

MULTIMEDIA GAMES INC
Form 10-Q
August 05, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

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: 000-28318

Multimedia Games, Inc.
(Exact name of Registrant as specified in its charter)

Texas 74-2611034
(State or other (IRS Employer
jurisdiction of Identification No.)
incorporation or
organization)

206 Wild Basin Road
South, Building B,
Fourth Floor
Austin, Texas 78746
(Address of principal (Zip Code)
executive offices)

(512) 334-7500

(Registrant's telephone number, including area code)

Registrant's website: www.multimediasgames.com

None

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

Indicate by check mark whether the Registrant (1) has 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 registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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. See the definitions of “large accelerated filer” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

| | |
|--|---|
| Large Accelerated Filer <input type="checkbox"/> | Accelerated Filer <input checked="" type="checkbox"/> |
| Non-Accelerated Filer <input type="checkbox"/> | Smaller Reporting Company <input type="checkbox"/> |

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

As of August 4, 2010, there were 27,572,407 shares of the Registrant’s common stock, par value \$0.01 per share, outstanding.

FORM 10-Q

INDEX

PART I. FINANCIAL INFORMATION

| | | |
|---------|--|----|
| Item 1. | Condensed Financial Statements (Unaudited) | |
| | Consolidated Balance Sheets (As of June 30, 2010 and September 30, 2009) | 3 |
| | Consolidated Statements of Operations (For the three months ended June 30, 2010 and 2009) | 5 |
| | Consolidated Statements of Operations (For the nine months ended June 30, 2010 and 2009) | 6 |
| | Consolidated Statements of Cash Flows (For the nine months ended June 30, 2010 and 2009) | 7 |
| | Notes to Consolidated Financial Statements | 8 |
| Item 2. | Management’s Discussion and Analysis of Financial Condition and Results of Operations | 22 |
| Item 3. | Quantitative and Qualitative Disclosures about Market Risk | 35 |
| Item 4. | Controls and Procedures | 35 |

PART II. OTHER INFORMATION

| | | |
|---------------|-------------------|----|
| Item 1. | Legal Proceedings | 36 |
| Item 1A. | Risk Factors | 36 |
| Item 6. | Exhibits | 50 |
| Signatures | | 51 |
| Exhibit Index | | |

PART I

FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

MULTIMEDIA GAMES, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 As of June 30, 2010 and September 30, 2009
 (In thousands, except shares)
 (Unaudited)

| | June 30, 2010 | September 30, 2009 |
|---|------------------|-----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$30,814 | \$12,455 |
| Accounts receivable, net of allowance for doubtful accounts of \$2,945 and \$3,676, respectively | 11,099 | 13,424 |
| Inventory | 4,967 | 5,742 |
| Deferred contract costs, net | — | 1,826 |
| Prepaid expenses and other | 2,311 | 2,806 |
| Current portion of notes receivable, net | 13,419 | 15,780 |
| Federal and state income tax receivable | 5,930 | 6,246 |
| Deferred income taxes | — | 1,138 |
| Total current assets | 68,540 | 59,417 |
| Restricted cash and long-term investments | 737 | 804 |
| Property and equipment and leased gaming equipment, net | 55,505 | 69,050 |
| Long-term portion of notes receivable, net | 27,617 | 40,124 |
| Intangible assets, net | 30,943 | 33,361 |
| Value added tax receivable | 6,997 | 7,516 |
| Other assets | 2,285 | 2,379 |
| Deferred income taxes | — | 2,969 |
| Total assets | \$192,624 | \$215,620 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | \$750 | \$750 |
| Accounts payable and accrued expenses | 26,025 | 27,626 |
| Deferred revenue | 2,619 | 2,341 |
| Total current liabilities | 29,394 | 30,717 |
| Revolving line of credit | 15,000 | 15,000 |
| Long-term debt, less current portion | 44,063 | 59,250 |
| Other long-term liabilities | 737 | 789 |
| Deferred revenue, less current portion | 2,272 | 2,409 |
| Total liabilities | 91,466 | 108,165 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock: | | |
| Series A, \$0.01 par value, 1,800,000 shares authorized, no shares issued and outstanding | — | — |
| Series B, \$0.01 par value, 200,000 shares authorized, no shares issued and outstanding | — | — |

| | | |
|---|-----|-----|
| Common stock, \$0.01 par value, 75,000,000 shares authorized, 33,348,687 and 33,121,337 shares issued, and 27,445,270 and 27,217,920 shares outstanding, respectively | 334 | 331 |
|---|-----|-----|

MULTIMEDIA GAMES, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS – (Continued)
 As of June 30, 2010 and September 30, 2009

(In thousands, except shares)

(Unaudited)

| | June 30, 2010 | September 30, 2009 |
|---|------------------|-----------------------|
| Additional paid-in capital | 88,766 | 86,317 |
| Treasury stock, 5,903,417 common shares at cost | (50,128) | (50,128) |
| Retained earnings | 63,437 | 72,803 |
| Accumulated other comprehensive loss, net | (1,251) | (1,868) |
| Total stockholders' equity | 101,158 | 107,455 |
| Total liabilities and stockholders' equity | \$ 192,624 | \$ 215,620 |

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

MULTIMEDIA GAMES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three Months Ended June 30, 2010 and 2009

(In thousands, except per share data)

(Unaudited)

| | Three Months Ended June 30, | |
|---|--------------------------------|-----------|
| | 2010 | 2009 |
| REVENUES: | | |
| Gaming operations | \$23,810 | \$27,407 |
| Gaming equipment and system sales | 4,935 | 3,786 |
| Other | 331 | 936 |
| Total revenues | 29,076 | 32,129 |
| OPERATING COSTS AND EXPENSES: | | |
| Cost of revenues (1) | 3,302 | 2,137 |
| Selling, general and administrative expenses | 14,703 | 15,326 |
| Write-off, reserve, impairment & settlement charges | 381 | 299 |
| Amortization and depreciation | 12,760 | 15,581 |
| Total operating costs and expenses | 31,146 | 33,343 |
| Operating loss | (2,070) | (1,214) |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 830 | 1,156 |
| Interest expense | (1,012) | (1,390) |
| Loss before income taxes | (2,252) | (1,448) |
| Income tax benefit | 2,612 | 288 |
| Net income (loss) | \$360 | \$(1,160) |
| Basic earnings (loss) per common share | \$0.01 | \$(0.04) |
| Diluted earnings (loss) per common share | \$0.01 | \$(0.04) |
| Shares used in earnings (loss) per common share: | | |
| Basic | 27,437 | 26,693 |
| Diluted | 27,962 | 26,693 |

(1) Cost of revenues exclude depreciation and amortization of gaming equipment, content license rights and other depreciable assets, which are included separately in the amortization and depreciation line item
The accompanying notes are an integral part of the condensed consolidated financial statements.

MULTIMEDIA GAMES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 For the Nine Months Ended June 30, 2010 and 2009
 (In thousands, except per share data)
 (Unaudited)

| | 2010 | Nine Months Ended June 30, 2009 |
|---|------------|---------------------------------------|
| REVENUES: | | |
| Gaming operations | \$69,648 | \$82,636 |
| Gaming equipment and system sales | 16,354 | 9,907 |
| Other | 1,477 | 2,032 |
| Total revenues | 87,479 | 94,575 |
| OPERATING COSTS AND EXPENSES: | | |
| Cost of revenues (1) | 9,139 | 6,311 |
| Selling, general and administrative expenses | 43,493 | 46,091 |
| Write-off, reserve, impairment & settlement charges | 3,896 | 10,271 |
| Amortization and depreciation | 39,984 | 46,085 |
| Total operating costs and expenses | 96,512 | 108,758 |
| Operating loss | (9,033) | (14,183) |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 2,798 | 3,692 |
| Interest expense | (3,462) | (5,416) |
| Other income | - | 74 |
| Loss before income taxes | (9,697) | (15,833) |
| Income tax benefit | 331 | 5,355 |
| Net loss | \$(9,366) | \$(10,478) |
| Basic and diluted loss per common share | \$(0.34) | \$(0.39) |
| Shares used in loss per common share: | | |
| Basic and diluted | 27,340 | 26,653 |

(1) Cost of revenues exclude depreciation and amortization of gaming equipment, content license rights and other depreciable assets, which are included separately in the amortization and depreciation line item
 The accompanying notes are an integral part of the condensed consolidated financial statements.

MULTIMEDIA GAMES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended June 30, 2010 and 2009
(In thousands)
(Unaudited)

| | Nine Months Ended | |
|--|-------------------|------------------|
| | 2010 | June 30, 2009 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$(9,366 |) \$(10,478) |
| Adjustments to reconcile net loss to cash provided by operating activities: | | |
| Amortization | 2,555 | 3,763 |
| Depreciation | 37,429 | 42,322 |
| Accretion of contract rights | 5,053 | 4,500 |
| Adjustments to long-lived assets | 704 | 1,316 |
| Deferred income taxes | 4,107 | (1,879) |
| Share-based compensation | 1,452 | 1,487 |
| Provision for doubtful accounts | 2,914 | 920 |
| Interest income from imputed interest | (2,528) | (3,313) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,124 | (1,151) |
| Inventory | 1,028 | (555) |
| Deferred contract costs | 1,826 | (1,144) |
| Prepaid expenses and other | 329 | (385) |
| Federal and state income tax receivable | 316 | (1,900) |
| Notes receivable | 1,679 | 1,176 |
| Accounts payable and accrued expenses | (571) | 2,547 |
| Other long-term liabilities | 15 | (210) |
| Deferred revenue | 141 | (860) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 49,207 | 36,156 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | |
| Acquisition of property and equipment and leased gaming equipment | (28,521) | (37,118) |
| Transfer of leased gaming equipment to inventory | 4,573 | 846 |
| Acquisition of intangible assets | (2,612) | (2,266) |
| Advances under development agreements | (3,040) | (7,000) |
| Repayments under development agreements | 13,233 | 15,766 |
| NET CASH USED IN INVESTING ACTIVITIES | (16,367) | (29,772) |
| CASH FLOWS USED IN FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options, warrants, and related tax benefit | 1,000 | 378 |
| Principal payments of long-term debt | (15,187) | (925) |
| Proceeds from revolving lines of credit | 15,000 | 10,000 |
| Payments on revolving lines of credit | (15,000) | (13,000) |
| NET CASH USED IN FINANCING ACTIVITIES | (14,187) | (3,547) |
| EFFECT OF EXCHANGE RATES ON CASH | (294) | 312 |
| Net increase in cash and cash equivalents | 18,359 | 3,149 |
| Cash and cash equivalents, beginning of period | 12,455 | 6,289 |
| Cash and cash equivalents, end of period | \$30,814 | \$9,438 |
| SUPPLEMENTAL CASH FLOW DATA: | | |

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| | | |
|---|-----------|-------------|
| Interest paid | \$2,889 | \$4,879 |
| Income tax refunded, net | \$(5,405) |) \$(2,124) |
| NON-CASH TRANSACTIONS: | | |
| Change in contract rights resulting from imputed interest on development agreement notes receivable | \$(229) |) \$(342) |

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

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying condensed consolidated financial statements should be read in conjunction with Multimedia Games, Inc. (the “Company,” “we,” “us,” or “our”) consolidated financial statements and footnotes contained within the Company’s Annual Report on Form 10-K for the year ended September 30, 2009.

The unaudited condensed consolidated financial statements included herein as of June 30, 2010, and for each of the three and nine month periods ended June 30, 2010 and 2009, have been prepared by the Company pursuant to accounting principles generally accepted in the United States (U.S. GAAP), and the rules and regulations of the Securities and Exchange Commission, or SEC. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The information presented reflects all adjustments consisting solely of normal recurring adjustments which are, in the opinion of management, considered necessary to present fairly the financial position, results of operations, and cash flows for the periods. Operating results for the period ended June 30, 2010 are not necessarily indicative of the results which will be realized for the year ending September 30, 2010. References to specific U.S. GAAP within this report cite topics within the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). We have evaluated all subsequent events through the date that the condensed consolidated financial statements were issued. The condensed consolidated balance sheet as of September 30, 2009 was derived from the audited consolidated financial statements at that date.

Operations – The Company is a supplier of interactive systems, server-based gaming systems, interactive electronic games, player terminals, stand-alone player terminals, video lottery terminals, electronic scratch ticket systems, electronic instant lottery systems, player tracking systems, casino cash management systems, slot accounting systems, slot management systems, unified currencies and electronic and paper bingo systems for Native American tribes, racetrack casino, casino, charity and commercial bingo, sweepstakes, lottery and video lottery markets and the Company provides support and services and operations support for its customers and products. The Company designs and develops networks, software and content that provide its customers with, among other things, comprehensive gaming systems, some of which are delivered through a telecommunications network that links its player terminals with one another, both within and among gaming facilities. The Company’s ongoing development and marketing efforts focus on Class II and Class III gaming systems and products for use by Native American tribes; video lottery terminals, video lottery systems, stand-alone player terminals, electronic instant scratch systems and other products for domestic and international lotteries; products for domestic and international charity and commercial bingo markets; and promotional, sweepstakes and amusement with prize systems. The Company’s gaming systems are typically provided to customers under revenue-sharing arrangements, except for video lottery terminals in the Class III market in Washington State, which are typically sold for an up-front purchase price. The Company has undertaken a concerted effort to generate additional revenue through the sale of Class II and Class III gaming systems and products. The Company offers content for its gaming systems that has been designed and developed by the Company, as well as game themes the Company has licensed from others. The Company currently operates in one business segment.

Consolidation Principles – The Company’s financial statements include the accounts of Multimedia Games, Inc. and its wholly-owned subsidiaries: MegaBingo, Inc., MGAM Systems, Inc., Innovative Sweepstakes Systems, Inc., MGAM Services, LLC, MGAM Systems International, Inc., MegaBingo International, LLC, Multimedia Games de Mexico 1, S. de R.L. de C.V., and Servicios de Wild Basin S. de R.L. de C.V. Intercompany balances and transactions have been eliminated in consolidation.

Accounting Estimates – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Examples include share-based compensation, provisions for

doubtful accounts, recoverability of notes and value added tax receivables, contract losses, estimated useful lives of property and equipment and intangible assets, impairment of property and equipment and intangible assets, valuation of deferred income taxes, and the provision for and disclosure of litigation and loss contingencies. Actual results may differ materially from these estimates in the future.

Reclassification – Reclassifications were made to the prior-period financial statements to conform to the current period presentation. Specifically, the presentation of revenue was changed to more closely reflect the manner in which Company management analyzes the performance of the business and charges for write-offs, reserves, impairments and settlements are separately presented on the condensed consolidated statement of operations. In addition, value added tax receivable from the Mexican government was reclassified from other assets (non-current) to a separate line item on the face of the balance sheet. These reclassifications did not have an impact on the Company’s previously reported results of operations or earnings (loss) per share amounts. Additionally, these reclassifications did not impact compliance with any applicable debt covenants in the Company’s credit agreement.

Revenue Recognition – In accordance with the provision of ASC Topic 605, “Revenue Recognition”, the Company recognizes revenue when all of the following have been satisfied:

- § Persuasive evidence of an arrangement exists;
- § Delivery has occurred;
- § Price to the buyer is fixed or determinable; and
- § Collectibility is probable.

Revenue – The Company derives revenue from the following sources:

- § Gaming Operations – Participation revenue generated from the Company’s games placed under the Oklahoma Compact, Native American Class II products, charity bingo and other bingo products, lottery systems and Class III back office systems
- § Gaming equipment and systems sales – Direct sales of player terminals, licenses, back office systems and other related equipment
- § Other – Maintenance and service arrangements and other

The majority of the Company’s gaming revenue is generated under lease participation arrangements when the Company provides its customers with player terminals, player terminal-content licenses and back-office equipment, collectively referred to as gaming equipment. Under these arrangements, the Company retains ownership of the gaming equipment installed at customer facilities, and the Company receives revenue based on a percentage of the net win per day generated by the gaming equipment. Revenue from lease participation arrangements are considered both realizable and earned at the end of each gaming day.

Gaming revenue generated by player terminals deployed at sites under development agreements is reduced by the accretion of contract rights from those development agreements. Contract rights are amounts allocated to intangible assets for dedicated floor space resulting from development agreements, described under “Development Agreements.” The related amortization expense, or accretion of contract rights, is netted against its respective revenue category in the condensed consolidated statements of operations.

The Company also generates gaming revenues from back-office fees with certain customers. Back-office fees cover the service and maintenance costs for back-office servers installed in each gaming facility to run its gaming equipment, as well as the cost of related software updates. Back-office fees are considered both realizable and earned at the end of each gaming day.

Gaming Equipment and System Sales – The Company sells gaming equipment and gaming systems under independent sales contracts through normal credit terms or may grant extended credit terms under contracts secured by the related equipment, with interest recognized at market rates.

For sales arrangements with multiple deliverables, the Company applies the guidance from ASC Topic 985, “Software” and ASC Topic 605, “Revenue Recognition.” Deliverables are divided into separate units of accounting if: (i) each item has value to the customer on a stand-alone basis; (ii) there is objective and reliable evidence of the fair value of the undelivered items; and (iii) delivery of the undelivered item is considered probable and substantially in the Company’s control.

The majority of the Company’s multiple element sales contracts are for some combination of gaming equipment, player terminals, content, system software, license fees and maintenance. For multiple element contracts considered a single unit of accounting, the Company recognizes revenues based on the method appropriate for the last delivered item.

The Company allocates revenue to each accounting unit based upon its fair value as determined by Vendor Specific Objective Evidence, or VSOE. VSOE of fair value for all elements of an arrangement is based upon the normal pricing and discounting practices for those products and services when sold individually. The Company recognizes revenue when the product is physically delivered to a customer controlled location or over the period in which the service is performed and defers revenue for any undelivered elements.

§ In those situations where each element is not essential to the function of the other, the “multiple deliverables” are bifurcated into accounting units based on their relative fair market value against the total contract value and revenue recognition on those deliverables is recorded when all requirements of revenue recognition have been met.

§ If any element is determined to be essential to the function of the other, revenues are generally recognized over the term of the services that are rendered.

In those situations where VSOE does not exist for any undelivered elements of a multiple element arrangement, the aggregate value of the arrangement, including the value of products and services delivered or performed, is initially deferred until all hardware and software is delivered, and then the entire amount of the arrangement is recognized ratably over the period of the last deliverable, generally the service period of the contract. Depending upon the elements and the terms of the arrangement, the Company recognizes certain revenues under the residual method. Under the residual method, revenue is recognized when VSOE of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. Under the residual method, the Company defers the fair value of undelivered elements, and the remainder of the arrangement fee is then allocated to the delivered elements and is recognized as revenue, assuming the other revenue recognition criteria are met.

Costs and Billings on Uncompleted Contract – During fiscal 2008, the Company entered into a fixed-price contract with a customer, pursuant to which it will deliver an electronic bingo system. Revenues from this fixed-price contract are being recognized on the completed-contract method in accordance with ASC Subtopic 605-35, “Construction-Type and Production-Type Contracts.” During the three month period ended June 30, 2010, the Company determined substantial completion of the contract occurred for revenue recognition purposes as all deliverables under the contract were provided to the customer, with the exception of a one year warranty, and the customer had approved the deliverables or the specified time allotted for testing had expired. Therefore, the Company began recognizing revenue ratably over the one year warranty period and thus recognized revenue and costs of \$795,000 and \$762,000, respectively, under the contract for the periods ended June 30, 2010.

