014.

NOTE 7. PRODUCTS LEASED AND HELD FOR LEASE

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

	September 30, 2014	December 31, 2013
Enhanced table systems	$228,634	$157,861
Less: accumulated depreciation	(95,691)	(71,978)
Products leased and held for lease, net	$132,943	$85,883

Included in depreciation expense was $24,143 and $16,689 related to products leased and held for lease for the nine months ended September 30, 2014 and 2013, respectively.

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NOTE 8. INTANGIBLE ASSETS

Intellectual property and intangible assets consisted of the following at:

	September 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	(4,774,837)	(3,604,456)
Intangible assets, net	$15,676,130	$16,811,511

Amortization expense was $1,170,381 and $1,191,678 for the nine months ended September 30, 2014 and 2013, respectively.

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:

	September 30, 2014	December 31, 2013
Commissions	$ 134,463	$ 92,744
Salaries & payroll taxes	63,722	59,266
Vacation	63,359	41,216
TableMAX reimbursement	39,910	—
Professional fees	25,283	75,000
Trade show expenses	9,911	48,718
Royalties	3,945	—
Accrued interest	3,079	2,443
Other accrued expenses	495	3,015
Accrued expenses	$ 344,167	$ 322,402

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NOTE 10. CAPITAL LEASE OBLIGATIONS

Capital lease obligations consisted of the following at:

	September 30, 2014
Capital lease obligation – office furniture	$ 77,325
Capital lease obligation – leasehold improvements	141,892
	219,217
Less: Current portion	(64,926)
Capital lease obligations	$ 154,291

The capital lease obligation – office furniture requires 30 monthly payments of $3,641, including interest at 10.2%, beginning April 2015 through September 2016.

The capital lease obligation – leasehold improvements requires 60 monthly payments of $2,879, including 5.5% interest, beginning May 2015 through May 2019.

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

September 30,	Total
2015	$ 78,237
2016	76,538
2017	34,545
2018	34,545
2019	23,027
Total minimum lease payments	$ 246,892
Less: amount representing interest	(27,675)
Present value of net minimum lease payments	$ 219,217

NOTE 11. NOTES PAYABLE

Notes payable consisted of the following at:

	September 30, 2014	December 31, 2013
Note payable – related party	$1,073,048	$1,095,181
Notes payable, net of debt discount - PTG	15,363,991	17,480,676
	16,437,039	18,575,857
Less: Current portion	(3,374,357)	(2,929,918)
Notes payable	$13,062,682	$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.

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Maturities of our notes payable are as follows:

Maturities as of September 30,	Total
2015	$3,374,357
2016	4,077,490
2017	5,405,130
2018	4,195,614
2019	288,552
Total notes payable	$17,341,143
Less: debt discount	(904,104)
Notes payable, net of debt discount	$16,437,039

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 ("TI") of $150,000. The base rent is increased by an amount sufficient to fully amortize the TI 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.

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 $161,358 and $109,398 for the nine months ended September 30, 2014 and 2013, respectively.

Future minimum lease payments are as follows:

Twelve Months Ended September 30,	Annual Obligation
2015	$211,752
2016	220,491
2017	229,236
2018	237,972
2019	184,794
Total Estimated Lease Obligations	$1,084,245

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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 September 30, 2014.

In February 2014, an independent contractor (the “Contractor”) was granted 150,000 shares of our 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 our 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 September 30, 2014.

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 $93,239 for the nine month periods ended September 30, 2014 and 2013, respectively.

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 GGLLC. The note receivable was 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 September 30, 2014 and December 31, 2013 was $383,298 and $383,298, respectively. Interest income associated with this note receivable was $16,432 and $17,114 for the nine month periods ended September 30, 2014 and 2013, respectively.

We have a note payable to a related party, GGLLC, 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 September 30, 2014 and December 31, 2013 was $1,073,048 and $1,095,181, respectively. 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 regarding the settlement with Bank of America.

Certain administrative, accounting and legal support services were 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 $3,105 for the nine months ended September 30, 2014 and 2013, respectively.

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NOTE 15. INCOME TAXES

Our forecasted effective tax rate at September 30, 2014 is 47.9%, a 9.9% increase from the 38.0% effective tax rate recorded at September 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.

After a discrete expense of $7,000, the effective tax rate for the nine months ended September 30, 2014 was 48.9%. The discrete tax expense was primarily due to adjustments to the prior year domestic manufacturing deduction foreign tax credits.

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 – September 30, 2014		