

MAJESCO ENTERTAINMENT CO

Form 10-Q

June 14, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended April 30, 2011  
Commission File No. 000-51128  
Majesco Entertainment Company  
(Exact name of registrant as specified in its charter)**

**DELAWARE** **06-1529524**  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)  
**160 Raritan Center Parkway, Edison, NJ 08837**  
(Address of principal executive offices)  
Registrant's Telephone Number, Including Area Code: **(732) 225-8910**

(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 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.4.05 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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of June 10, 2011, there were 40,884,436 shares of the Registrant's common stock outstanding.

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**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share amounts)

	April 30, 2011 (unaudited)	October 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 18,478	\$ 8,004
Due from factor	6,357	1,015
Accounts and other receivables, net	1,219	725
Inventory, net	7,626	8,418
Advance payments for inventory	203	5,454
Capitalized software development costs and license fees	5,557	4,903
Prepaid expenses	698	921
<b>Total current assets</b>	40,138	29,440
Property and equipment, net	906	520
Other assets	88	69
<b>Total assets</b>	\$ 41,132	\$ 30,029
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 13,863	\$ 11,375
Inventory financing payables		5,557
Advances from customers and deferred revenue	560	945
<b>Total current liabilities</b>	14,423	17,877
Warrant liability	2,551	144
Commitments and contingencies		
Stockholders' equity:		
Common stock \$.001 par value; 250,000,000 shares authorized; 40,588,964 and 39,326,376 shares issued and outstanding at April 30, 2011 and October 31, 2010, respectively	40	39
Additional paid-in capital	118,138	114,824
Accumulated deficit	(93,496)	(102,333)
Accumulated other comprehensive loss	(524)	(522)
<b>Net stockholders' equity</b>	24,158	12,008
<b>Total liabilities and stockholders' equity</b>	\$ 41,132	\$ 30,029

See accompanying notes

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**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited, in thousands, except share amounts)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30</b>		<b>April 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Net revenues</b>	\$ 32,142	\$ 10,906	\$ 80,608	\$ 40,112
<b>Cost of sales</b>				
Product costs	13,280	5,447	34,104	17,175
Software development costs and license fees	5,210	2,232	13,222	10,099
Loss on impairment of software development costs and license fees-future releases		116		1,021
	18,490	7,795	47,326	28,295
<b>Gross profit</b>	13,652	3,111	33,282	11,817
<b>Operating costs and expenses</b>				
Product research and development	1,973	707	3,203	1,641
Selling and marketing	2,630	1,527	9,639	4,584
General and administrative	2,321	2,266	5,603	4,390
Loss on impairment of software development costs and license fees cancelled games	1,337	160	1,362	160
Depreciation and amortization	57	44	102	97
	8,318	4,704	19,909	10,872
<b>Operating income (loss)</b>	5,334	(1,593)	13,373	945
<b>Other expenses (income)</b>				
Interest and financing costs, net	245	125	955	621
Change in fair value of warrant liability	2,928	(27)	3,344	(229)
<b>Income (loss) before income taxes</b>	2,161	(1,691)	9,074	553
Income taxes	86	(84)	237	(1,647)
<b>Net income (loss)</b>	\$ 2,075	\$ (1,607)	\$ 8,837	\$ 2,200
<b>Net income (loss) per share:</b>				
Basic	\$ 0.05	\$ (0.04)	\$ 0.23	\$ 0.06
Diluted	\$ 0.05	\$ (0.04)	\$ 0.22	\$ 0.06
<b>Weighted average shares outstanding:</b>				
Basic	38,051,035	36,874,270	37,841,453	36,789,337
Diluted	40,426,306	36,874,270	39,322,894	36,793,821

See accompanying notes

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**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited, in thousands)**

	<b>Six Months Ended</b>	
	<b>April 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 8,837	\$ 2,200
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	102	97
Change in fair value of warrant liability	3,344	(229)
Non-cash compensation expense	627	911
Loss on disposal of assets		19
Provision for price protection and customer allowances	2,202	2,331
Amortization of software development costs and license fees	3,220	2,839
Loss on impairment of software development costs and license fees	1,362	1,181
Provisions for excess inventory	848	16
Changes in operating assets and liabilities:		
Due from factor	(6,833)	(2,314)
Accounts and other receivables	(1,205)	157
Inventory	(55)	1,974
Capitalized software development costs and license fees	(5,178)	(3,895)
Advance payments for inventory	5,251	1,936
Prepaid expenses and other assets	203	39
Accounts payable and accrued expenses	2,326	(1,943)
Advances from customers and other liabilities	(385)	(680)
Net cash provided by operating activities	14,666	4,639
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property and equipment	(325)	(104)
Net cash used in investing activities	(325)	(104)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Inventory financing	(5,557)	(4,844)
Proceeds from exercise of warrants	1,691	
Net cash used in financing activities	(3,866)	(4,844)
Effect of exchange rates on cash and cash equivalents	(1)	(27)
Net increase (decrease) in cash and cash equivalents	10,474	(336)
Cash and cash equivalents beginning of period	8,004	11,839
Cash and cash equivalents end of period	\$ 18,478	\$ 11,503

**SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND  
FINANCING ACTIVITIES**

Landlord-provided leasehold improvements	\$	163	\$
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Warrant liability reclassified to additional paid-in capital upon exercise		937	
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**SUPPLEMENTAL CASH FLOW INFORMATION**

Cash paid for interest	\$	955	\$	621
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See accompanying notes

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**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited, in thousands, except share amounts)**

**1. PRINCIPAL BUSINESS ACTIVITY AND BASIS OF PRESENTATION**

The accompanying financial statements present the financial results of Majesco Entertainment Company and Majesco Europe Limited, its wholly-owned subsidiary, (Majesco or the Company) on a consolidated basis.

The Company is a provider of video game products primarily for the family-oriented, mass-market consumer. It sells its products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors. It publishes video games for major current generation interactive entertainment hardware platforms, including Nintendo DS, DSi and Wii, Sony's PlayStation 3, or PS3, and PlayStation Portable, or PSP, Microsoft's Xbox 360 and the personal computer, or PC. It also publishes games for numerous digital platforms, including mobile platforms such as iPhone, iPad and iPod Touch, as well as online platforms such as Facebook.

The Company's video game titles are targeted at various demographics at a range of price points. Due to the larger budget requirements for developing and marketing premium console titles for core gamers, the Company focuses on publishing more casual games targeting mass-market consumers. In some instances, its titles are based on licenses of well-known properties and, in other cases based on original properties. The Company enters into agreements with content providers and video game development studios for the creation of its video games.

The Company's operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company may also enter into agreements with licensees, particularly for sales of its products internationally. The Company is centrally managed and its chief operating decision makers, the chief executive and other officers, use consolidated and other financial information supplemented by sales information by product category, major product title and platform for making operational decisions and assessing financial performance. Accordingly, the Company operates in a single segment.

Net revenues by geographic region were as follows:

	Three Months Ended April 30,				Six Months Ended April 30,			
	2011	%	2010	%	2011	%	2010	%
United States	\$ 28,964	90.1%	\$ 10,406	95.4%	\$ 77,211	95.9%	\$ 38,365	95.6%
Europe	3,178	9.9%	500	4.6%	3,397	4.1%	1,747	4.4%
Total	\$ 32,142	100%	\$ 10,906	100%	\$ 80,608	100%	\$ 40,112	100%

The accompanying interim condensed consolidated financial statements of the Company are unaudited, but in the opinion of management, reflect all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim period. Accordingly, they do not include all information and notes required by generally accepted accounting principles for complete financial statements. The Company's financial results are impacted by the seasonality of the retail selling season and the timing of the release of new titles. The results of operations for interim periods are not necessarily indicative of results to be expected for the entire fiscal year. The balance sheet at October 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes for the year ended October 31, 2010 filed with the Securities and Exchange Commission on Form 10-K on January 31, 2011.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Revenue Recognition.* The Company recognizes revenue upon the shipment of its products when: (1) title and the risks and rewards of ownership are transferred; (2) persuasive evidence of an arrangement exists; (3) there are no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. Certain products are sold to customers with a street date (the earliest date these products may be resold by retailers). Revenue for sales of these products is not recognized prior to their street date. Some of the Company's software products

provide limited online features at no additional cost to the consumer. Generally, such features have been considered to be incidental to the Company's overall product offerings and an inconsequential deliverable. Accordingly, the

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Company does not defer any revenue related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying the Company's revenue recognition policy.

The Company generally sells its products on a no-return basis, although in certain instances, the Company provides price protection or other allowances on certain unsold products. Price protection, when granted and applicable, allows customers a partial credit against amounts they owe the Company with respect to merchandise unsold by them. Revenue is recognized, and accounts receivable is presented, net of estimates of these allowances.

The Company estimates potential future product price protection and other allowances related to current period product revenue. The Company analyzes historical experience, current sell through of retailer inventory of the Company's products, current trends in the video game market, the overall economy, changes in customer demand and acceptance of the Company's products and other related factors when evaluating the adequacy of price protection and other allowances.