Contract costs include all direct material and labor costs, and those indirect costs related to contract performance, such as indirect labor, supplies and tools. General and administrative costs are charged to expense as incurred.

Costs in excess of amounts billed were classified as current assets under “Deferred contract costs, net.”

At September 30, 2009, the following amounts were recorded in the Company’s condensed consolidated balance sheet:

| | September 30, 2009 (in thousands) |
|---|---|
| Costs incurred on uncompleted contracts | \$ 3,697 |
| Billings on uncompleted contracts | (1,871) |
| Deferred contract costs, net | \$ 1,826 |

Cash and Cash Equivalents – The Company considers all highly liquid investments (i.e., investments which, when purchased, have original maturities of three months or less) to be cash equivalents.

Restricted Cash and Long-Term Investments – Restricted cash and long-term investments at June 30, 2010 and September 30, 2009, amounted to \$737,000 and \$804,000, respectively, representing the fair value of investments held by the Company’s prize fulfillment firm related to outstanding MegaBingo® jackpot prizes.

Allowance for Doubtful Accounts – The Company maintains an allowance for doubtful accounts related to its accounts receivable and notes receivable that have been deemed to have a high risk of uncollectibility. Management reviews its accounts receivable and notes receivable on a quarterly basis to determine if any receivables will potentially be uncollectible. Management analyzes historical collection trends and changes in its customer payment patterns, customer concentration, and creditworthiness when evaluating the adequacy of its allowance for doubtful accounts. In its overall allowance for doubtful accounts, the Company includes any receivable balances where uncertainty exists as to whether the account balance has become uncollectible. Based on the information available, management believes the allowance for doubtful accounts is adequate; however, actual write-offs might exceed the recorded allowance.

Inventory – The Company’s inventory consists primarily of completed player terminals, related component parts and back-office computer equipment expected to be sold over the next twelve months. Inventories are stated at average costs, which approximate the lower of cost (first in, first out) or market.

Property and Equipment and Leased Gaming Equipment – Property and equipment and leased gaming equipment are stated at cost. The cost of property and equipment and leased gaming equipment is depreciated over their estimated useful lives, generally using the straight-line method for financial reporting, and regulatory acceptable methods for income tax reporting purposes. Player terminals and related components and equipment are included in the Company’s rental pool. The rental pool can be further delineated as “rental pool – deployed”, which consists of assets deployed at customer sites under participation agreements, and “rental pool – undeployed”, which consists of assets with the Company that are available for customer use. Rental pool – undeployed consists of both new units awaiting deployment to a customer site and previously deployed units currently back with the Company to be refurbished awaiting re-deployment. Routine maintenance of property and equipment and leased gaming equipment is expensed in the period incurred, while major component upgrades are capitalized and depreciated over the estimated remaining useful life of the component. Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains or losses on sales and retirements of property are reflected in the Company’s results of operations.

Management reviews long-lived asset classes for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to its fair value, which considers the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs of disposal.

Deferred Revenue – Deferred revenue represents amounts from the sale of gaming equipment and systems that have been billed, or for which notes receivable have been executed, but which transaction has not met the Company’s revenue recognition criteria. The cost of the related gaming equipment and systems has been offset against deferred revenue. Amounts are classified between current and long-term liabilities, based upon the expected period in which the revenue will be recognized.

Other Long-Term Liabilities – Other long-term liabilities include investments held at fair value by the Company’s prize-fulfillment firm related to outstanding MegaBingo jackpot-prize-winner annuities. These annuities were \$737,000 and \$800,000 as of June 30, 2010 and September 30, 2009, respectively.

Fair Value of Financial Instruments – The carrying value of financial instruments reported in the accompanying condensed consolidated balance sheets for cash, accounts receivable, current portion of notes receivable, accounts payable, and accrued expenses payable and other liabilities, approximate fair value due to the immediate or short-term nature or maturity of these financial instruments. The carrying amount for our credit facility approximates fair value due to the fact that the underlying instrument includes provisions to adjust interest rates to approximate fair value.

Segment and Related Information – Although the Company has a number of operating divisions the Company reports as one segment, as these divisions meet the criteria for aggregation as permitted by ASC Topic 280, “Segment Reporting.” ASC 280-10-50-11, “Aggregation Criteria”, allows for the aggregation of operating segments if the segments have similar economic characteristics and if the segments are similar in each of the following areas:

1. The nature of the products and services
2. The nature of the production processes
3. The type or class of customer for their products and services
4. The methods used to distribute their products or provide their services
5. The nature of the regulatory environment, if applicable.

The Company is engaged in the business of designing, manufacturing and distributing gaming machines, video lottery terminals and associated systems and equipment, as well as the maintenance of these machines and equipment. Our production process is essentially the same for the entire Company and is performed via outsourced manufacturing partners, as well as in house manufacturing performed primarily at our warehouse and assembly facility in Austin, Texas. Our customers consist of entities in the business of operating gaming, bingo or lottery facilities, and include Native American Tribes, charity bingo operators and commercial entities licensed to conduct such business in their jurisdictions. The distribution of our products is consistent across the entire Company and is performed via an internal fleet of vehicles, as well as third party transportation companies. The regulatory environment is similar in every jurisdiction in that gaming is regulated and our games must meet the regulatory requirements established. In addition, the economic characteristics of each customer arrangement are similar in that we obtain revenue via a revenue share arrangement or direct sale of product or service, depending on the customer's need. These sources of revenue are consistent with respect to both product line and geographic area.

In addition, discrete financial information, such as costs and expenses, operating income, net income and EBITDA (Earnings before interest expense, income taxes, depreciation, amortization and accretion of contract rights), are not captured or analyzed by product line or geographic area. Our “Chief Operating Decision Maker” analyzes our product performance based on average daily play on a game level basis, which is consistent across all product lines and geographic areas. This average daily performance data along with customer needs are the key drivers for assessing how the Company allocates resources and assesses operating performance of the Company.

Costs of Computer Software – Software development costs have been accounted for in accordance with ASC Topic 985, “Software.” Under ASC Topic 985, capitalization of software development costs begins upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. The Company capitalized software development costs of approximately \$820,000 and \$677,000 during the three month periods ended June 30, 2010 and 2009, respectively, and \$2.5 million and \$1.8 million for the nine month periods ended June 30, 2010 and 2009, respectively. Software development costs primarily consist of personnel costs. The Company began to amortize capitalized costs when a product is available for general release to customers. Amortization expense is determined on a product-by-product basis at a rate not less than straight-line basis over the product’s remaining estimated economic life, not to exceed five years. Amortization of software development costs is included in amortization and depreciation in the accompanying condensed consolidated statements of operations.

Income Taxes – The Company accounts for income taxes using the asset and liability method and applies the provisions of ASC Topic 740, “Income Taxes”. Under ASC Topic 740, deferred tax liabilities or assets arise from differences between the tax basis of liabilities or assets and their bases for financial reporting, and are subject to tests of recoverability in the case of deferred tax assets. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets to the extent realization is not judged to be more likely than not. Additionally, in accordance with ASC Topic 740, we are required to determine whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position in order to record any financial statement benefit. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

Treasury Stock – The Company utilizes the cost method for accounting for its treasury stock acquisitions and dispositions.

Share-Based Compensation – The Company accounts for share-based compensation under the provisions of ASC Topic 718, “Compensation – Stock Compensation.” Among other items, ASC Topic 718 requires the Company to recognize in the financial statements, the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards. To measure the fair value of stock options granted to employees, the Company currently utilizes the Black-Scholes-Merton option-pricing model. The Company applied the “modified prospective” method, under which compensation cost is recognized in the financial statements beginning with the adoption date for all share-based payments granted after that date, and for all unvested awards granted prior to the adoption date. Expense is recognized over the required service period, which is generally the vesting period of the options.

The Black-Scholes-Merton model incorporates various assumptions, including expected volatility, expected life, and risk-free interest rates. The expected volatility is based on the historical volatility of the Company’s common stock over the most recent period commensurate with the estimated expected life of the Company’s stock options, adjusted

for the impact of unusual fluctuations not reasonably expected to recur. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees.

There were 7,600 option grants issued to employees during the three months ended June 30, 2010 at an average fair value per share price of \$4.50. Total pretax share-based compensation for the three and nine month periods ended June 30, 2010 were \$230,000 and \$1.5 million, respectively; and \$363,000 and \$1.5 million, respectively, for the three and nine month periods ended June 30, 2009. The Company did not recognize an income tax benefit for stock-based compensation arrangements in the three or nine month periods ended June 30, 2010. The total income tax benefit recognized in the statement of operations for share-based compensation arrangements was \$89,000 and \$384,000 for the three and nine month periods ended June 30, 2009. As of June 30, 2010, \$4.9 million of unamortized stock compensation expense, including estimated forfeitures, remained, which will be recognized over the vesting periods of the various option grants.

Foreign Currency Translation. The Company accounts for currency translation in accordance with ASC Topic 830, "Foreign Currency Matters." Balance sheet accounts are translated at the exchange rate in effect at each balance sheet date. Income statement accounts are translated at the average rate of exchange prevailing during the period. Translation adjustments resulting from this process are charged or credited to other comprehensive income (loss) a component of shareholder equity, in accordance with ASC Topic 220, "Comprehensive Income." Transactional currency gains and losses arising from transactions in currencies other than the Company's local functional currency are included in the condensed consolidated statement of operations in accordance with ASC Topic 830.

Comprehensive Income (Loss). Comprehensive income (loss) consists of the following:

| | Three months ended June 30, | | Nine months ended June 30, | |
|---|--------------------------------|-----------|-------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | (in thousands) | |
| Net income (loss) | \$360 | \$(1,160) | \$(9,366) | \$(10,478) |
| Foreign currency translation adjustment | (448) | 846 | 617 | (1,443) |
| Comprehensive loss | \$(88) | \$(314) | \$(8,749) | \$(11,921) |

Recent Accounting Pronouncements Issued. In June 2009, the Financial Accounting Standards Board (“FASB”), issued Statement of Financial Accounting Standards No. 168, “The FASB Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles.” FASB Accounting Standards Codification (ASC) has become the source of authoritative generally accepted accounting principles GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this statement, the codification will supersede all then-existing non-SEC accounting and reporting standards; and all non-grandfathered, non-SEC accounting literature not included in the codification will be superseded and deemed non-authoritative. The new codification standards have been adopted by the Company in its annual report on Form 10-K as of September 30, 2009. Reference to the new ASC topic, subtopic, or section has been provided in place of historical accounting literature. The adoption of codification standards did not impact our consolidated financial position, results of operation or cash flows.

In October 2009, FASB issued ASU No. 2009-13, “Revenue Recognition (Topic 605), Multiple-Deliverable Revenue Arrangements” and ASU No. 2009-14, “Software (Topic 985), Certain Revenue Arrangements that Include Software Elements,” both consensus of the FASB Emerging Issues Task Force. ASU No. 2009-13 establishes the accounting and reporting guidance for arrangements under which the vendor will perform multiple revenue-generating activities; specifically, how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. ASU No. 2009-14 affects vendors that sell or lease tangible products in an arrangement that contains software that is more than incidental to the tangible product as a whole and clarifying what guidance should be used in allocating and measuring revenue. Upon adoption of these standards, a company can recognize revenue on delivered elements within a multiple elements arrangement based upon estimated selling prices, which is a departure from previous guidance. These standards are required to be implemented by October 1, 2010, We are currently evaluating the impact of implementation.

2. DEVELOPMENT AGREEMENTS

The Company enters into development agreements, including placement fees, to provide financing for new gaming facilities or for the expansion of existing facilities. In return, the facility dedicates a percentage of its floor space to placement of the Company’s player terminals, and the Company receives a fixed percentage of those player terminals’ win per unit over the term of the agreement. The agreements typically provide for some or all of the advances to be repaid by the customer to the Company. Amounts advanced in excess of those to be reimbursed by the customer are allocated to intangible assets and are generally amortized over the life of the contract, which is recorded as a reduction of revenue generated from the gaming facility. Certain of the agreements contain player terminal performance standards that could allow the facility to reduce a portion of the Company’s floor space. In the past and in the future, the Company may by mutual agreement and for consideration, amend these contracts to reduce its floor space at the facilities. Any proceeds received for the reduction of floor space is first applied as a recovery against the intangible asset or property and development for that particular development agreement, if any.

Management reviews intangible assets related to development agreements for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. There were no events or changes in circumstances during the three and nine month periods ended June 30, 2010, which would require an impairment charge to the carrying value of intangible assets recorded in connection with development agreements. See Notes 6 “Notes Receivable” and Note 10 “Write-off, reserve, impairment and settlement charges” for further discussion of reserves recorded on notes receivable from development agreements.

During the nine month periods ended June 30, 2010, the Company advanced under development agreements \$3.0 million compared to \$7.0 million for the same period of 2009. The following net amounts related to advances made under development agreements and were recorded in the following balance sheet captions:

| | June 30, 2010 | September 30, 2009 |
|---|------------------|-----------------------|
| Included in: | | (In thousands) |
| Notes receivable, net | \$37,188 | \$50,288 |
| Intangible assets – contract rights, net of accumulated amortization | \$25,934 | \$28,175 |

3. INVENTORY

Inventory consisted of the following (in thousands):

| | June 30, 2010 | September 30, 2009 |
|-----------------------------------|------------------|-----------------------|
| Raw materials and component parts | \$2,309 | \$3,753 |
| Work in progress | 1,491 | 936 |
| Finished goods | 1,167 | 1,053 |
| Total Inventory | \$4,967 | \$5,742 |

Included in inventory as of June 30, 2010 and September 30, 2009, were reserves of approximately \$121,000 and \$931,000 for slow-moving or obsolete inventory and to reduce the carrying value of inventory to the lower of cost or market.

4. PROPERTY AND EQUIPMENT AND LEASED GAMING EQUIPMENT

The Company's property and equipment and leased gaming equipment consisted of the following (in thousands):

| | June 30, 2010 | | | September 30, 2009 | | |
|---|---------------|-----------------|-------------------|--------------------|-----------------|-------------------|
| | Cost | Accum. Depr. | Net Book Value | Cost | Accum. Depr. | Net Book Value |
| Rental pool – deployed | \$ 172,387 | \$ 129,783 | \$ 42,604 | \$ 192,944 | \$ 140,363 | \$ 52,581 |
| Rental pool – undeployed (1) | 78,011 | 67,566 | 10,445 | 85,031 | 72,219 | 12,812 |
| Machinery and equipment | 14,572 | 13,395 | 1,177 | 16,371 | 15,084 | 1,287 |
| Computer software | 7,789 | 7,237 | 552 | 7,720 | 6,636 | 1,084 |
| Vehicles | 2,472 | 2,139 | 333 | 3,064 | 2,900 | 164 |
| Other | 4,272 | 3,878 | 394 | 6,554 | 5,432 | 1,122 |
| Total property and equipment and leased gaming equipment | \$ 279,503 | \$ 223,998 | \$ 55,505 | \$ 311,684 | \$ 242,634 | \$ 69,050 |

(1) Gaming equipment and third-party gaming content licenses begin depreciating when they are available for customer use.

Property and equipment and leased gaming equipment is depreciated as follows: Rental pool – deployed and undeployed – 1.5 to 3 years; Machinery and equipment – 5 to 7 years; Computer software – 3 to 5 years; Vehicles – 3 to 10 years and Other – 3 to 7 years.

In accordance with ASC Topic 360, “Property, Plant, and Equipment,” the Company (i) recognizes an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows; and (ii) measures an impairment loss as the difference between the carrying amount and fair value of the asset.

During the three and nine month periods ended June 30, 2010, in the ordinary course of business activities or upon reviewing the nature of the assets, the Company disposed, wrote off or sold \$303,000 and \$1.9 million, respectively of third-party gaming content licenses, Native American tribal gaming facilities and portable buildings, vehicles, deployed gaming equipment, or other equipment. In the same period ended June 30, 2009, the Company disposed, wrote off or sold \$55,000 and \$132,000, respectively.

The rental pool includes leased gaming equipment placed under participation arrangements that are either at customer facilities (rental pool – deployed) or warehoused by the Company for future deployment (rental pool – undeployed).

5. INTANGIBLE ASSETS

The Company's intangible assets consisted of the following:

| | June 30, 2010 | September 30, 2009 | Estimated Useful Lives |
|---|------------------|-----------------------|------------------------------|
| | (In thousands) | | |
| Contract rights | \$49,131 | \$46,319 | 4-7 years |
| Internally-developed gaming software | 30,615 | 28,388 | 1-5 years |
| Patents and trademarks | 8,368 | 8,226 | 1-5 years |
| Other | 961 | 961 | 3-5 years |
| Total intangible assets | 89,075 | 83,894 | |
| Less accumulated amortization – all other | (58,132) | (50,533) | |
| Total intangible assets, net | \$30,943 | \$33,361 | |

Contract rights are amounts allocated to intangible assets for dedicated floor space resulting from development agreements or placement fees. The related amortization expense, or accretion of contract rights, is netted against its respective revenue category in the accompanying condensed consolidated statements of operations.

Internally developed gaming software is accounted for under the provisions of ASC Topic 985 “Software” and is stated at cost, which is amortized over the estimated useful life of the software, generally using the straight-line method. The Company amortizes internally-developed games over a twelve month period, gaming engines over an eighteen month period, gaming systems over a three-year period and its central management systems over a five-year period. Software development costs are capitalized once technological feasibility has been established, and are amortized when the software is placed into service. Any subsequent software maintenance costs, such as bug fixes and subsequent testing, are expensed as incurred. Discontinued software development costs are expensed when the determination to discontinue is made. For the three and nine month periods ended June 30, 2010, amortization expense related to internally-developed gaming software was \$739,000 and \$1.9 million, respectively; and \$813,000 and \$3.0 million, respectively, for the three and nine month periods ended June 30, 2009. During the three and nine month periods ended June 30, 2010, the Company wrote off \$43,000 and \$233,000, respectively, related to internally-developed gaming software and patents and trademarks, compared to write-offs of \$372,000 and \$827,000 in the same periods ended June 30, 2009.

Management reviews intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

6. NOTES RECEIVABLE

The Company's notes receivable consisted of the following:

| | June 30, 2010 | September 30, 2009 |
|--|------------------|-----------------------|
| | (In thousands) | |
| Notes receivable from development agreements | \$44,413 | \$57,558 |
| Less imputed interest discount reclassified to contract rights | (4,513) | (7,270) |

| | | | |
|---|----------|---|----------|
| Less allowance | (2,712 |) | — |
| Notes receivable from equipment sales and other | 3,848 | | 5,616 |
| Notes receivable, net | 41,036 | | 55,904 |
| Less current portion | (13,419 |) | (15,780 |
| Notes receivable – non-current | \$27,617 | | \$40,124 |

Notes receivable from development agreements are generated from reimbursable amounts advanced under development agreements. As of March 31, 2010, the Company reserved for a note receivable outstanding with an Alabama customer in the amount of \$2.7 million. On April 27, 2010, this customer indicated to the Company that under current conditions its facility will remain closed and consequently has doubts as to their ability, in the short term, to make scheduled payments pursuant to the terms of its development agreement, which led the Company to conclude that collectability of the note receivable was no longer considered probable.

Notes receivable from equipment sales consisted of financial instruments issued by customers for the purchase of player terminals and licenses, and bore interest at 5.25% as of June 30, 2010. All of the Company's notes receivable from equipment sales are collateralized by the related equipment sold, although the value of such equipment, if repossessed, may be less than the note receivable outstanding.

7. VALUE ADDED TAX RECEIVABLE

The value added tax (VAT) receivable is a receivable from the Mexican taxing authority primarily related to a value added tax levied on product shipments originating outside of Mexico. At June 30, 2010 and September 30, 2009, the Company's VAT receivable was \$7.0 million and \$7.5 million, respectively. The majority of the VAT receivable relates to shipments that occurred from 2006 through 2008. A portion of the \$7.0 million balance remains under audit by the Mexican taxing authority.

Preliminary audit results indicate that \$2.3 million has been approved through audit for payment, \$1.8 million of which was received in July 2010. The Company expects to collect the remaining \$0.5 million within the next twelve months. Additionally, the Company believes it will be able to offset a portion of the current VAT receivable against a corresponding \$1.3 million VAT payable recorded on our June 30, 2010 balance sheet.

The Company has received an initial ruling from the Mexican taxing authority indicating that the Mexican tax authority has challenged the registration of certain of the Company's transactions that have generated approximately \$600,000 in VAT receivable. Mexican tax law permits the Company to formally contest the initial ruling, and the Company believes that it has the necessary documentation to support the portion that has been challenged. However, the final resolution of the contested balances remains uncertain and may adversely affect the carrying value of the receivable and may have an adverse affect on our foreign income tax expense.

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

At June 30, 2010 and September 30, 2009, the Company's accounts payable and accrued expenses consisted of the following:

| | June 30, 2010 | September 30, 2009 |
|---------------------------------------|------------------|-----------------------|
| | (In thousands) | |
| Trade accounts payable | \$ 12,816 | \$ 12,431 |
| Accrued expenses | 5,208 | 7,272 |
| Accrued bonus and salaries | 4,452 | 4,196 |
| Other | 3,549 | 3,727 |
| Accounts payable and accrued expenses | \$ 26,025 | \$ 27,626 |

9. CREDIT AGREEMENT, LONG-TERM DEBT AND CAPITAL LEASES

The Company's Credit Agreement, long-term debt and capital leases consisted of the following:

| | June 30, 2010 | September 30, 2009 |
|-------------------------------------|------------------|-----------------------|
| | (In thousands) | |
| Long-term revolving lines of credit | \$ 15,000 | \$ 15,000 |
| Term loan facility | \$ 44,813 | \$ 60,000 |
| Less current portion | (750) | (750) |

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| | | |
|---|-----------|-----------|
| Long-term debt, less current portion | \$ 44,063 | \$ 59,250 |
| Total indebtedness under Credit Agreement | \$ 59,813 | \$ 75,000 |

Credit Agreement. On April 27, 2007, the Company entered into a credit agreement with Comerica Bank, the Credit Agreement, to provide the Company a \$150 million credit facility which replaced its previous credit facility in its entirety. On October 26, 2007, the Company amended the Credit Agreement, and transferred a portion of the revolving credit commitment to a fully funded term loan. The term loan is amortized at an annual amount of 1% per year, payable in equal quarterly installments beginning January 1, 2008, with the remaining amount due on the maturity date. The Company entered into a second amendment to the Credit Agreement on December 20, 2007. The second amendment (i) extended the hedging arrangement date related to a portion of the term loan to June 1, 2008; and (ii) modified the interest rate margin applicable to the Credit Agreement. On July 22, 2009, the Company entered into a third amendment to the Credit Agreement, which amended certain covenants, reduced the total borrowing capacity of the Credit Agreement to \$125 million (\$65 million under the revolving credit commitment and \$60 million under the term loan) from the previous total borrowing capacity of \$150 million, and agreed to a LIBOR floor of 2%.

On April 6, 2010, the Company entered into a fourth amendment to the Credit Agreement which (i) removed the requirement to maintain a minimum consolidated EBITDA (earnings before net interest expense, taxes, depreciation and amortization and accretion of contract rights); (ii) amended the consolidated total leverage ratio to a ratio of not greater than 1.50 to 1.00; (iii) reduced the total borrowing capacity of the Credit Agreement by reducing the revolving commitment of the credit facility from \$65 million to \$45 million and the term loan from \$60 million to \$45 million; and (iv) amended the definition of Consolidated EBITDA to include any extraordinary, unusual or non-cash non-recurring expenses or losses (including, whether or not otherwise includable as a separate item in the Consolidated Statement of Operations for such period, losses on sales of assets outside the ordinary course of business) of up to \$10 million, commencing June 30, 2010. As a result of this amended definition of Consolidated EBITDA in the fourth amendment, commencing June 30, 2010, the Company modified its calculation of Adjusted EBITDA. Adjusted EBITDA is presented and reconciled to EBITDA and Net Income/Loss and Adjusted EBITDA continues to be the basis for which compliance with a number of covenants will be determined, including certain ratios. As of June 30, 2010, the calculation of Adjusted EBITDA is as follows:

Consolidated net income or loss
 + Interest expense
 + Depreciation and amortization expense
 + Non-cash expense related to stock compensation
 + Extraordinary, unusual or non-cash non-recurring expenses or losses (up to \$10 million)
 - Non-cash income items
 - Extraordinary income or gains

There are no items included in the calculation of Adjusted EBITDA that were not previously agreed to as part of the amendments to the Credit Agreement.

The Company accounts for amendments or changes to its Credit Agreement in accordance with ASC 470-50-40-21, "Modifications and exchanges of line of credit or revolving debt arrangements." Based on the requirements of ASC 470-50-40-21, the Company wrote-off \$381,000 during the three month period ended June 30, 2010 related to unamortized deferred costs of the original Credit Agreement and subsequent amendments. The remaining deferred costs of approximately \$1.0 million, in addition to the approximately \$284,000 of costs related to the fourth amendment will be amortized over the remaining term of the Credit Agreement.

The Credit Agreement is collateralized by substantially all of the Company's assets, and also contains financial covenants as defined in the agreement. As of June 30, 2010, the Company is in compliance with the loan covenants. The Credit Agreement requires certain mandatory prepayments be made on the term loan from the net cash proceeds of certain asset sales and condemnation proceedings (in each case to the extent not reinvested, within certain specified time periods, in the replacement or acquisition of property to be used in its businesses).

The Credit Agreement provides the Company with the ability to finance development agreements and acquisitions and working capital for general corporate purposes. Advances under the revolving credit commitment and the term loan mature on April 27, 2012, and bear interest at the Eurodollar rate plus the applicable spread, tied to various levels of interest pricing determined by total debt to EBITDA.

As of June 30, 2010, the \$44.8 million on the term loan bore interest at 6.5% and the \$15 million revolver bore interest at 5.25%. The Company has approximately \$30 million available under the Credit Agreement, subject to covenant restrictions.

10. WRITE-OFF, RESERVE, IMPAIRMENT AND SETTLEMENT CHARGES

Write-off, reserve, impairment and settlement charges for the three and nine month periods ended June 30, 2010 and 2009 consisted of the following(in thousands):

| | Three month period ended | | Nine month period ended | |
|---|--------------------------|------------------|-------------------------|------------------|
| | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| Litigation and settlement costs | \$- | \$299 | \$- | \$8,220 |
| Reserve against note and accounts receivable (1) | - | - | 2,912 | 397 |
| Write-off of install costs and portable buildings in Alabama | - | - | 332 | - |
| Severance and related benefit costs | - | - | - | 1,064 |
| Write-off of prepaid loan fees | 381 | - | 381 | - |
| Write-off of property and equipment and intangibles | - | - | 271 | 590 |
| Total write-off, reserve, impairment and settlement charges | \$381 | \$299 | \$3,896 | \$10,271 |

(1) See Note 6 of the Notes to Condensed Consolidated Financial Statements.

11. INCOME TAXES

Income tax benefit for the three and nine month periods ended June 30, 2010 were \$2.6 million and \$331,000, respectively. The benefit for the current period was primarily due to a change in method for calculating depreciation expense for tax purposes related to game licenses acquired from third party vendors and utilized in the Company's rental pool. The Company claimed a cumulative adjustment for the method change under Internal Revenue Service(IRS) guidelines and will prospectively utilize the new method for future game license purchases. The adjustment will be realized by the Company through a carryback to prior taxable income years. In addition, the Company recorded a benefit for a research and development credit study performed during the current period in the amount of \$474,000. As of June 30, 2010, the Company has fully reserved for all of its deferred tax assets as management has determined that it is more likely than not that the Company will not be able to realize the benefit of those assets. Income tax benefits were recorded during the three and nine month periods ended June 30, 2009 of \$288,000 and \$5.4 million commensurate with the net loss reported in those respective periods.

12. INCOME (LOSS) PER COMMON SHARE

Income (loss) per common share is computed in accordance with ASC Topic 260, "Earnings per Share." Presented below is a reconciliation of net income (loss) available to common shareholders and the differences between weighted average common shares outstanding, which are used in computing basic earnings (loss) per share, and weighted average common and potential shares outstanding, which are used in computing diluted earnings (loss) per share. Diluted amounts are not included in the computation of diluted loss per share, as such amounts would be antidilutive.

| | Three months ended June 30, | | Nine months ended June 30, | |
|---|-----------------------------|-------------|----------------------------|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income (loss) available to common shareholders (in thousands) | \$ 360 | \$ (1,160) | \$ (9,366) | \$ (10,478) |
| Weighted average common shares outstanding | 27,436,616 | 26,693,006 | 27,339,511 | 26,653,093 |
| Effect of dilutive securities: | | | | |
| Options | 525,058 | - | - | - |
| Weighted average common and potential shares outstanding | 27,961,674 | 26,693,006 | 27,339,511 | 26,653,093 |
| Basic earnings (loss) per share | \$ 0.01 | \$ (0.04) | \$ (0.34) | \$ (0.39) |
| Diluted earnings (loss) per share | \$ 0.01 | \$ (0.04) | \$ (0.34) | \$ (0.39) |

The Company had the following options to purchase shares of common stock that were not included in the weighted average common and potential shares outstanding in the computation of dilutive earnings per share, due to the antidilutive effects:

| | Three months ended June 30, | | Nine months ended June 30, | |
|-------------------------|-----------------------------|---------------|----------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Common Stock Options | 3,857,108 | 7,071,583 | 6,374,719 | 6,989,626 |
| Range of exercise price | \$ 3.58-18.71 | \$ 1.00-18.71 | \$ 3.58-\$18.71 | \$ 1.00-\$21.53 |

In the three and nine month periods ended June 30, 2010, options to purchase approximately 3.9 million and 4.2 million shares of common stock, with exercise prices ranging from \$3.58 to \$18.71 per share respectively, were not included in the computation of dilutive loss per share, due to the antidilutive effect. In addition, for the nine month period ended June 30, 2010 approximately 2.2 million equivalent shares were not included, due to the loss generated in the period.

13. COMMITMENTS AND CONTINGENCIES

Litigation and Regulatory Proceedings

The Company is subject to the possibility of loss contingencies arising in its business and such contingencies are accounted for in accordance with ASC Topic 450, "Contingencies." In determining loss contingencies, the Company considers the possibility of a loss as well as the ability to reasonably estimate the amount of such loss or liability. An estimated loss is recorded when it is considered probable that a liability has been incurred and when the amount of loss can be reasonably estimated.

In addition to the threat of litigation relating to the Class II or Class III status of the Company's games and equipment, the Company is the subject of various pending and threatened claims arising out of the ordinary course of business. The Company believes that any liability resulting from these various other claims will not have a material adverse effect on its results of operations or financial condition or cash flows. During its ordinary course of business, the Company enters into obligations to defend, indemnify and/or hold harmless various customers, officers, directors, employees and other third parties. These contractual obligations could give rise additional litigation cost and involvement in court proceedings.

International Gamco. International Gamco, Inc., or Gamco, claiming certain rights in U.S. Patent No. 5,324,035, or the '035 Patent, brought suit against the Company on May 25, 2004 in the U.S. District Court for the Southern District of California alleging that the Company's central determinant system, as operated by the New York State Lottery, infringes the '035 Patent. Gamco claims to have acquired ownership of the '035 Patent from Oasis Technologies, Inc., or Oasis, a previous owner of the '035 Patent. In February 2003, Gamco assigned the '035 Patent to International Game Technology, or IGT. Gamco claims to have received a license back from IGT for the New York State Lottery. The lawsuit claims that the Company infringed the '035 Patent after the date on which Gamco assigned the '035 Patent to IGT.

We have made a number of challenges to Gamco's standing to sue for infringement of the '035 Patent. On October 15, 2007, pursuant to an interlocutory appeal, the federal circuit court reversed the district court's order when it held that Gamco did not have sufficient rights in the '035 Patent to sue us without the involvement of the patent owner, IGT.

On December 4, 2007, Gamco and IGT entered into an Amended and Restated Exclusive License Agreement whereby IGT granted to Gamco exclusive rights to the '035 Patent in the state of New York and the right to sue for past infringement of the same. On January 9, 2008, Gamco filed its third amended complaint for infringement of the '035 Patent against us. On January 28, 2008, we filed an answer to the complaint denying liability. We also filed a third amended counterclaim against Oasis, Gamco and certain officers of Gamco, for fraud, promise without intent to perform, negligent misrepresentation, breach of contract, specific performance and reformation of contract with regard to the Company's rights under the Sublicense Agreement for the '035 Patent, as well as for non-infringement and invalidity of the '035 Patent. These parties filed a motion to dismiss and a motion for summary judgment as to these claims. On August 11, 2009, the Court issued an order denying the motion to dismiss and granting in part and denying in part the motion for summary judgment. The Court entered judgment against the Company on its claims for fraud, promise without intent to perform and negligent misrepresentation. However, the Court held that Gamco was not entitled to judgment as a matter of law on our claims for breach of contract, reformation and specific performance. Our affirmative motion for partial summary judgment was denied.

The court issued a claim construction ruling in this case on April 20, 2009. On August 28, 2009, the court held a telephonic conference, issued pre-trial deadlines and set the Final Pre-Trial Conference date for September 9, 2010.

On February 23, 2010, we filed a motion for summary judgment of non-infringement of the '035 Patent and a motion for summary judgment challenging the validity of the '035 Patent under 35 U.S.C. § § 102 and 103. The Court heard oral argument on both motions on July 22, 2010, and the matters were taken under submission. A trial date will be scheduled during the Final Pre-Trial Conference on September 9, 2010.

We continue to vigorously defend this matter. Given the inherent uncertainties in this litigation, we are unable to make any prediction as to the ultimate outcome.

Alabama Litigation. The Company, along with other major manufacturers, recently was named in three lawsuits, as further described below, all pending in federal court in Alabama. The lawsuits were filed on behalf of patrons of either White Hall Gaming Center in Lowndes County, Alabama or VictoryLand in Shorter, Alabama, and include several claims related to the alleged illegality of electronic bingo in Alabama. The Company has filed motions to dismiss the complaints for, among other things, failure to state a claim upon which relief could be granted.

Ethel Adell, et al., v. Macon County Greyhound Park, Inc., et al., a civil action, was filed on February 16, 2010 in the United States District Court for the Middle District of Alabama Eastern Division, on behalf of over 800 plaintiffs against the Company, Macon County Greyhound Park, Inc. (VictoryLand), as a corporation, International Gaming Technologies, Inc., Cadillac Jack, Inc., Colossus, Inc., Rocket Gaming Systems, LLC, Nova Gaming, LLC, and Bally Gaming, Inc. The plaintiffs, who were patrons of VictoryLand, are seeking actual damages, compensatory damages, treble damages and/or punitive damages based on Ala. Code, Sec 8-1-150(A), the Alabama Deceptive Trade Practices Act, and the Racketeer Influenced and Corruption Organizations Act 18 U.S.C. sec 1961(1).

On April 28, 2010, the Company filed a motion to dismiss the entire complaint pursuant to Rules 12(b)(2), (5) and (6) of the Federal Rules of Civil Procedure based, in part, on the grounds that the plaintiffs failed to state a claim against the Company upon which relief could be granted. All briefing on the motion has been completed. The court is expected to rule on the motion in the near future.

We continue to vigorously defend this matter. Given the inherent uncertainties in this litigation, we are unable to make any prediction as to the ultimate outcome.

Walter Bussey, et al., v. Macon County Greyhound Park, Inc., et al., a civil action, was filed on March 8, 2010 in the United States District Court for the Middle District of Alabama Eastern Division against the Company, Macon County Greyhound Park, Inc. (VictoryLand), as a corporation, International Gaming Technologies, Inc., Cadillac Jack, Inc., Colossus, Inc., Rocket Gaming Systems, LLC, Nova Gaming, LLC, and Bally Gaming, Inc. The plaintiffs, who were patrons of VictoryLand, originally sought actual damages, compensatory damages, treble damages and/or punitive damages based on both Ala. Code, Sec 8-1-150(A), and the Racketeer Influenced and Corruption Organizations Act (“RICO”), 18 U.S.C. sec 1961(1) and claim, in part, that the defendants conspired to promote gambling and/or to advance or profit from gambling activity in violation of Ala. Code Sec. 13 A-12-23 and have requested that the court certify the action as a Class Action as required under the Federal Rules of Civil Procedure.

On April 28, 2010, the Company filed a motion to dismiss the entire complaint pursuant to Rules 12(b)(2), (5) and (6) of the Federal Rules of Civil Procedure based, in part, on the grounds that the plaintiffs failed to state a claim against the Company upon which relief could be granted. After the Company filed its motion to dismiss, Plaintiffs voluntarily dismissed their RICO claim, leaving only a claim for recovery of gambling losses under Ala. Code Sec. 8-1-150(A). All briefing on the Company’s motion has been completed. The court is expected to rule on the motion in the near future.

We continue to vigorously defend this matter. Given the inherent uncertainties in this litigation, we are unable to make any prediction as to the ultimate outcome.

Ozetta Hardy v. Whitehall Gaming Center, LLC, et al., a civil action, was filed against White Hall Gaming Center, LLC, Cornerstone Community Outreach, Inc., and Freedom Trail Ventures, Ltd., in the Circuit Court of Lowndes County, Alabama. On June 3, 2010, Plaintiffs filed an amended complaint adding the Company, IGT, Bally, Inc., Eclipse Gaming Systems, LLC, Video Gaming Technologies, Inc., Cadillac Jack, Inc., and AGS, LLC. The plaintiffs, who were patrons of White Hall, seek recovery of gambling losses based on Ala. Code, Sec 8-1-150(A) and have requested that the court certify the action as a Class Action as required under the Federal Rules of Civil Procedure.

On July 2, 2010, the defendants removed the case to the United States District Court for the Middle District of Alabama Northern Division. On July 9, 2010, the Company filed a motion to dismiss the complaint pursuant to Rules 12(b)(2), (5) and (6) of the Federal Rules of Civil Procedure based, in part, on the grounds that the plaintiffs failed to state a claim against the Company upon which relief could be granted. Plaintiffs have until August 13, 2010, to respond to the motion.

We continue to vigorously defend this matter. Given the inherent uncertainties in this litigation, we are unable to make any prediction as to the ultimate outcome.

Alabama Regulatory Environment. On November 13, 2009, the Supreme Court of Alabama, in a 6-3 decision, reversed and remanded a trial court's preliminary injunction in favor of a charity operating bingo in the Town of White Hall, Lowndes County, Alabama, referred to herein as the White Hall decision. The appeal arose out of a raid conducted by the Governor's Task Force on Illegal Gambling on March 19, 2009. The Governor's Task Force on Illegal Gambling seized server-based bingo gaming systems, computers, servers, and cash. Included with the equipment seized were approximately 34 of the Company's games and certain of the Company's charity bingo equipment located in Alabama. The Governor's Task Force on Illegal Gambling also filed a forfeiture action against all of the equipment seized at White Hall. The forfeiture action remains pending in the trial court. The Supreme Court of Alabama denied an application for rehearing filed by the charity that operates White Hall.

In the White Hall decision, the Supreme Court of Alabama established a definition of "bingo" that included a set of standards that apply to the operation of charity bingo in Alabama. We believe that our modified games comply with the standards established by the recent Supreme Court decision and have received certifications and/or formal written opinions from independent gaming laboratories verifying to us that each game, as modified, is compliant with the applicable Alabama standards.

Notwithstanding our initiatives to have our games comply with the specified standards, there can be no assurance that we will not encounter further legal, regulatory, financial, or competitive issues related to this matter as the legality of charitable bingo gaming in Alabama continues to be challenged by the state's Governor. Legislation to put the legality question to a public referendum in Alabama failed to pass the recently concluded legislative session. As a result, many charitable bingo properties have voluntarily ceased operations pending resolution of the matter.

Three of the four facilities in Alabama which have historically placed our charitable bingo units, as well as other game manufacturers' units, have ceased operations. We voluntarily removed our charitable bingo units from one of the facilities before it ceased operations. One of the Alabama facilities where the Company has historically placed units has been operating under the protection of a temporary restraining order. On July 30, 2010, however, the Supreme Court of Alabama issued a ruling reversing the trial court's entry of the temporary restraining order.

As of June 30, 2010, the net book value of charitable bingo machines held by the Company in Alabama totaled \$4.8 million.

14. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the date the financial statements were issued, and determined that no events, other than those disclosed within the footnotes hereto, have occurred subsequent to June 30, 2010 that warrant additional disclosure or accounting considerations.

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21

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FUTURE EXPECTATIONS AND FORWARD-LOOKING STATEMENTS

This Quarterly Report and the information incorporated herein by reference contain various "forward-looking statements" within the meaning of federal and state securities laws, including those identified or predicated by the words "believes," "anticipates," "expects," "plans," "will," or similar expressions with forward-looking connotations. Such statements are subject to a number of risks and uncertainties that could cause the actual results to differ materially from those projected. Such factors include, but are not limited to, the uncertainties inherent in the outcome of any litigation of the type described in this Quarterly Report under "PART II – Item 1. Legal Proceedings," trends and other expectations described in "PART I – Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," risk factors disclosed in our earnings and other press releases issued to the public from time to time, as well as those other factors as described under "PART II – Item 1A. Risk Factors" set forth below. Given these uncertainties, readers of this Quarterly Report are cautioned not to place undue reliance upon such statements. All forward-looking statements in this document are based on information available to us as of the date hereof, and we assume no obligations to update any such forward-looking statements.

Overview

Multimedia Games, Inc. designs, manufactures and supplies innovative standalone and networked gaming systems. Our products and systems are used by Native American tribes and commercial casino operators as well as state lottery operators in North America, and our electronic bingo and lottery systems are deployed in certain international markets. We have long been a provider of server-based gaming systems known as central determinant and downloadable systems. These systems are used by our Native American gaming operator customers in both Class II and Class III, as defined below, settings, by our commercial casino customers, by operators of charity and commercial bingo gaming facilities, and by lottery jurisdictions for operation of their video lottery systems.

As part of our networked gaming systems, we also provide customers with access to proprietary local-area and wide-area telecommunications networks that allow us to link player terminals with one another inside a single casino, inside an operator's multiple casinos and across many casinos nationwide. Our games include a mix of proprietary content that has been designed and developed internally by our own game studios as well as themes that we license from third parties. Behind our products and systems is a suite of back-office, player tracking, slot accounting, slot management and slot monitoring systems that enable our customers to track their operations and adjust the performance of their slot floor in real-time to ensure optimum financial performance.

We derive the majority of our gaming revenues from participation, or revenue share, agreements. Under our participation agreements, we place third party player terminals and systems, as well as our proprietary and other licensed game content, at a customer's facility in return for a share of the revenues that these terminals and systems generate. As of June 30, 2010, we have 13,782 gaming units in operation domestically and internationally which are installed pursuant to revenue share arrangements. The Company has undertaken a concerted effort to generate additional revenue through the sale of Class II and Class III gaming systems and products and we also generate revenues from the sale of gaming units and systems as we continue to expand into additional gaming jurisdictions and into other segments of the gaming market. We also generate revenues from our provision of the central determinant system for approximately 12,500 video lottery terminals installed at racetracks in the State of New York and operated by the New York State Division of the Lottery.

RESULTS OF OPERATIONS

Three and Nine Month Periods Ended June 30, 2010 Compared to Three and Nine Month Periods Ended June 30, 2009

Below are our revenues and costs and expenses for the periods noted above. This information should be read in conjunction with our Condensed Consolidated Financial Statements and notes thereto. (in thousands)

| | Three month periods ended | | | Nine month periods ended | | |
|--------------------|---------------------------|------------------|----------|--------------------------|------------------|----------|
| | 2010 | June 30, 2009 | % change | 2010 | June 30, 2009 | % change |
| Revenue | | | | | | |
| Gaming Operations | | | | | | |
| Participation | | | | | | |
| revenue | \$ 21,784 | \$ 25,395 | (14.2)% | \$ 63,962 | \$ 77,167 | (17.1)% |
| Lottery | 2,026 | 2,012 | 0.7 % | 5,686 | 5,469 | 3.9 % |
| Gaming Equipment | | | | | | |
| and Systems Sales | | | | | | |
| Player terminal | | | | | | |
| and equipment | | | | | | |
| sales | 3,818 | 2,624 | 45.5 % | 13,000 | 8,649 | 50.3 % |
| Systems and | | | | | | |
| Licensing | 1,117 | 1,162 | 3.9 % | 3,354 | 1,258 | 166.6 % |
| Other Revenue | 331 | 936 | (64.7)% | 1,477 | 2,032 | (27.4)% |
| Total Revenue | 29,076 | 32,129 | (9.5)% | 87,479 | 94,575 | (7.5)% |
| Costs and Expenses | | | | | | |
| Cost of revenues | 3,302 | 2,137 | 54.5 % | 9,139 | 6,311 | 44.8 % |
| Selling, general | | | | | | |
| and administrative | 14,703 | 15,326 | (4.1)% | 43,493 | 46,091 | (5.6)% |
| Write-offs, | | | | | | |
| reserves, | | | | | | |
| impairment and | | | | | | |
| settlement charges | 381 | 299 | 27.4 % | 3,896 | 10,271 | (62.1)% |
| Depreciation and | | | | | | |
| amortization | 12,760 | 15,581 | (18.1)% | 39,984 | 46,085 | (13.2)% |
| Other expense, net | (182) | (234) | 22.64 % | (664) | (1,650) | 59.8 % |

| | At June 30, 2010 | 2009 | % change |
|---|---------------------|--------|----------|
| End-of-period installed player terminal base: | | | |
| Oklahoma | 7,041 | 7,553 | (6.8)% |
| Mexico | 5,093 | 5,727 | (11.1)% |
| Alabama(1) | 559 | 2,280 | (75.5)% |
| Other | 1,089 | 1,641 | (33.6)% |
| Total participation units | 13,782 | 17,201 | (19.9)% |

(1) See Note 13 of the Notes to Condensed Consolidated Financial Statements. Some of the facilities of the Company's Alabama customers are currently closed, and if the facilities of the Company's Alabama customers continue to remain closed, or if additional facilities close, the resulting decrease in our revenue and EBITDA for the 2010 fiscal year, as well as additional write-down of assets currently dedicated to the Alabama market, may adversely impact our financial position and results of operations.

Three Months Ended June 30, 2010, Compared to Three Months Ended June 30, 2009

Total revenues for the three months ended June 30, 2010, were \$29.1 million, compared to \$32.1 million for the three months ended June 30, 2009, a \$3.0 million or 9.5% decrease.

Gaming Operations – Participation revenue

§ Oklahoma gaming revenues were \$15.8 million in the three months ended June 30, 2010, compared to \$17.6 million in the three months ended June 30, 2009, a decrease of \$1.8 million, or 10.0%. Oklahoma's end of period unit count as of June 30, 2010 was 7,041 compared to 7,553 as of June 30, 2009, a 512 unit or 6.8% decrease. This unit reduction was primarily caused by casinos that purchased or removed 239 units from their floor. To a lesser extent the revenue decrease can also be attributed to the continuing economic slowdown in the Oklahoma market.

§ Revenues from the Mexico bingo market were \$2.1 million in the three months ended June 30, 2010 and \$2.4 million during the same period of 2009, a decrease of \$314,000 or 13.2%. As of June 30, 2010, we had installed 5,093 player terminals at 29 bingo parlors in Mexico compared to 5,727 terminals installed at 28 bingo parlors at June 30, 2009. The reduction in the number of units relates to our strategic initiative to reduce our overall footprint in the facilities of our largest customer in Mexico and the beginning of a transition in the Mexico market from a Class II product to a Class III product. In addition, the decrease in revenue relates to a reduction in the win per unit in Mexico caused by an increase in competition into the major Mexican markets and can also be attributable to a national smoking policy change that has affected traffic into our customers' locations since the first quarter of Fiscal 2010.

§ Alabama gaming revenues decreased \$1.0 million, or 46.5%, to \$1.1 million for the three months ended June 30, 2010, compared to \$2.1 million for the three months ended June 30, 2009. The decrease in revenue relates to the previously disclosed matter that the Company no longer has units in operation at three of the four facilities in Alabama where the Company has historically placed its charitable bingo units. The fourth facility where the Company has historically placed units has been operating under the protection of a temporary restraining order. On July 30, 2010, however, the Supreme Court of Alabama issued a ruling reversing the trial court's entry of the temporary restraining order. Accordingly, this fourth facility will no longer be operating under the protection of a temporary restraining order. See Note 13 of the Notes to Condensed Consolidated Financial Statements.

§ Other gaming operations revenue relates to participation revenue from other states, including Washington, Wisconsin, Texas, New York, Minnesota, California and Rhode Island. Gaming revenue from these states combined was \$2.8 million in the three months ended June 30, 2010 compared to \$2.9 million during the same period of 2009, a 2.8%, decrease. The end of period unit count for these states decreased to 1,089 as of June 30, 2010 from 1,641 as of June 30, 2009. Other gaming operations revenue includes back office fees for system installations of \$1.3 million and \$838,000 for the three months ended June 30, 2010 and 2009, respectively.

Gaming Operations – Lottery

§ Revenues from the New York Lottery system increased \$13,000, or 1.0%, to \$2.0 million in the three months ended June 30, 2010, from \$2.0 million in the three months ended June 30, 2009. Currently, eight of the nine planned racetrack casinos are operating, with approximately 12,500 total terminals. The increase is attributable to increased activity within the New York Lottery system.

Gaming Equipment and System Sales –Player Terminal and Equipment Sales

§ Player terminal and equipment sales were \$3.8 million for the three months ended June 30, 2010, and \$2.6 million for the three months ended June 30, 2009, an increase of \$1.2 million or 45.5%. Player terminal sales for the three months ended June 30, 2010 were \$2.0 million on the sale of 128 new proprietary units, with no comparable sales for the three month period ended June 30, 2009. Gaming equipment sales were \$1.3 for the three month period ended June 30, 2010 compared to \$283,000 in the June 30, 2009 period. Generally, gaming equipment sales include ancillary equipment necessary for the full functionality of the player terminals in a casino. Player terminal and equipment sales also include \$288,000 and \$2.3 million related to deferred revenue recognized during the three month periods ended June 30, 2010 and 2009, respectively, due to contract amendments or final execution of deliverables.

Gaming Equipment and System Sales – Systems and Licensing

§ Systems and licensing sales revenue was \$1.1 million for the three months ended June 30, 2010, and \$1.2 million for the three months ended June 30, 2009. Systems and licensing revenue for the three months ended June 30, 2010 relates to \$163,000 of licenses associated with the player terminal sales during the period and \$880,000 of systems and game themes sold in prior periods being amortized to revenue from deferred revenue over the contract period. Systems and licensing revenue for the three months ended June 30, 2009 relates to \$350,000 of licenses associated with game changes, and \$812,000 of systems and game themes sold in prior periods being amortized to revenue from deferred revenue over the contract period.

Cost of Revenues

§ Total cost of revenues, which includes cost of gaming equipment and system sales and royalty fees, increased \$1.2 million, or 54.5%, to \$3.3 million in the three months ended June 30, 2010, from \$2.1 million in the three months ended June 30, 2009. Costs of sales related to player terminal sales were \$938,000 for the three months periods ended June 30, 2010, Royalty fees were \$765,000 and \$549,000 for the same periods. Cost of sales for the three months ended June 30, 2010 also includes \$935,000 of costs of prior period shipments being amortized from deferred revenue over the contract period and \$425,000 related to the sale of gaming equipment during the period. Cost of sales for the three months ended June 30, 2009 also includes \$1.5 million of costs of prior period shipments being amortized from deferred revenue over the contract period, and \$333,000 related to the sale of gaming equipment during the period.

Selling, General and Administrative Expenses

§ Selling, general and administrative expenses, or SG&A, decreased approximately \$623,000, or 4.1%, to \$14.7 million for the three months ended June 30, 2010, from \$15.3 million in the same period of 2009. This decrease was primarily a result of (i) a decrease in repair and maintenance of leased gaming equipment of \$422,000, (ii) decrease in bad debt of \$523,000, (iii) other taxes and license fees of \$328,000 offset by an increase of \$684,000 to salaries and wages.

Write-off, reserve, impairment and settlement charges

§ Write-off, reserve, impairment and settlement charges for the three month period ended June 30, 2010 were \$381,000 compared to \$299,000 for three month period ended June 30, 2009. The charges in the current period consisted of approximately \$381,000 of write offs for loan costs from the amendment of our credit facility.

§ On May 1, 2009, the Company entered into a comprehensive settlement agreement to resolve all claims arising from a November 2004 lawsuit. The Company incurred charges of \$299,000 for the three month period ended June 30, 2009 related to legal fees and settlement costs, net of insurance proceeds.

Amortization and Depreciation

§ Amortization expense decreased \$117,000, or 11.0%, to \$948,000 for the three months ended June 30, 2010, compared to \$1.1 million for the same period of 2009. Depreciation expense decreased \$2.7 million, or 18.6%, to \$11.8 million for the three months ended June 30, 2010 from \$14.5 million for the three month period ended June 30, 2009, primarily as a result of a reduction in capital expenditures and assets becoming fully depreciated.

Other Income and Expense

§ Interest income decreased \$326,000, or 28.2%, to \$830,000 for the three months ended June 30, 2010, from \$1.2 million in the same period of 2009. We entered into development agreements with a customer under which approximately \$41.7 million has been advanced and is outstanding at June 30, 2010, and for which we impute interest on these interest-free loans. For the three months ended June 30, 2010, we recorded imputed interest of \$778,000 relating to development agreements with an imputed interest rate range of 5.75% to 9.0%, compared to \$1.0 million for the same period in 2009. In addition, interest income of \$52,000 was accrued during the three month period ended June 30, 2010 on interest bearing notes.

§ Interest expense decreased \$378,000, or 27.2%, to \$1.0 million for the three months ended June 30, 2010, from \$1.4 million in the same period of 2009 due to a reduction in the outstanding debt balance.

Income Taxes

§ Income tax benefit increased by \$2.3 million to \$2.6 million for the three months ended June 30, 2010, from an income tax benefit of \$288,000 in the same period of 2009. These figures represent effective income tax rates of 116.0% and 19.9% for the three months ended June 30, 2010 and 2009, respectively. During the three month period ended June 30, 2010, we recorded benefit of \$3.7 million due to a change in method for calculating depreciation expense for tax purposes related to game licenses acquired from third party vendors and utilized in our rental pool. The Company claimed a cumulative adjustment for the method change under IRS guidelines and will prospectively utilize the new method for future game license purchases. The adjustment will be realized by the Company through a carryback to prior taxable income years. In addition, we recorded a benefit for a research and development credit study performed during the current period in the amount of \$474,000. These amounts were offset by a valuation allowance against our remaining deferred tax assets in the amount of \$1.6 million. As of June 30, 2010, the Company has fully reserved for all of its deferred tax assets as management has determined that it is more likely than not that the Company will not be able to realize the benefit of those assets.

Nine Months Ended June 30, 2010, Compared to Nine Months Ended June 30, 2009

Total revenues for the nine months ended June 30, 2010, were \$87.5 million, compared to \$94.6 million for the nine months ended June 30, 2009, a \$7.1 million or 7.5% decrease.

Gaming Operations – Participation revenue

§ Oklahoma gaming revenues were \$45.3 million in the nine months ended June 30, 2010, compared to \$52.4 million in the nine months ended June 30, 2009, a decrease of \$7.1 million or 13.5%. Oklahoma's end of period unit count as of June 30, 2010 was 7,041 compared to 7,553 as of March 31, 2009, a 512 unit or 6.8% decrease. This unit reduction was primarily caused by casinos that purchased or removed 599 units from their floor. To a lesser extent the revenue decrease can also be attributed to the continuing economic slowdown in the Oklahoma market.

§ Revenues from the Mexico bingo market were \$6.5 million in the nine months ended June 30, 2010 and \$7.4 million during the same period of 2009, a decrease of \$912,000 or 12.2%. As of June 30, 2010, we had installed 5,093 player terminals at 29 bingo parlors in Mexico compared to 5,727 terminals installed at 28 bingo parlors at June 30, 2009. The reduction in the number of units relates to our strategic initiative to reduce our overall footprint in the facilities of our largest customer and the beginning of a transition in the Mexico market from a Class II product to a Class III product. In addition, the decrease in revenue relates to a reduction in the win per unit in Mexico caused by an increased supply into the major Mexican markets and can also be attributable to a national smoking policy change that has affected traffic into our customers' locations during the period.

§ Alabama gaming revenues decreased \$3.4 million, or 45.8%, to \$4.0 million for the nine months ended June 30, 2010, compared to \$7.3 million for the nine months ended June 30, 2009. The decrease in revenue relates to the previously disclosed fact that the Company no longer has units in operation at three of the four facilities in Alabama where the Company has historically placed its charitable bingo units. The fourth facility where the Company has historically placed units has been operating under the protection of a temporary restraining order. On July 30, 2010, however, the Supreme Court of Alabama issued a ruling reversing the trial court's entry of the temporary restraining order. Accordingly, this fourth facility will no longer be operating under the protection of a temporary restraining order. See Note 13 of the Notes to Condensed Consolidated Financial Statements.

§ Other gaming operations revenue relates to participation revenue from other states, including Washington, Wisconsin, Texas, New York, Minnesota, California and Rhode Island. Gaming revenue from these states combined was \$8.2 million in the nine months ended June 30, 2010 compared to \$9.9 million during the same

period of 2009 a \$1.7 million, or 17.3%, decrease. The end of period unit count for these states decreased to 1,089 as of June 30, 2010 from 1,641 as of June 30, 2009. Other gaming operations revenue includes back office fees for system installations of \$3.2 million and \$2.4 million for the nine months ended June 30, 2010 and 2009, respectively.

Gaming Operations – Lottery

§ Revenues from the New York Lottery system increased \$218,000, or 4.0%, to \$5.7 million in the nine months ended June 30, 2010, from \$5.5 million in the six months ended June 30, 2009. Currently, eight of the nine planned racetrack casinos are operating, with approximately 12,500 total terminals. The increase is attributable to increased activity within the New York Lottery system.

Gaming Equipment and System Sales –Player Terminal and Equipment Sales

§ Player terminal and equipment sales were \$13.0 million for the nine months ended June 30, 2010, and \$8.6 million for the nine months ended June 30, 2009, an increase of \$4.4 million or 50.3%. Player terminal sales for the nine months ended June 30, 2010 were \$8.7 million on sales of 621 new proprietary units, compared to \$4.4 million on sales of third party units for the nine month period ended June 30, 2009. Gaming equipment sales were \$2.9 million and \$1.9 million for the nine month periods ended June 30, 2010 and 2009, respectively. Generally, gaming equipment sales include ancillary equipment necessary for the full functionality of the player terminals in a casino; however, in nine months ended June 30, 2010 and 2009 gaming equipment sales also included \$344,000 and \$160,000 of used equipment sales, respectively. Player terminal and equipment sales also include \$1.1 million and \$2.3 million related to deferred revenue recognized during the nine months period ended June 30, 2010 and 2009, respectively, due to contract amendments or final execution of deliverables.

Gaming Equipment and System Sales – Systems and Licensing

§ Systems and licensing sales revenue was \$3.4 million for the nine months ended June 30, 2010, and \$1.3 million for the nine months ended June 30, 2009. Systems and licensing revenue for the nine months ended June 30, 2010 relates to: (i) a system sale of \$1.0 million; (ii) \$724,000 of licenses associated with the player terminal sales during the period; (iii) \$1.3 million of systems and game themes sold in prior periods being amortized to revenue from deferred revenue over the contract period. Systems and licensing revenue for the nine months ended June 30, 2009 relates to: (i) \$812,000 of systems and game themes sold in prior periods being amortized to revenue from deferred revenue over the contract period; (ii) \$250,000 from the sale of third party units; and (iii) \$115,000 from game changes.

Cost of Revenues

§ Total cost of revenues, which includes cost of gaming equipment and system sales and royalty fees, increased \$2.8 million, to \$9.1 million in the nine months ended June 30, 2010, from \$6.3 million in the nine months ended June 30, 2009. Costs of sales related to player terminal sales were \$4.8 million and \$2.2 million for the nine months periods ended June 30, 2010 and 2009, respectively, and royalty fees were \$1.6 million and \$1.6 million for the same periods. Cost of sales for the nine months ended June 30, 2010 also includes \$1.4 million of costs from deferred revenue related to prior period shipments recognized during the period, and \$937,000 related to the sale of gaming equipment during the period. Cost of sales for the nine months ended June 30, 2009 also includes: (i) \$1.5 million of costs from deferred revenue related to prior period shipments recognized during the period; (ii) \$2.2 million from the sale of third part units; and (iii) \$1.1 million related to the sale of gaming equipment during the period.

Selling, General and Administrative Expenses

§ Selling, general and administrative expenses, or SG&A, decreased approximately \$2.6 million, or 5.6.%, to \$43.5 million for the nine months ended June 30, 2010, from \$46.1 million in the same period of 2009. This decrease was primarily a result of (i) a decrease in repairs and maintenance expenses of \$1.8 million, (ii) decrease in consulting and contract labor of \$764,000 and (iii) decrease in accounting fees of \$575,000.

Write-off, reserve, impairment and settlement charges

§ Write-off, reserve, impairment and settlement charges for the nine month period ended June 30, 2010 were \$3.9 million compared to \$10.3 million for nine month period ended June 30, 2009. The charges in the current period consisted of approximately \$381,000 of write offs for loan costs from the amendment of our credit facility along

with charges of approximately \$3.1 million of reserves and impairment charges for a note receivable and installation and other costs within the state of Alabama. In addition to the charges related to the Alabama market, during the nine month period ended June 30, 2010 as part of the Company's routine asset analysis, charges of \$421,000 were incurred, including the write-off of facility install costs, components, licenses, capitalized software and reserves for bad debts.

§ On May 1, 2009, the Company entered into a comprehensive settlement agreement to resolve all claims arising from a November 2004 lawsuit. The Company incurred charges of \$8.2 million nine month period ended June 30, 2009 related to legal fees and settlement costs, net of insurance proceeds. In addition, during the three and nine month period ended June 30, 2009 as part of the Company's routine asset analysis, charges of \$987,000 were incurred, including the write-off of facility install costs, components, licenses, patents, capitalized software and reserves for bad debts; and \$1.1 million for severance and other benefits.

Amortization and Depreciation

§ Amortization expense decreased \$1.2 million, or 32.1%, to \$2.6 million for the nine months ended June 30, 2010, compared to \$3.8 million for the same period of 2009. Depreciation expense decreased \$4.9 million, or 11.6%, to \$37.4 million for the six months ended June 30, 2010 from \$42.3 million for the nine month period ended June 30, 2009, primarily as a result of a reduction in capital expenditures and assets becoming fully depreciated.

Other Income and Expense

§ Interest income decreased \$894,000, or 24.2%, to \$2.8 million for the nine months ended June 30, 2010, from \$3.7 million in the same period of 2009. We entered into development agreements with a customer under which approximately \$41.7 million has been advanced without interest and is outstanding at June 30, 2010, and for which we impute interest on these interest-free loans. For the nine months ended June 30, 2010, we recorded imputed interest of \$2.5 million relating to development agreements with an imputed interest rate range of 5.75% to 9.0%, compared to \$3.3 million for the same period in 2009. In addition, interest income of \$270,000 was accrued during the nine month period ended June 30, 2010 on interest bearing notes.

§ Interest expense decreased \$1.9 million, or 36.1%, to \$3.5 million for the nine months ended June 30, 2010, from \$5.4 million in the same period of 2009 due to a reduction in the outstanding debt balance.

§ We had no other income for the nine months ended June 30, 2010, compared to \$74,000 in the same period of 2009. Other income primarily decreased due to the last distribution from a partnership interest.

Income Taxes

§ Income tax benefit decreased by \$5.0 million to \$331,000 for the nine months ended June 30, 2010, from an income tax benefit of \$5.4 million in the same period of 2009. These figures represent effective income tax rates of 3.4% and 33.8% for the nine months ended June 30, 2010 and 2009, respectively. During the nine month period ended June 30, 2010, we recorded a valuation allowance against our remaining deferred tax assets in the amount of \$4.1 million. The full valuation allowance on our deferred tax assets is the result of changes in our forecast, based on events described above, for the remainder of the 2010 fiscal year and the determination that it is more likely than not that we will not be able to realize the benefit of those assets.

RECENT ACCOUNTING PRONOUNCEMENTS

We monitor new, generally accepted accounting principles and disclosure reporting requirements issued by the Securities and Exchange Commission, or SEC, and other standard setting agencies. Recently issued accounting standards affecting our financial results are described in Note 1 of our unaudited condensed consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based on the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the periods presented. There can be no assurance that actual results will not differ from those estimates. We believe the following represent our most critical accounting policies.

Management considers an accounting estimate to be critical if:

- § It requires assumptions to be made that were uncertain at the time the estimate was made (Critical Assumption #1),
and
- § Changes in the estimate or different estimates that could have been selected could have a material impact on our consolidated results of operation or financial condition (Critical Assumption #2).

Revenue Recognition. As further discussed in the discussion of our Revenue Recognition policy in Note 1 of our condensed consolidated financial statements, revenue from the sale of software is accounted for under ASC Topic 985, "Software". If Vendor-Specific Objective Evidence, or VSOE, of fair value does not exist, the revenue is deferred until such time that all elements have been delivered or services have been performed. If any element is determined to be essential to the function of the other, revenues are generally recognized over the term of the services that are rendered. In those limited situations where VSOE does not exist for any undelivered elements of a multiple element arrangement, then the aggregate value of the arrangement, including the value of products and services delivered or performed, is initially deferred until all hardware and software is delivered, and then is recognized ratably over the period of the last deliverable, generally the service period of the contract. Depending upon the elements and the terms of the arrangement, we recognize certain revenues under the residual method. Under the residual method, revenue is recognized when VSOE of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. Under the residual method, we defer the fair value of undelivered elements, and the remainder of the arrangement fee is then allocated to the delivered elements and is recognized as revenue, assuming the other revenue recognition criteria are met.

Assumptions/Approach Used: The determination whether all elements of sale have VSOE is a subjective measure, where we have made determinations about our ability to price certain aspects of transactions.

Effect if Different Assumptions Used: When we have determined that VSOE does not exist for any undelivered elements of an arrangement, then the aggregate value of the arrangement, including the value of products and services delivered or performed, is initially deferred until all hardware and software is delivered, and then is recognized ratably over the period of the last deliverable, generally the service period of the contract. The deferral of revenue under arrangements where we have determined that VSOE does not exist has resulted in \$4.9 million being recorded as deferred revenue at June 30, 2010. If we had made alternative assessments as to the existence of VSOE in these arrangements, some or all of these amounts could have been recognized as revenue prior to June 30, 2010.

Share-Based Compensation Expense. We recognize compensation expense for all share-based payments granted after October 1, 2005 and prior to but not yet vested as of October 1, 2005, in accordance with ASC Topic 718, "Compensation-Stock Compensation" and ASC Subtopic 505-50, "Equity-Based Payments to Non-Employees". Under the fair value recognition provisions of ASC Topic 718 and Subtopic 505-50, we recognize share-based compensation net of an estimated forfeiture rate, and only recognize compensation cost for those shares expected to vest on a straight-line basis over the service period of the award.

Assumptions/Approach Used: Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the input of highly subjective assumptions, including the expected life of the share-based payment awards, and stock price volatility. Management determined that volatility is based on historical volatility trends. In addition, we are required to estimate the expected forfeiture rate, and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be significantly different from what we have recorded in the current period.

Effect if Different Assumptions Used: The assumptions used in calculating the fair value of share-based payment awards, along with the forfeiture rate estimation, represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future.

Property and Equipment and Leased Gaming Equipment. Property and equipment and leased gaming equipment is stated at cost. The cost of property and equipment and leased gaming equipment is depreciated over their estimated useful lives, generally using the straight-line method for financial reporting, and regulatory acceptable methods for tax reporting purposes. Player terminals and related components and equipment are included in the Company's rental

pool. The rental pool can be further delineated as “rental pool – deployed”, which consists of assets deployed at customer sites under participation agreements, and “rental pool – undeployed”, which consists of assets with the Company that are available for customer use. Rental pool – undeployed consists of both new units awaiting deployment to a customer site and previously deployed units currently back with the Company to be refurbished awaiting re-deployment. Routine maintenance of property and equipment and leased gaming equipment is expensed in the period incurred, while major component upgrades are capitalized and depreciated over the estimated useful life (Critical Assumption #1) of the component. Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains or losses on sales and retirements of property are reflected in our results of operations.

Management reviews long-lived asset classes for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For impairment analysis purposes, the Company's rental pool is viewed as a fungible pool of assets; including assets in both rental pool-deployed and rental pool-undeployed. In order to determine whether these assets are impaired, the net book value of the rental pool is compared to an estimate of future net cash flows from all existing facilities. The primary assumption used in determining future cash flows is our estimate of future revenue. In addition, the Company analyzes the composition of its rental pool to determine the future use of older models and related components for those models. The impairment analysis for the fiscal year ended September 30, 2009 indicated that we had substantial cash flows to fully recover the carrying value of the entire rental pool. As of June 30, 2010 and September 30, 2009, the balance sheet consisted of \$53.0 million and \$65.4 million, respectively, of rental pool assets. (Critical Assumption #2)

Assumptions/Approach used for Critical Assumption #1: The carrying value of the asset is determined based upon management's assumptions as to the useful life of the asset, where the assets are depreciated over the estimated life on a straight line basis, where the useful life of items in the rental pool has been determined by management to be three years.

Effect if different assumptions used for Critical Assumption #1: While we believe that the useful lives that have been determined for our fixed assets are reasonable, different assumptions could materially affect the carrying value of the assets, as well as the depreciation expense recorded in each respective period related to those assets. During the nine month period ended June 30, 2010, a significant portion of the \$40.0 million of depreciation and amortization expense related to assets in the rental pool. If the depreciable life of assets in our rental pool were changed from three years to another period of time, we could incur a materially different amount of depreciation expense during the period.

Assumptions/Approach used for Critical Assumption #2: Recoverability of assets to be held and used is measured through considerations of the future undiscounted cash flows expected to be generated by the assets as a group, as opposed to analysis by individual asset. We also reviewed the future undiscounted cash flows of assets in place at specific locations for further analysis. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs of disposal. The carrying value of the asset is determined based upon management's assumptions as to the useful life of the asset, where the assets are depreciated over the estimated life on a straight-line basis.

Effect if different assumptions used for Critical Assumption #2: Impairment testing requires judgment, including estimations of useful lives of the assets, estimated cash flows, and determinations of fair value. While we believe our estimates of useful lives and cash flows are reasonable, different assumptions could materially affect the measurement of useful lives, recoverability and fair value. If actual cash flows fall below initial forecasts, we may need to record additional amortization and/or impairment charges. Additionally, while we believe that analysis of the recoverability of assets in our rental pool is accurately assessed from a homogenous level due to the interchangeability of player stations and parts, if these assets were to be reviewed for impairment using another approach, there could be different outcomes to any impairment analysis performed.

Development Agreements. We enter into development agreements to provide financing for new gaming facilities or for the expansion of existing facilities. In return, the facility dedicates a percentage of its floor space to exclusive placement of our player terminals, and we receive a fixed percentage of those player terminals' hold per day over the term of the agreement. Certain of the agreements contain player terminal performance standards that could allow the facility to reduce a portion of our guaranteed floor space. In addition, certain development agreements allow the facilities to buy out floor space after advances that are subject to repayment have been repaid. The agreements typically provide for a portion of the amounts retained by the gaming facility for their share of the hold to be used to repay some or all of the advances recorded as notes receivable. Amounts advanced in excess of those to be reimbursed

by the customer for real property and land improvements are allocated to intangible assets and are generally amortized over the life of the contract, using the straight-line method of amortization (Critical Assumption #1), which is recorded as a reduction of revenue generated from the gaming facility. In the past and in the future, we may by mutual agreement and for consideration, amend these contracts to reduce our floor space at the facilities. Any proceeds received for the reduction of floor space is first applied against the intangible asset for that particular development agreement, if any.

Management reviews intangible assets related to development agreements for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable (Critical Assumption #2). For the nine month period ended June 30, 2010, there was no impairment to the assets' carrying values.

Assumptions/Approach used for Critical Assumption #1: Amounts advanced in excess of those to be reimbursed by the customer for real property and land improvements are allocated to intangible assets and are generally amortized over the life of the contract, using the straight-line method of amortization, which is recorded as a reduction of revenue generated from the gaming facility. We use a straight-line amortization method, as a pattern of future benefits cannot be readily determined.

Effect if Different Assumptions used for Critical Assumption #1: While we believe that the use of the straight-line method of amortization is the best way to account for the costs associated with the costs of acquiring exclusive floor space rights at our customers facilities, the use of an alternative method could have a material effect on the amount recorded as a reduction to revenue in the current reporting period.

Assumptions/Approach used for Critical Assumption #2: We estimate cash flows directly associated with the used of the intangible assets to test recoverability and remaining useful lives based upon the forecasted utilization of the asset and expected product revenues. In developing estimated cash flows, we incorporate assumptions regarding future performance, including estimations of hold per day and estimated units. When the carrying amount exceeds the undiscounted cash flows expected to result from the use and eventual disposition of the asset, we then compare the carrying amount to its current fair value. We recognize an impairment loss if the carrying amount is not recoverable and exceeds its fair value.

Effect if Different Assumptions used for Critical Assumption #2: Impairment testing requires judgment, including estimations of cash flows, and determinations of fair value. While we believe our estimates of future revenues and cash flows are reasonable, different assumptions could materially affect the measurement of useful lives, recoverability and fair value. If actual cash flows fall below initial forecasts, we may need to record additional amortization and/or impairment charges.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts related to our accounts receivable and notes receivable that have been deemed to have a high risk of uncollectibility. Management reviews its accounts receivable and notes receivable on a monthly basis to determine if any receivables will potentially be uncollectible. Management analyzes historical collection trends and changes in its customer payment patterns, customer concentration, and creditworthiness when evaluating the adequacy of its allowance for doubtful accounts. In our overall allowance for doubtful accounts, we include any receivable balances where uncertainty exists as to whether the account balance has become uncollectible. Based on the information available, management believes the allowance for doubtful accounts is adequate; however, actual write-offs may vary from the recorded allowance.

Income Taxes. In accordance with ASC Topic 740, "Income Taxes", we have recorded deferred tax assets and liabilities to account for the expected future tax benefits and consequences of events that have been recognized in our financial statements and our tax returns. There are several items that result in deferred tax asset and liability impact to the balance sheet. If we conclude that it is more likely than not that some portion or all of the deferred tax assets will not be realized under accounting standards, it is reduced by a valuation allowance to remove the benefit of recovering those deferred tax assets from our financial statements. Additionally, in accordance with ASC Topic 740, as of June 30, 2010, we have recorded a liability of \$263,000 associated with uncertain tax positions. ASC Topic 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We are required to determine whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position in order to record any financial statement benefit. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

Assumptions/Approach Used: Numerous judgments and assumptions are inherent in the determination of future taxable income and tax return filing positions that we take, including factors such as future operating conditions. As of September 30, 2009, management evaluated its ability to utilize the full extent of its deferred tax assets and noted that as of September 30, 2008, the Company had historically reflected a strong earnings history, and had reported cumulative book income for the three years ending September 30, 2008. However, as of September 30, 2009, the Company's earnings had deteriorated, and given the large loss experienced, the Company had reported three years of

cumulative book losses. Furthermore, management's 2010 financial forecast indicated that the Company expected to be near breakeven, and due to uncertainties in the overall economy and the gaming industry specifically, felt that we would not be able to rely, with a sufficient level of certainty, on projections beyond the coming fiscal year.

Effect if Different Assumptions Used: Management, along with consultation from an independent public accounting firm used in tax consultation, continually evaluate complicated tax law requirements and their effect on our current and future tax liability and our tax filing positions. Despite our attempt to make an accurate estimate, the ultimate utilization of our gross deferred tax assets of \$28.2 million, primarily associated with the tax basis of our leased gaming equipment and property and equipment is largely dependent upon our ability to generate taxable income in the future or carryback losses to prior years with taxable income. Our liability for uncertain tax positions is dependent upon our judgment on the amount of financial statement benefit that an uncertain tax position will realize upon ultimate settlement and on the probabilities of the outcomes that could be realized upon ultimate settlement of an uncertain tax position using the facts, circumstances and information available at the reporting date to establish the appropriate amount of financial statement benefit. To the extent that a valuation allowance or liability for uncertain tax position is established or increased or decreased during a period, we may be required to include an expense or benefit within income tax expense in the income statement. As of September 30, 2009, management determined that it was not more likely than not that the Company would realize the full benefits associated with its gross deferred tax assets. Therefore, a valuation allowance has been recorded on our deferred tax assets to the full extent that those balances as of June 30, 2010. This reserve was determined due to the uncertainty as to our ability to realize the full extent of these tax differences in future periods.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2010, we had \$30.8 million in unrestricted cash and cash equivalents, compared to \$12.5 million as of September 30, 2009. Our working capital as of June 30, 2010, was \$39.1 million, compared to a working capital of \$28.7 million at September 30, 2009. The increase in working capital was primarily the result an increase in cash collections from notes receivable and a slight decrease in accounts payable and accrued expenses. During the nine month period ended June 30, 2010, we used \$23.9 million for capital expenditures of property and equipment compared to \$36.3 million for the nine month period ended June 30, 2009. We collected \$13.2 million and \$15.8 million on development agreements during the nine month periods ended June 30, 2010 and 2009, respectively. In addition, we have \$59.8 million outstanding and \$30 million available for future borrowings under our Credit Agreement, as amended, subject to covenant restrictions (see the discussion of our Credit Agreement in Note 9 and below).

As of June 30, 2010, our total contractual cash obligations were as follows (in thousands):

| | Payments Due by period | | | | Total |
|------------------------------|------------------------|-----------------|----------------|----------------------|-----------------|
| | Less than 1 year | 1-3 years | 3-5 years | More than 5 years | |
| Revolving Credit Facility(1) | \$— | \$15,000 | \$— | \$— | \$15,000 |
| Credit Facility Term Loan(2) | 750 | 44,063 | — | — | 44,813 |
| Operating leases(3) | 1,505 | 1,989 | 2,150 | 393 | 6,037 |
| Purchase commitments | 6,674 | — | — | — | 6,674 |
| Total | \$8,929 | \$61,052 | \$2,150 | \$393 | \$72,524 |

(1) Relating to the revolving credit commitment under the Credit Agreement, bearing interest at the Eurodollar rate plus the applicable spread (5.25% as of June 30, 2010).

(2) Consists of amounts borrowed under the term loan to our Credit Agreement at the Eurodollar rate plus the applicable spread (6.5% as of June 30, 2010).

(3) Consists of operating leases for our facilities and office equipment.

During the nine month period ended June 30, 2010, we generated \$49.2 million in cash from our operations, compared to \$36.2 million during the same period of 2009. This \$13.0 million increase in cash generated from operations over the prior period was primarily due to collections on accounts receivable, reductions in inventories and prepaids; offset by a decrease in accounts payable.

Cash used in investing activities decreased \$13.4 million to \$16.4 million in the nine month period ended June 30, 2010, from \$29.8 million in the three month period ended June 30, 2009. The decrease was primarily the result of an decrease in net capital expenditures (acquisition of property and equipment and leased gaming equipment less transfer of leased gaming equipment to inventory) of \$12.4 million, offset by a decrease in repayments under development agreements of \$2.6 million and an increase in advances under development agreements of \$4.0 million. Net additions to property and equipment and leased gaming equipment consisted of the following:

| | Nine month periods ended June 30, | |
|---|-----------------------------------|----------|
| | 2010 | 2009 |
| | (In thousands) | |
| Gaming equipment | \$23,368 | \$30,351 |
| Third-party gaming content licenses | 4,763 | 6,723 |
| Other | 390 | 44 |
| Acquisition of property and equipment and leased gaming equipment | 28,521 | 37,118 |
| Transfer of leased gaming equipment to inventory | (4,573) | (846) |
| Total | \$23,948 | \$36,272 |

Cash from financing activities increased by \$10.7 million to a \$14.2 million usage in the nine month period ended June 30, 2010, from \$3.5 million used in financing activities in the same period of 2009. The increase was primarily the result of the paydown of the Credit Agreement by \$15.2 million during the current period in comparison to the \$3.9 million, net of repayments, borrowed during the same period in 2009.

Our capital expenditures for the next 12 months will depend upon the number of new player terminals that we are able to place into service at new or existing facilities and the actual number of repairs and equipment upgrades to the player terminals that are currently in the field. We will continue to offer games developed by us, as well as games from third parties in an attempt to optimize the balance between Oklahoma compact games (Class III) and our Class II product.

Credit Agreement

See discussion of the Credit Agreement and our credit facility in Note 9 – Credit Agreement, Long-Term Debt and Capital Leases.

The Credit Agreement provides us with the ability to finance development agreements and acquisitions and working capital for general corporate purposes. Advances under the revolving credit commitment and the term loan mature on April 27, 2012, and bear interest at the Eurodollar rate plus the applicable spread, tied to various levels of interest pricing determined by total debt to Adjusted EBITDA.

We are currently in compliance with the covenants in our Credit Agreement, as recently amended; however, we cannot be certain that we will be able to achieve our operating objectives for fiscal 2010 and that we will continue to meet our covenants in the Credit Agreement.

If we fail to remain in compliance with the covenants of our Credit Agreement, we will be required to seek modification or waiver of the provisions of that agreement and potentially secure additional sources of capital. We cannot be certain that, if required, we will be able to successfully negotiate additional changes to or waivers of the Credit Agreement. Alternatively, we may incur significant costs related to obtaining requisite waivers or renegotiation of the Credit Agreement that could have a material and adverse effect on our operating results.

Our performance and financial results are, to a certain extent, subject to (i) general conditions in or affecting the Native American gaming industry, and (ii) general economic, political, financial, competitive and regulatory factors beyond our control. If our business does not continue to generate cash flow at appropriate levels or if we receive a material judgment against us in a lawsuit (See “Risk Factors – “Litigation may adversely affect our business, financial condition and results of operations,” and “Part I – Item 1. Condensed Consolidated Financial Statements – Note 13 – Commitments and Contingencies”), we may need to raise additional financing. Sources of additional financing might include additional bank debt or the public or private sale of equity or debt securities. However, sufficient funds may not be available, on terms acceptable to us or at all, from these sources, or any others, to enable us to make necessary capital expenditures and to make discretionary investments in the future. See Item 1A.Risk Factors – “Our Credit Agreement contains covenants that limit our ability to finance future operations or capital needs and to engage in other business activities.”

Stock-Based Compensation

At June 30, 2010, we had approximately 5.5 million options outstanding, with exercise prices ranging from \$1.61 to \$18.71 per share. At June 30, 2010, approximately 3.7 million of the outstanding options were exercisable.

During the three months ended June 30, 2010, options to purchase 7,600 shares of common stock were granted at a weighted average exercise price of \$4.50 per share, and we issued 15,925 shares of common stock as a result of stock option exercises with a weighted average exercise price of \$2.91.

At June 30, 2009, we had approximately 6.8 million options outstanding, with exercise prices ranging from \$1.00 to \$18.71 per share. At June 30, 2009, approximately 3.8 million of the outstanding options were exercisable.

During the three months ended June 30, 2009, options to purchase 41,400 shares of common stock were granted at a weighted average exercise price of \$3.49 per share, and we issued 217,062 shares of common stock as a result of stock option exercises with a weighted average exercise price of \$1.41.

SEASONALITY

We believe our operations are not materially affected by seasonal factors, although we have experienced fluctuations in our revenues from period to period.

CONTINGENCIES

For information regarding contingencies, see “Item 1. Condensed Financial Statements – Note 13 - Commitments and Contingencies” and “PART II – Item 1. Legal Proceedings.”

INFLATION AND OTHER COST FACTORS

Our operations have not been nor are they expected to be materially affected by inflation. However, our domestic and international operational expansion is affected by the cost of hardware components, which are not considered to be inflation sensitive, but rather, sensitive to changes in technology and competition in the hardware markets. In addition, we expect to continue to incur increased legal and other similar costs associated with regulatory compliance requirements and the uncertainties present in the operating environment in which we conduct our business.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the ordinary course of business, primarily associated with interest rate fluctuations.

Our Credit Agreement provides us with additional liquidity to meet our short-term financing needs, as further described under “Item 1. Condensed Financial Statements - Note 9 – Credit Agreement, Long-Term Debt and Capital Leases.” Pursuant to the Credit Agreement, as amended, we may currently borrow up to a total of \$90 million, of which \$59.8 is outstanding and \$30 million is available for future borrowings, subject to covenant restrictions.

Pursuant to the development agreements we enter into with many of our customers, we are required to advance funds for the construction and development of gaming facilities, some of which are required to be repaid. As a result of our adjustable-interest-rate notes payable and fixed-interest-rate-notes receivable described in “Item 1. Condensed Financial Statements – Note 6 – Notes Receivable and Note 9 – Credit Agreement, Long-Term Debt and Capital Leases,” we are subject to market risk with respect to interest rate fluctuations. Any material increase in prevailing interest rates could cause us to incur significantly higher interest expense.

The Credit Agreement also requires that we enter into hedging arrangements covering at least \$50.0 million of the term loan for a three-year period. On May 29, 2008, we purchased, for \$390,000, an interest rate cap (5% cap rate) covering \$50.0 million of the term loan. To the extent that LIBOR rates do not exceed the 5% cap rate, we estimate that a hypothetical increase of 100 basis points in interest rates would increase our annual interest expense by approximately \$599,000, based on our variable debt outstanding of \$59.8 million as of June 30, 2010.

We account for currency translation from our Mexico operations in accordance with ASC Topic 830, “Foreign Currency Matters.” Balance sheet accounts are translated at the exchange rate in effect at each balance sheet date. Income statement accounts are translated at the average rate of exchange prevailing during the period. Translation adjustments resulting from this process are charged or credited to other comprehensive income. We do not currently manage this exposure with derivative financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Control and Procedures. As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of management’s disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) to ensure information required to be disclosed in our filings under the Securities Exchange Act of 1934, is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms; and (ii) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving desired control objectives, and management is necessarily required to apply its judgment when evaluating the cost-benefit relationship of potential controls and procedures. Based upon the evaluation, the Chief Executive Officer and our Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as of June 30, 2010.

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting identified in management's evaluation during the third quarter of fiscal 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is a party to various material legal proceedings, which are described in Note 13 – Commitments and Contingencies, and incorporated by reference into this item and in the Company’s Annual Report on Form 10-K filed for the year ended September 30, 2009 under the caption “Item 3. Legal Proceedings.” We are subject to litigation from time to time in the ordinary course of our business, as well as litigation to which we are not a party that may establish laws that affect our business. Except as discussed in Note 13 of the Notes to Consolidated Condensed Financial Statements included herein, which is incorporated by reference into this item, during the three month period covered by this Quarterly Report on Form 10-Q, the Company has not been named in any new material legal proceeding, and there have been no material developments in the previously reported legal proceedings.

ITEM 1A. RISK FACTORS

Investing in our common stock involves risks. Prospective investors in our common stock should carefully consider, among other things, the following risk factors in connection with the other information and financial statements contained in this Annual Report, including “PART I – Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” prior to making an investment decision. We have identified the following important factors that could cause actual results to differ materially from those projected in any forward looking statements we may make from time to time. We operate in a continually changing business environment in which new risk factors emerge from time to time. We can neither predict these new risk factors, nor can we assess the impact, if any, of these new risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward looking statement. If any of these risks, or combination of risks, actually occur, our business, financial condition and results of operations could be seriously and materially harmed, and the trading price of our common stock could decline.

Our efforts to explore strategic transactions may not result in any definitive transaction or enhance shareholder value, and may create a distraction for our management and uncertainty that may adversely affect our operating results and business.

As previously announced on March 15, 2010, the Board has commenced a process to evaluate the Company’s strategic alternatives to enhance shareholder value and has established a Special Committee to manage that process. No timetable has been set for completion of this evaluation process, and there can be no assurance that any transaction will result. The Board has engaged Deutsche Bank to provide financial advice and assist the Board with its evaluation process. There are various uncertainties and risks relating to our evaluation and negotiation of possible strategic transactions and our ability to consummate a definitive transaction, including:

§ expected benefits may not be successfully achieved;

§ decisions made by the Special Committee and the Board may not have to be approved by our shareholders;

§ evaluation and negotiation of a proposed transaction may distract management from focusing its time and resources on execution of our 2010 operating plan, which could have a material adverse effect on our operating results and business;

§ the current market price of our common stock may reflect a market assumption that a transaction will occur, and a failure to complete the transaction could result in a negative perception by investors in the Company generally and

could cause a decline in the market price of our common stock, which could adversely affect our ability to access the equity and financial markets, as well as our ability to explore and enter into different strategic alternatives;

§ the process of evaluating the proposed transaction may be time consuming and expensive and may result in the loss of business opportunities;

§ perceived uncertainties as to our future direction may result in increased difficulties in retaining key employees and recruiting new employees, particularly senior management;

§ perceived uncertainties as to our future may cause business partners to terminate, or not to renew or enter into, arrangements with us; and

§ even if the Board of Directors of the Company negotiates a definitive agreement, we may be unable to complete the transaction due to the failure to obtain shareholder approval, failure to receive regulatory approval, failure to obtain customer consent, failure to satisfy other conditions to consummate the transaction, or we may be subject to litigation regarding the strategic review process or the transaction.

In addition, the market price of our common stock could be highly volatile during the period in which we are evaluating and negotiating a transaction, and may continue to be more volatile if we announce that we are no longer pursuing a proposed transaction.

We are largely dependent upon one customer and most of our customers are based in Oklahoma.

For the nine month periods ended June 30, 2010 and 2009, approximately 58% and 65%, respectively, of our total revenues were from Native American tribes located in Oklahoma, and approximately 44% and 43%, respectively, of our gaming revenues were from one tribe in that state. The significant concentration of our customers in Oklahoma means that local economic, regulatory and licensing changes may adversely affect our customers, and therefore our development agreements and our business, disproportionately to changes in national economic conditions, including adverse economic declines or slower economic recovery from prior declines. While we continue to seek to diversify the markets in which we operate, the loss of any of our Oklahoma tribes as customers, including our largest customer, would have a material and adverse effect upon our financial condition and results of operations. In addition, the legislation allowing tribal-state compacts in Oklahoma has resulted in increased competition from other vendors, who we believe previously avoided entry into the Oklahoma market due to its uncertain and ambiguous legal environment. The State of Oklahoma permits other types of gaming, both at Native American tribal gaming facilities and at Oklahoma racetracks, and many of our competitors may seek entry into this market. The loss of significant market share to these new gaming opportunities or the increased presence of our competitors' products in Oklahoma could also have a material adverse effect upon our financial condition and results of operations. We believe that the introduction of our competitor's more aggressive Class II machines, with characteristics of traditional slot machines, into the Oklahoma Class II market has adversely affected our operating results and market position in that state and may continue to do so in the future.

Our exclusive distribution agreements with third party manufacturers are expiring which may impact product performance and overall revenue.

Our exclusive right, granted to us by WMS Industries, Inc., or WMS, to be the third party provider of WMS products to the Chickasaw Nation expired on June 30, 2010. We plan to continue purchasing equipment in order to maintain our footprint of WMS product while concurrently continuing our strategy of transitioning away from a reliance on third party product. Additionally we have the right to distribute products from Aristocrat Technologies, Inc., or Aristocrat, per an agreement with Aristocrat which is set to expire on December 31, 2010. Though we do not presently expect a loss of exclusivity to significantly affect the product portfolio we offer our customers, the loss of exclusivity increases the likelihood that these manufacturers could place product directly or through other distributors on our customer's floor. Our loss of exclusivity could have the effect of diluting our win per unit, thus negatively impacting our revenue.

As of June 30, 2010, we had approximately 2,476 WMS Class III units in operation at the Chickasaw properties, and 3,534 units in the aggregate at all our properties, which, in the aggregate, accounts for approximately 37% for the three months ended June 30, 2010 and 33% for the nine months ended June 30, 2010. In addition we had approximately 1,577 Aristocrat units in operation in the aggregate, which accounts for approximately 10% for the three months ended June 30, 2010 and 12% for the nine months ended June 30, 2010.

Our charitable bingo operations in Alabama are subject to legal uncertainty.

The Alabama Supreme Court, in the November 13, 2009 decision related to the White Hall Gaming Center, referred to herein as the White Hall decision, established a definition of “bingo” that included a limited set of standards for charity bingo games in Alabama. We believe that our modified games comply with the standards established by the Alabama Supreme Court decision and have received certifications and/or formal written opinions from independent gaming laboratories verifying to us that each game, as modified, is compliant with the applicable Alabama standards. Notwithstanding our initiatives to have our games comply with the specified standards, there can be no assurance that we will not encounter further legal, inclusive of civil action, regulatory, financial, or competitive issues related to this matter. We cannot be certain that operators, law enforcement officials or regulatory bodies in Alabama will decide that our games, as reintroduced to the Alabama market, are in compliance with the standard set forth by the Alabama Supreme Court or that a court will not later determine that the modified equipment does not comply with the standards set forth in the White Hall decision or other applicable laws. Furthermore, unfavorable changes in laws, regulatory requirements or unanticipated enforcement action against us, our games or customers, and/or adverse decisions by courts, regulators and/or governmental bodies in Alabama could have a material adverse effect on our Alabama clients’ businesses, and, ultimately, a material adverse impact on our results of operations and financial condition, including our revenue and any money lent pursuant to our development agreements in the State may not be adequately repaid.

The legality of charitable bingo gaming in Alabama is under challenge by the state's Governor. Legislation to put the legality question to a public referendum in Alabama failed to pass the legislative session. Many charitable bingo properties voluntarily ceased operations pending resolution of the matter as enforcement actions against operators is a continued threat. It therefore remains a possibility that certain of our charity bingo equipment located in Alabama could be seized and made subject to a forfeiture proceeding. In addition, legal and regulatory uncertainty in Alabama has introduced new competitive issues as other equipment manufacturers take different approaches to compliance which may prove more popular with our customers than the approaches we've taken. If our reintroduced machines are not as popular with customers as those of our competitors, our market share and operating results in Alabama could suffer.

Some of the facilities of our Alabama customers are currently closed and if the facilities continue to remain closed, the resulting decrease in our revenue and EBITDA for the 2010 fiscal year, as well as additional write-down of assets currently dedicated to the Alabama market, may adversely impact our financial position and results of operations. As previously disclosed, in April 2010, one of the Alabama facilities where we have historically placed games indicated that under current conditions it will remain closed and consequently has substantial doubts as to its ability, in the short term, to make scheduled payments pursuant to the terms of the development agreement. These developments led us to conclude that the closures of this and certain other Alabama customer facilities are likely to be other than temporary. One of the facilities where we have historically placed units has been operating under the protection of a temporary restraining order. On July 30, 2010, however, the Supreme Court of Alabama issued a ruling reversing the trial court's entry of the temporary restraining order. Accordingly, this fourth facility will no longer be operating under the protection of a temporary restraining order. If such facility does not continue to operate in the future, we may need to take additional impairment charges for assets at this customer facility.

Furthermore, we were recently named in three lawsuits in Alabama, one mass action (Ethel Adell, et al., v. Macon County Greyhound Park, Inc., et al.) and two purported class action (Walter Bussey, et. al., v. Macon County Greyhound Park, Inc., et al., and Ozetta Hardy v. Whitehall Gaming Center, LLC, et al.), pending in federal court in Alabama. The lawsuits were filed on behalf of patrons of VictoryLand in Shorter, Alabama, and White Hall Gaming Center in White Hall, Alabama, and include claims related to the alleged illegality of electronic bingo in Alabama. There may be other cases pending or threatened involving electronic bingo that might have an impact upon our operations in Alabama and it is possible that further proceedings will be initiated in the future, which could have a material affect on our business and results of operations.

We may not collect all amounts recorded for value added taxes related to our operations in Mexico.

Our Mexican operations are subject to Value Added Tax, or VAT, which has been applied to product shipments originating outside of Mexico. We have an outstanding VAT receivable from the Mexican taxing authority primarily related to VAT levied on product shipments for 2006 and 2007. At June 30, 2010 and September 30, 2009, the Company's VAT receivable was \$7.0 million and \$7.5 million, respectively. These balances remain uncollected as of June 30, 2010 and a portion are currently under audit by the Mexican taxing authority. The carrying value of the receivable may be adversely impacted by the outcome of these audits. The Company has received an initial ruling from the Mexican taxing authority indicating that the Mexican tax authority has challenged the registration of certain of the Company's transactions that have generated approximately \$600,000 in VAT receivable. Mexican tax law permits the Company to formally contest the initial ruling, and the Company believes that it has the necessary documentation to support the portion that has been challenged. However, the final resolution of the contested balances remains uncertain and may adversely affect the carrying value of the receivable and may have an adverse affect on our foreign income tax expense.

Our success in the gaming industry depends in large part on our ability to expand into new and non-Native American markets. Our expansion into non-Native American gaming activities will present new challenges and risks that could adversely affect our business and results of operations.

As we expand into new markets, we expect to encounter business, legal, operational and regulatory uncertainties similar to those we face in our Native American gaming business. As a result, we may encounter legal and regulatory challenges that are difficult or impossible to foresee and which could result in an unforeseen adverse impact on planned revenues or costs associated with the new market opportunity. If we are unable to effectively develop and operate within these new markets, then our business, operating results and financial condition would be impaired.

New market entry may require us to make changes to our gaming systems to ensure that they comply with applicable regulatory requirements, and may require us to obtain additional licenses. In certain jurisdictions and for certain venues, our ability to enter these markets will depend on effecting changes to existing laws and regulatory regimes. The ability to effect these changes is subject to a great degree of uncertainty and may never be achieved. We may not be successful in entering into other segments of the gaming industry.

Generally, our placement of systems, games and technology into new market segments involves a number of business uncertainties, including:

- § whether our resources and expertise will enable us to effectively operate and grow in such new markets;
- § whether our internal processes and controls will continue to function effectively within these new segments;
- § whether we have enough experience to accurately predict revenues and expenses in these new markets;
- § whether the diversion of management attention and resources from our traditional business, caused by entering into new market segments, will have harmful effects on our traditional business;
- § whether we will be able to successfully compete against larger companies who dominate the markets that we are trying to enter; and
- § whether we can timely perform under our agreements in these new markets because of other unforeseen obstacles.

If we are unable to keep pace with rapid innovations in new technologies or product design and deployment, or if we are unable to quickly adapt our development and manufacturing processes to compete, our business and results of operation could be negatively impacted.

Our success is dependent on our ability to develop and sell new products and systems that are attractive not only to our customers, but also to their customers, the end players. If our gaming devices do not appeal to customers, or if our gaming devices do not meet or sustain revenue and profitability expectations, our gaming devices may be replaced by our competitor's devices. Additionally, we may be unable to enhance existing products in a timely manner in response to changing regulatory, legal or market conditions or customer requirements, or new products or new versions of our existing products may not achieve market acceptance in new or existing markets. Therefore, our future success depends upon our ability to design and market technologically sophisticated products that meet our customer's needs regarding, among other things, ease of use and adaptability, but also that are unique and entertaining such that they achieve high levels of player appeal and sustainability. If we fail to keep pace with our competitors, our business could be adversely affected and a decrease in demand for our games could also result in an increase in our inventory obsolescence charges.

The demands of our customers and the preferences of the end players are continuously changing. As a result, there is constant pressure to develop and market new game content and technologically innovative products. As our revenues are heavily dependent on the earning power and life span of our games and because newer game themes tend to have a shorter life span than more traditional game themes, we face increased pressure to design and deploy new and successful game themes to maintain our revenue stream and remain competitive. Our ability to develop new and innovative products could be adversely affected by:

§ the failure of our new gaming products to become popular with end players;

§ a decision by our customers or the gaming industry in general to decline to purchase our new gaming devices or to cancel or return previous orders, content or systems in anticipation of newer technologies;

§ an inability to roll out new games, services or systems on schedule as a result of delays in regulatory product approval in the applicable jurisdictions, or otherwise; and

§ an increase in the popularity of competitors' games.

Our newer products are generally more technologically sophisticated and are of a different form than those we have produced in the past and we must continually refine our production capabilities to meet the needs of our product innovation. If we cannot adapt our manufacturing infrastructure to meet the needs of our product innovations, or if we are unable to make upgrades to our production capacity in a timely manner, our business could be negatively impacted.

The gaming industry is intensely competitive. We may not be able to successfully compete in new and existing markets due to research and development, intellectual property and regulatory challenges, and if we are unable to compete effectively, our business could be negatively impacted.

We operate in an intensely competitive industry against larger companies with significant financial, research design and development, and marketing resources. These larger companies, most of whom have greater resources, are aggressively competing against us in our core business operations, including but not limited to, charity bingo, lottery, Class II, Class III, commercial slot and international bingo/gaming markets. Additionally, new smaller competitors may enter our traditional markets, and these smaller competitors often do not have the same regulatory and/or compliance restraints that we have. The increased competition will intensify pressure on our pricing model. We expect to face increased competition as we attempt to enter new markets and new geographical locations.

There are a number of established, well-financed companies producing gaming devices, game content and systems that compete with our products. Certain of these competitors may have access to greater capital resources than we do, and as a result, may be better positioned to compete in the marketplace. The market is crowded, with International Game Technology, WMS Industries, Inc., Bally Technologies, Inc., Aristocrat Technologies, Inc. and Konami Co. Ltd. comprising the primary competition. Pricing, accuracy, reliability, product features and functions are among the factors affecting a provider's success in selling its system.

Competition in the gaming industry is intense due to the number of providers, as well as the limited number of facilities and jurisdictions in which they operate. As a result of consolidation among the gaming facilities and the recent cutbacks in spending by facility operators due to the downturn in the economy, the level of competition among providers has increased significantly as the number of potential customers has decreased. Other members of our industry may independently develop games similar to our games, and competitors may introduce noncompliant games that unfairly compete in certain markets due to uneven regulatory enforcement policies/actions.

Additionally, our customers compete with other providers of entertainment for their end user's entertainment budget. Consequently, our customers might not be able to spend new capital on acquiring gaming equipment. Moreover, our customers might reduce their utilization of revenue share agreements.

Slow growth in the establishment of new gaming jurisdictions or the number of new casinos and declines in the rate of replacement for existing gaming machines could limit or reduce our future profits.

Demand for our products is driven substantially by the establishment of new gaming jurisdictions, the addition of new casinos or expansion of existing casinos within existing gaming jurisdictions and the replacement of existing gaming machines. The establishment or expansion of gaming in any jurisdiction typically requires a public referendum or other legislative action. As a result, gaming continues to be the subject of public debate, and there are numerous active organizations that oppose gaming. Opposition to gaming, such as that which we are currently experiencing in Alabama, could result in restrictions on or even prohibitions of gaming operations or the expansion of operations in any jurisdiction. In addition, the construction of new casinos or expansion of existing casinos fluctuates with demand, general economic conditions and the availability of financing. The rate of gaming growth in North America has diminished and machine replacements are at historically low levels. Slow growth in the establishment of new gaming jurisdictions, public protest, political opposition, delays in the opening of new or expanded casinos and continued declines in or low levels of demand for machine replacements could reduce the demand for our products and our future profits.

Our business operations and product offerings are subject to strict regulatory licenses, findings of suitability, registrations, permits and/or approvals.

Our ability to conduct our existing traditional business, expand operations, develop and distribute new products, games and systems, and expand into new gaming markets is subject to significant federal, state, local, Native American, and foreign regulations. Specifically, our company, our officers, directors, key employees, major shareholders, as well as our business partners and certain suppliers, products, games and systems are subject to licenses, findings of suitability, registrations, permits or approvals necessary for the operation of our gaming activities.

We have received licenses, findings of suitability, registrations, permits or approvals from a number of state, local, Native American, and foreign gaming regulatory authorities. Our Native American tribal customers are empowered to develop their own licensing procedures and requirements, and we currently have limited, if any, information regarding the ultimate process or expenses involved with securing or maintaining licensure by the Native American tribes. Moreover, Native American tribal policies and procedures, as well as tribal selection of gaming vendors, are subject to the political and governance environment within the Native American tribe.

We require new licenses, permits and approvals in order to meet our expectations under our product rollout plan, and such licenses, permits or approvals may not be timely granted to us, or granted to us at all, which could have a material effect on our business in general and product rollout plan specifically. Obtaining and maintaining all required licenses, findings of suitability, registrations, permits or approvals is time consuming and expensive. The suspension, revocation, nonrenewal or limitation of any of our licenses would have a material adverse effect on our business operations, financial condition and results of operations.

Our ability to effectively compete in Native American gaming markets is vulnerable to legal and regulatory uncertainties, including the ability to enforce contractual rights on Native American land.

Historically, we have derived most of our revenue from the placement of Class II player terminals and systems for gaming activities conducted on Native American lands. Because federally recognized Native American tribes are independent governments with sovereign powers, Native American tribes can enact their own laws and regulate gaming operations and contracts. Native American tribes maintain their own governmental systems and often their own judicial systems and have the right to tax persons and enterprises conducting business on Native American lands, and also have the right to require licenses and to impose other forms of regulation and regulatory fees on persons and businesses operating on their lands. In the absence of a specific grant of authority by Congress, states may regulate activities taking place on Native American lands only if the Native American tribe has a specific agreement or compact with the state. Our contracts with Native American tribal customers normally provide that only certain provisions will be subject to the governing law of the state in which a Native American tribe is located. However, these choice-of-law clauses may not be enforceable.

Further, Native American tribes generally enjoy sovereign immunity from lawsuits similar to that of the individual states and the United States. In order for the Company to sue or enforce contract rights with a Native American tribe, or an agency or instrumentality of a Native American tribe, the Native American tribe must effectively waive its sovereign immunity with respect to the matter in dispute, which we are not always able to obtain. For example, our largest customer, who accounts for over 44% of our revenue as of June 30, 2010, has not given us a limited waiver of sovereign immunity. Without a limited waiver of sovereign immunity or if such waiver is held to be ineffective, we could be precluded from judicially enforcing any rights or remedies against a Native American tribe, including the right to enter Native American lands to retrieve our property in the event of a breach of contract by the tribe party to that contract. Even if the waiver of sovereign immunity by a Native American tribe is deemed effective, there will be an issue as to the forum in which a lawsuit can be brought against the Native American tribe. Federal courts are courts of limited jurisdiction and generally do not have jurisdiction to hear civil cases relating to Native American

tribes and we may be unable to enforce any arbitration decision effectively.

41

Our agreements with Native American tribes are subject to review by regulatory authorities. For example, our development agreements are subject to review by the NIGC and any such review could require substantial modifications to our agreements or result in the determination that the Company has a proprietary interest in a Native American tribe's gaming activity which could materially and adversely affect the terms on which we conduct our business. The NIGC has previously expressed its view that some of our development agreements could be in violation of the requirements of the Indian Gaming Regulatory Act of 1988 and Native American tribal gaming regulations, which state that the Native American tribes must hold "sole proprietary interest" in the Native American tribes' gaming operations, which presents additional risk for our business. The NIGC may also reinterpret applicable laws and regulations, which could affect our agreements with Native American tribes.

We could be affected by alternative interpretations of the Gambling Devices Act, 15 U.S.C. § 1171, et seq, or the Johnson Act, as the customers of our Class II games, the Native American tribes, could be subject to significant fines and penalties if it is ultimately determined they are offering an illegal game, and an adverse regulatory or judicial determination regarding the legal status of our products could have material adverse consequences for our business, operating results and prospects.

Government enforcement, regulatory action, judicial decisions, and proposed legislative action have in the past, and will likely continue to affect our business, operating results and prospects in Native American tribal lands. We believe that a number of our competitors have not complied with published regulation restrictions. We have lost, and could continue to lose, market share to competitors who offer games that do not appear to comply with published regulatory restrictions on Class II games and therefore offer features not available in our products. The legal and regulatory uncertainties surrounding our Native American tribal agreements could result in a significant and immediate adverse impact on our business and operating results. Additionally, such uncertainties could increase our cost of doing business and could take management's attention away from operations. The trading price of our common stock has in the past been, and may in the future be, subject to significant fluctuations based upon market perceptions of the legal status of our products and our ability to compete in the Native American markets. Regulatory action against our customers or equipment in these or in other markets could result in machine seizures and significant revenue disruptions, among other adverse consequences. Moreover, Native American tribal policies and procedures, as well as tribal selection of gaming vendors, are subject to the political and governance environment within the Native American tribe. Changes in tribal leadership or tribal political pressure can affect our business relationships within Native American markets.

State compacts with our existing Native American tribal customers to allow Class III gaming could reduce demand for our Class II games and our entry into the Class III market may be difficult as we compete against larger companies in the tribal Class III market.

Certain of Class II Native American tribal customers have entered into compacts with the states in which they operate to permit the operation of Class III games. We believe the number of our Class II game machine placements in those customers' facilities could decline significantly, and our operating results could be materially and adversely affected. As our Native American tribal customers continue to transition to gaming under compacts with the state, we continue to face significant uncertainty in the market that makes our business in these states difficult to manage and predict and we may be forced to compete with larger companies that specialize in Class III gaming as these companies move into these newly created Class III markets. We believe the establishment of state compacts depends on a number of political, social, and economic factors that are inherently difficult to ascertain. Accordingly, although we attempt to closely monitor state legislative developments that could affect our business, we may not be able to timely predict if or when a compact could be entered into by one or more of our Native American tribal customers. For example, in Oklahoma, we anticipate that the introduction of Class III games continues to pressure our market and revenue share percentages and may cause a shift in the market from revenue share arrangements to a "for sale" model.

Casino operations are conducted at the discretion of our customers.

We seek to provide assistance to our key customers in the form of project management, with a focus on facility layout and planning, gaming floor configuration and customized marketing and promotional initiatives. Our key customers, however, are solely responsible for the operations of their facilities and are not required to consult us or take our advice on their operations, marketing, facility layout, gaming floor configuration, or promotional initiatives. Further, our customers' are solely responsible for safety and security at their facilities. Our customers have in the past, and will in the future, remodel and expand their facilities. To the extent that our machines are not a part of an optimized facility layout or gaming floor configuration, are not supported by effective marketing or promotional initiatives or are scheduled to be out of service during a facility remodeling, or our customer's facilities are closed or not visited because of end-users concern for safety, our operating results could suffer.

We may not realize satisfactory returns on money lent to new and existing customers to develop or expand gaming facilities.

We enter into development agreements to provide financing for construction, expansion, or remodeling of gaming facilities, primarily in the State of Oklahoma, but also have such agreements in place in other jurisdictions, such as Alabama. Under our development agreements, we secure a long-term revenue share percentage and a fixed number of player terminal placements in the facility, in exchange for funding the development and construction of the gaming facility. We may not, however, realize the anticipated benefits of any of these strategic relationships or financings as our success in these ventures is dependent upon the timely completion of the gaming facility, the placement of our player terminals, and a favorable regulatory environment. For example, we recently took a material impairment charge for a note receivable for money lent in connection with a development agreement for an Alabama facility because of the legal uncertainty of electronic bingo in that state, and could be required, under generally accepted accounting principles, to take similar impairment charges in the future.

Our development efforts and financing activities may result in unforeseen operating difficulties, financial risks, or required expenditures that could adversely affect our liquidity. In connection with one or more of these transactions, and to obtain the necessary development funds, we may need to issue additional equity securities which would dilute existing shareholders; extend secured and unsecured credit to potential or existing customers that may not be repaid; incur debt on terms unfavorable to us or that we are unable to repay; or incur other contingent liabilities.

The failure to maintain controls and processes related to billing and collecting accounts receivable or the deterioration of the financial condition of our customers could negatively impact our business. As a result of our development agreements, the collection of accounts receivable has become a matter of greater significance. While we believe the increased level of these specific receivables has allowed us to grow our business, it has also required direct, additional focus of and involvement by management. Further, and especially due to the current downturn in the economy, some of our customers may not pay accounts receivable when due.

Litigation may adversely affect our business, financial condition and results of operations.

We are subject to legal and regulatory requirements applicable to our business and industry. We are also subject to the risk of litigation by employees, customers, patent owners, suppliers, shareholders or others through private actions, class actions, administrative proceedings and other legal proceedings. Litigation can be lengthy, expensive, and disruptive to our operations and results cannot be predicted with certainty. Current estimates of loss regarding pending litigation may not be reflective of any particular final outcome. The results of rulings, judgments or settlements of pending litigation may result in financial liability that is materially higher than what management has estimated at this time and we may experience adverse publicity associated with litigation, regardless of whether the allegations are valid or whether we are ultimately found liable. We make no assurances that we will not be subject to liability with respect to current or future litigation. We maintain various forms of insurance coverage. However, substantial rulings, judgments or settlements could exceed the amount of insurance coverage (or any cost allocation agreement with an insurance carrier), or could be excluded under the terms of an existing insurance policy. Moreover, our failure to comply with procedural or operational requirements inherent to our policies may void coverage. Additionally, failure to secure favorable outcomes in pending litigation could result in adverse consequences to our business, operating results and/or overall financial condition (including without limitation, possible adverse effects on compliance with the terms of our Credit Agreement).

Our Credit Agreement contains covenants that limit our ability to finance future operations or capital needs and to engage in other business activities.

The operating and financial restrictions and covenants in our debt agreements, including the Credit Agreement, may adversely affect our ability to finance future operations or capital needs or to engage in other business activities. Our Credit Agreement requires us to limit capital expenditures to \$40 million plus the value of any fixed assets transferred to inventory during the fiscal year, maintain a total leverage ratio of no more than 1.50:1.00 and a minimum fixed charge coverage ratio of at least 1.50:1.00. The Credit Agreement contains certain covenants that, among other things, restrict our and our subsidiaries' ability to:

- § incur additional indebtedness, assume a guarantee or issue preferred stock;
- § pay dividends or make other equity distributions or payments to or affecting our subsidiaries;
 - § purchase treasury stock;
 - § make certain investments;
 - § create liens;
- § sell or dispose of assets or engage in mergers or consolidations;
- § engage in certain transactions with subsidiaries and affiliates; and
 - § enter into sale leaseback transactions.

These restrictions could limit our ability to obtain future financing, make strategic acquisitions or needed capital expenditures, withstand economic downturns in our business or the economy in general, conduct operations or otherwise take advantage of business opportunities that may arise. A failure to comply with the restrictions contained in the Credit Agreement could lead to an event of default, which could result in an acceleration of our indebtedness. Our future operating results may not be sufficient to enable compliance with the covenants in the Credit Agreement or to remedy any such default. In addition, in the event of acceleration, we may not have or be able to obtain sufficient funds to refinance our indebtedness or make any accelerated payments. Also, we may not be able to obtain new financing. Even if we were able to obtain new financing, we cannot guarantee that the new financing will be on commercially reasonable terms or terms that are acceptable to us. If we default on our indebtedness, our business financial condition and results of operation could be materially and adversely affected.

Current borrowings, as well as potential future financings, may substantially increase our current indebtedness.

No assurance can be given that we will be able to generate the cash flows necessary to permit us to meet our fixed charges and payment obligations with respect to our debt. We could be required to incur additional indebtedness to meet these fixed charges and payment obligations. Should we incur additional debt, among other things, such increased indebtedness could:

- § adversely affect our ability to expand our business, market our products and make investments and capital expenditures;
- § adversely affect the cost and availability of funds from commercial lenders, debt financing transactions and other sources; and
 - § create competitive disadvantages compared to other companies with lower debt levels.

Any inability to service our fixed charges and payment obligations, or the incurrence of additional debt, would have an adverse effect on our cash flows, results of operations and business generally.

An inability to maintain sufficient liquidity could negatively affect expected levels of operations and new product development.

Future revenue may not be sufficient to meet operating, product development and other cash flow requirements. Sufficient funds to service our debt and maintain new product development efforts and expected levels of operations may not be available, and additional capital, if and when needed by us, may not be available on terms acceptable to us. If we cannot obtain sufficient capital on acceptable terms when needed, we may not be able to carry out our planned product development efforts and level of operations, which could harm our business.

Our financial results vary from quarter to quarter, which could negatively impact our business.

Various factors affect our quarterly operating results, some of which are not within our control. These factors include, among others:

§ the financial strength of the gaming industry;

- § consumers' willingness to spend money on leisure activities;
- § an outbreak of a communicable disease;
- § the timing and introduction of new products and services;
- § the mix of products and services sold;
- § the timing of significant orders from and shipments to customers;
- § product and service pricing and discounts; and
- § the timing of acquisitions of other companies and businesses or dispositions.

Our current international businesses and potential expansion into other international gaming markets may present new challenges and risks that could adversely affect our business or results of operations.

In recent years, we have expanded our business into several countries, including Mexico, Israel, Malta, and Canada. The Maltese operations have ceased; the Israeli operations are immaterial to us; the Canadian business has been project oriented to date; however, the Mexican business has grown significantly since inception. We now operate approximately 5,000 units in Mexico, primarily across numerous facilities operated by one customer. Although the revenue results in Mexico have not met original expectations, we plan to continue to operate in the country but there can be no assurances that either revenues will grow or that we will continue supplying new products to that market. International business is inherently subject to various risks, including, but not limited to:

- § currency fluctuations;
- § difficulty in enforcing agreements;
- § higher operating costs due to local laws or regulations;
- § unexpected changes in regulatory requirements;
- § tariffs, taxes and other trade barriers, including value added tax;
- § general government instability;
- § costs and risks of localizing products for foreign countries;
- § difficulties in staffing and managing geographically disparate operations;
- § greater difficulty in safeguarding intellectual property, licensing and other trade restrictions;
- § challenges negotiating and enforcing contractual provisions;
- § repatriation of earnings; and
- § anti-American sentiment as a result of perceived cultural, social, religious and/or political differences.

The carrying value of our assets is dependent upon our ability to successfully deploy games into new or existing markets.

We have player stations not deployed as of June 30, 2010, which are considered part of our rental pool. If the opening of new facilities or the expansion of existing facilities is altered negatively, either by significant delay or by cancellation, the realizable value of these assets could be adversely impacted. In such instances we may be required to recognize impairment charges on these assets.

We may not be able to successfully implement new sales strategies.

As we attempt to generate new streams of revenue by selling units to new customers we may have difficulty implementing an effective sales strategy. Our failure to successfully implement an effective sales strategy could cause our future operating results to vary materially from what management has forecast.

We may not be successful in protecting our intellectual property rights, or avoiding claims that we are infringing upon the intellectual property rights of others.

We rely upon patent, copyright, trademark and trade secret laws, license agreements and employee nondisclosure agreements to protect our proprietary rights and technology, but these laws and contractual provisions provide only limited protection. We rely to a greater extent upon proprietary know-how and continuing technological innovation to maintain our competitive position. Insofar as we rely on trade secrets, unpatented know-how and innovation, others may be able to independently develop similar technology, or our secrecy could be breached. The issuance of a patent to us does not necessarily mean that our technology does not infringe upon the intellectual property rights of others. As we enter into new markets by leveraging our existing technology, and by developing new technology and new products, it becomes more and more likely that we will become subject to infringement claims from other parties. We are currently involved in a patent dispute with a competitor, International Gamco, Inc., regarding the '035 Patent. See "Part II – Item I. Financial Statements – Note 13 – Commitments and Contingencies." Problems with patents or other rights could increase the cost of our products, or delay or preclude new product development and commercialization. If infringement claims against us are valid, we may seek licenses that might not be available to us on acceptable terms or at all. Litigation would be costly and time consuming, but may become necessary to protect our proprietary rights or to defend against infringement claims. We could incur substantial costs and diversion of management resources in the defense of any claims relating to the proprietary rights of others or in asserting claims against others. We cannot guarantee that our intellectual property will provide us with a competitive advantage or that it will not be circumvented by our competitors.

Some of our products may incorporate open source software. Open source licenses typically mandate that software developed based on source code that is subject to the open source license, or combined in specific ways with such open source software, become subject to the open source license. Open source licenses typically require that source code subject to the license be released or made available to the public. We take steps to ensure that proprietary software we do not wish to disclose is not combined with, or does not incorporate, open source software in ways that would require such proprietary software to be subject to an open source license. However, few courts have interpreted the open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty.

We rely on software and games licensed from third parties, and on technology provided by third-party vendors, the loss of which could materially affect our business, increase our costs and delay deployment or suspend development of our gaming systems and player terminals.

We integrate various third-party software products as components of our software. Our business would be disrupted if this software, or functional equivalents of this software, were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to either redesign our software to function with alternate third-party software, or to develop these components ourselves, which would result in increased costs and could result in delays in our deployment of our gaming systems and player terminals. Furthermore, we might be forced to limit the features available in our current or future software offerings.

We rely on the content of certain software that we license from third-party vendors and often distribute and sell such software to our customers. The software could contain "open source" code, require a resale license or contain bugs that could have an impact on our business. We also rely on the technology of third-party vendors, such as telecommunication providers, to operate our nationwide broadband telecommunications network. A serious or sustained disruption of the provision of these services could result in some of our player terminals being non-operational for the duration of the disruption, which would reduce over-all revenue from those player terminals.

We do not rely upon the term of our customer contracts to retain the business of our customers.

Our contracts with our customers are on a year-to-year or multi-year basis. Except for customers with whom we have entered into development agreements, we do not rely upon the stated term of our customer contracts to retain the business of our customers. We rely instead upon providing competitively superior player terminals, games and systems to give our customers the incentive to continue doing business with us. At any point in time, a significant portion of our business is subject to nonrenewal, which may materially and adversely affect our earnings, financial condition and cash flows. In addition, certain of our customer contracts have "buy out" provisions enabling our customer to purchase machines formerly under revenue participation arrangements. To the extent our customers exercise their buy out rights pursuant to these provisions, we recognize revenue from equipment sales in the current period while losing future participation revenue from purchased machines. This could have the effect of reducing our overall future revenues from these customers and thereby adversely affect our future operating results.

If our key personnel leave us, our business could be materially adversely affected.

We depend on the continued performance of the members of our senior management team and our technology team to assist in executing our strategy. In order to retain our key personnel, we have established a retention plan, however, key employees may depart despite our efforts. If we were to lose the services of any of our senior officers, directors, or any key member of our technology team, and could not find suitable replacements for such persons in a timely manner, it could have a material adverse effect on our business. We expect that our efforts to grow will place a significant strain on our personnel, management systems, infrastructure and other resources. Our ability to manage future growth effectively will also require us to successfully attract, train, motivate, retain and manage new employees and continue to update and improve our operational, financial and management controls and procedures.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report financial results or prevent fraud.

Effective internal controls are necessary to provide reliable financial reports and to assist in the effective prevention of fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. We must annually evaluate our internal procedures to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which requires management and auditors to assess the effectiveness of internal controls. If we fail to remedy or maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we could be subject to regulatory scrutiny, civil or criminal penalties or shareholder litigation.

In addition, failure to maintain adequate internal controls could result in financial statements that do not accurately reflect our financial condition. There can be no assurance that we will be able to complete the work necessary to fully comply with the requirements of the Sarbanes-Oxley Act or that our management and our independent registered public accounting firm will continue to conclude that our internal controls are effective.

Any unauthorized, and potentially improper, actions of our personnel could adversely affect our business, operating results and financial condition.

The recognition of our revenue depends on, among other things, the terms negotiated in our contracts with our customers. Our personnel may act outside of their authority and negotiate additional terms without our knowledge. We discourage such conduct, but there can be no assurance that our policy will be followed. For instance, in the event that our sales personnel negotiate terms that do not appear in the contract and of which we are unaware, whether the additional terms are written or verbal, we could be prevented from recognizing revenue in accordance with our plans. Furthermore, depending on when we learn of unauthorized actions and the size of transactions involved, we may have to restate revenue for a previously reported period, which would seriously harm our business, operating results and financial condition.

Furthermore, certain of our customers and testing laboratories have policies and procedures in place regarding the shipment and installation of our products. If such policies and procedures are not properly complied with by our personnel, we may experience a delay in installation, which could result in a loss of revenue, penalties, fines or fees, which could adversely affect our business, operating results and financial condition.

Our business prospects and future success rely heavily upon the integrity of our employees and executives and the security of our gaming systems.

The integrity and security of our gaming systems are critical to our ability to attract customers and players. We strive to set exacting standards of personal integrity for our employees and for system security involving the gaming systems that we provide to our customers. Our reputation in this regard is an important factor in our business dealings with our

current and potential customers as well as state licensing boards. For this reason, an allegation or a finding of improper conduct on our part or on the part of one or more of our employees that is attributable to us, or of an actual or alleged system security defect or failure attributable to us could have a material adverse effect upon our business, financial condition, results and prospects, including our ability to retain existing contracts or obtain new or renewed contracts.

In the event gaming authorities determine that any of our officers, directors, key employees, shareholders or any other person is unsuitable to act in such a capacity, we will either be required to terminate our relationship with such person, which termination could have a material adverse effect on our business, or may not be able to terminate such relationship, which could impact our ability to obtain such license or approval.

We do not have the right to redeem shares of an unsuitable shareholder, and a finding of unsuitability could have a material adverse effect on our business. In some jurisdictions, the gaming authority may determine that any of our officers, directors, key employees, shareholders or any other person is unsuitable to act in such capacity. There can be no assurance that we will obtain all the necessary licenses and approvals or that our officers, directors, key employees, their affiliates and certain other shareholders will satisfy the suitability requirements in each jurisdiction in which we seek to operate. The failure to obtain such licenses and approvals in one jurisdiction may affect our licensure and/or approvals in other jurisdictions. In addition, a significant delay in obtaining such licenses and approvals could have a material adverse effect on our business prospects.

We may incur prize payouts in excess of game revenues.

Certain of our contracts with our Native American customers relating to our Legacy and Reel Time Bingo system games provide that our customers receive, on a daily basis, an agreed percentage of gross gaming revenues based upon an assumed level of prize payouts, rather than the actual level of prize payouts. This arrangement can result in our paying our customers amounts greater than our customers' percentage share of the actual win per unit. In addition, because the prizes awarded in our games are based upon assumptions as to the number of players in each game and statistical assumptions as to the frequency of winners, we may experience on any day, or over short periods of time, a "game deficit," where the aggregate amount of prizes paid exceeds aggregate game revenues. If we have to make any excess payments to customers, or experience a game deficit over any statistically relevant period of time, we are contractually entitled to adjust the rates of prize payout to end users in order to recover any deficit. In addition, a "game deficit" generates a receivable and we may be unable to offset such receivable against a "game surplus" payable. In the future, we may miscalculate our statistical assumptions, or for other reasons we may experience abnormally high rates of jackpot prize wins, which could materially and adversely affect our cash flow on a temporary or long-term basis, which could materially and adversely affect our earnings and financial condition.

Our games and systems may experience loss based on malfunctions, anomalies or fraudulent activities.

Our games and systems, and games and systems we license or distribute from third parties, could produce false payouts as the result of malfunctions, anomalies or fraudulent activities, which we may be required to pay. We depend on our security precautions to prevent fraud. We depend on regulatory safeguards, which may not be available in all jurisdictions or markets, to protect us against jackpots awarded as a result of malfunctions, anomalies or fraudulent activities. There can be no guarantee that regulatory safeguards, in jurisdictions or markets where they do exist, will be sufficient to protect us from liabilities associated with malfunctions, anomalies or fraudulent activities.

The occurrence of malfunctions, anomalies or fraudulent activities could result in litigation against us by our customers based on lost revenue or other claims based in tort or breach of contract. Moreover, these occurrences could result in investigations or disciplinary actions by applicable gaming regulators. Additionally, in the event of such issues with our gaming devices or software, substantial engineering and marketing resources may be diverted from other areas to rectify the problem.

Any disruption in our network or telecommunications services, adverse weather conditions or other catastrophic events in the areas in which we operate could affect our ability to operate our games, which would result in reduced revenues and customer down time.

Our network is susceptible to outages due to fire, floods, power loss, break-ins, cyberattacks and similar events. We have multiple site back-up for our services in the event of any such occurrence. Despite our implementation of network security measures, our servers are vulnerable to computer viruses and break-ins. Similar disruptions from unauthorized tampering with our computer systems in any such event could have a material adverse effect on our business, operating results and financial condition.

Adverse weather conditions, particularly flooding, tornadoes, heavy snowfall and other extreme weather conditions often deter our customer's end users from traveling, or make it difficult for them to frequent the sites where our games are installed. If any of those sites experienced prolonged adverse weather conditions, or if the sites in Oklahoma, where a significant number of our games are installed, simultaneously experienced adverse weather conditions, our results of operations and financial condition would be materially and adversely affected.

We are parties to certain agreements that could require us to pay damages resulting from loss of revenues if our systems are not properly functioning, or as a result of a system malfunction or an inaccurate pay table. In addition, our agreement with the New York State Division of the Lottery permits termination of the contract at any time for failure by us or our system to perform properly. Failure to perform under this contract or similar contracts could result in substantial monetary damages, as well as contract termination.

Worsening economic conditions may adversely affect our business.

The demand for entertainment and leisure activities tends to be highly sensitive to consumers' disposable incomes, and thus a decline in general economic conditions or an increase in gasoline prices may lead to our end users having less discretionary income with which to wager. This situation could cause a reduction in our revenues and have a material adverse effect on our operating results. The gaming industry is currently experiencing a period of reduced demand. If, as a result of deteriorating economic conditions, fewer people frequent our customers' facilities, or if amounts spent per person in our customers' facilities are reduced from historical levels, our business could be materially and adversely affected. Additionally, a decline in general economic conditions might negatively impact our customers' abilities to pay us in a timely fashion. Our customers' failures to make timely payments could result in an increase in our provision for bad debt.

Current environmental laws and regulations, or those enacted in the future, could result in additional liabilities and costs.

The manufacturing of our products may require the use of materials that are subject to a variety of environmental, health and safety laws and regulations. Compliance with these laws could increase our costs and impact the availability of components required to manufacture our products. Violation of these laws may subject us to significant fines, penalties or disposal costs, which could negatively impact our results of operations, financial position or cash flows.

Our ability to recognize revenue at the time of sale and delivery is dependent upon obtaining Vendor Specific Objective Evidence (VSOE) for products yet to be delivered or services yet to be performed.

We believe future transactions with both existing and future customers may be more complex than transactions entered into currently. As a result, we may enter into more complicated business and contractual relationships with customers which, in turn, can engender increased complexity in the related financial accounting. Legal and regulatory uncertainty may also affect our ability to recognize revenue associated with a particular project, and therefore the timing and possibility of actual revenue recognition may differ from our forecast.

The ability of the Board of Directors to issue preferred stock or anti-takeover provisions of Texas law and our governing documents could discourage a merger or other type of corporate reorganization or a change in control even if it could be favorable to the interests of our shareholders.

Our Board of Directors has the authority to issue 2,000,000 shares of preferred stock and determine the terms of such preferred stock without shareholder approval. While we currently do not have any preferred stock issued and our Board of Directors has no current plans, agreements or commitments to issue any shares of preferred stock, the

issuance of such preferred stock may delay, defer or prevent a change in control because the terms of any issued preferred stock could potentially prohibit our consummation of any acquisition, reorganization, sale of substantially all of our assets, liquidation or other extraordinary corporate transaction. In addition, the issuance of preferred stock could have a dilutive effect on our shareholders and affect the price of our common stock.

Other provisions of Texas law and our Articles of Incorporation and Bylaws may have the effect of delaying or preventing a change in control or acquisition, whether by means of a tender offer, business combination, proxy contest, or otherwise. Our Articles of Incorporation and Bylaws include purported limits on shareholder action by written consent in lieu of a meeting and certain procedural requirements governing the nomination of directors by shareholders and shareholder meetings. These provisions could have the effect of delaying or preventing a change in control.

ITEM 6. EXHIBITS

(a) Exhibits

See Exhibit Index.

50

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.

Date: August 5, 2010

Multimedia Games, Inc.

By: /s/ Adam D. Chibib†
Adam D. Chibib
Chief Financial Officer

†Mr. Chibib is signing as an authorized officer and as our Principal Financial Officer and Principal Accounting Officer.

EXHIBIT INDEX

| EXHIBIT NO. | TITLE | LOCATION |
|-------------|---|----------|
| 3.1 | Amended and Restated Articles of Incorporation | (1) |
| 3.2 | Amendment to Articles of Incorporation | (2) |
| 3.3 | Third Amended and Restated Bylaws | (3) |
| 10.1 | Fourth Amendment to Credit Agreement by and among MegaBingo, Inc., MGAM Systems, Inc., and Comerica Bank, dated as of April 6, 2010 | (4) |
| 31.1 | Certification of Principal Executive Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002 | (*) |
| 31.2 | Certification of Principal Accounting Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002 | (*) |
| 32.1 | Certification as required by Section 906 of the Sarbanes Oxley Act of 2002 | (*) |

(1) Incorporated by reference to our Form 10-QSB for the quarter ended March 31, 1997, as filed with the Securities and Exchange Commission, or SEC, on May 15, 1997.

(2) Incorporated by reference to our Form 10-Q for the quarter ended December 31, 2003, as filed with the SEC on February 17, 2004.

(3) Incorporated by reference to our Current Report on Form 8-K, as filed with the SEC on March 15, 2010.

(4) Incorporated by reference to our Current Report on Form 8-K, as filed with the SEC on April 7, 2010.

(*) Filed herewith.