Sales incentives or other consideration given by the Company to customers that are considered adjustments of the selling price of its products, such as rebates and product placement fees, are reflected as reductions of revenue. Sales incentives and other consideration that represent costs incurred by the Company for benefits received, such as the appearance of the Company's products in a customer's national circular ad, are reflected as selling and marketing expenses, in accordance with Accounting Standards Codification (ASC) 605-50, *Customer Payments and Incentives*.

In addition, some of the Company's software products are sold exclusively as downloads of digital content for which the consumer takes possession of the digital content for a fee. Revenue from product downloads is generally recognized when the download is made available (assuming all other recognition criteria are met).

The Company records revenue for distribution agreements where it is acting as an agent as defined by ASC Topic 605, Revenue Recognition, Subtopic 45, Principal Agent Considerations, on a net basis. When the Company enters into license or distribution agreements that provide for multiple copies of games in exchange for guaranteed amounts, revenue is recognized in accordance with the terms of the agreements, generally upon delivery of a master copy, assuming our performance obligations are complete and all other recognition criteria are met, or as per-copy royalties are earned on sales of games.

*Inventory.* Inventory, which consists primarily of finished goods, is stated at the lower of cost as determined by the first-in, first-out method, or market. As of April 30, 2011 and October 31, 2010, inventory included \$2.0 and \$1.7 million respectively of unpackaged games and game accessories. The Company estimates the net realizable value of slow-moving inventory on a title-by-title basis and charges the excess of cost over net realizable value to cost of sales. In the six months ended April 30, 2011, such charges to cost of sales amounted to \$848 based on current estimates of net realizable value. Such estimates may change and additional charges may be incurred until the related inventory items are sold.

*Capitalized Software Development Costs and License Fees.* Software development costs include fees in the form of milestone payments made to independent software developers and licensors. Software development costs are capitalized once technological feasibility of a product is established and management expects such costs to be recoverable against future revenues. For products where proven game engine technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Amounts related to software development that are not capitalized are charged immediately to product research and development costs. Commencing upon a related product's release capitalized software development costs and prepaid license fees are amortized to cost of sales based upon the higher of (i) the ratio of current revenue to total projected revenue or (ii) straight-line charges over the expected marketable life of the product.

Prepaid license fees represent license fees to owners for the use of their intellectual property rights in the development of the Company's products. Minimum guaranteed royalty payments for intellectual property licenses are initially recorded as an asset (prepaid license fees) and a current liability (accrued royalties payable) at the contractual amount upon execution of the contract or when specified milestones or events occur and when no significant performance remains with the licensor. Licenses are expensed to cost of sales at the higher of (i) the contractual royalty rate based on actual sales or (ii) an effective rate based upon total projected revenue related to such license.

Capitalized software development costs are classified as non-current if they relate to titles for which the Company estimates the release date to be more than one year from the balance sheet date.

The amortization period for capitalized software development costs and prepaid license fees is usually no longer than one year from the initial release of the product. If actual revenues or revised forecasted revenues fall below the initial forecasted revenue for a

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particular license, the charge to cost of sales may be larger than anticipated in any given quarter. The recoverability of capitalized software development costs and prepaid license fees is evaluated quarterly based on the expected performance of the specific products to which the costs relate. When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, the Company expenses these capitalized costs to cost of sales—software development costs and license fees—future release, in the period such a determination is made. These expenses may be incurred prior to a game's release for games that have been developed. If a game is cancelled prior to completion of development and never released to market, the amount is expensed to general and administrative expenses. If the Company was required to write off licenses, due to changes in market conditions or product acceptance, its results of operations could be materially adversely affected.

The Company has expensed as research and development all costs associated with the development of social games for Facebook, including, in the six months ended April 30, 2011, \$626 of costs of third-party developers. The Company launched one Facebook game, in the six months ended April 30, 2011, which has not earned significant revenues to date, and is continuing to evaluate alternatives for future development and monetization.

Prepaid license fees and milestone payments made to the Company's third party developers are typically considered non-refundable advances against the total compensation they can earn based upon the sales performance of the products. Any additional royalty or other compensation earned beyond the milestone payments is expensed to cost of sales as incurred.

*Estimates.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities or the disclosure of gain or loss contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Among the more significant estimates included in these financial statements are price protection and customer allowances, the valuation of inventory and the recoverability of advance payments for software development costs and intellectual property licenses. Actual results could differ from those estimates.

*Income (Loss) Per Share.* Basic income (loss) per share of common stock is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Basic income (loss) per share excludes the impact of unvested shares of restricted stock issued as long term incentive awards to directors, officers and employees. Diluted income per share reflects the potential impact of common stock options and unvested shares of restricted stock and outstanding common stock purchase warrants that have a dilutive effect.

The table below provides a reconciliation of basic and diluted average shares outstanding, after applying the treasury stock method.

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Basic weighted average shares outstanding	38,051,035	36,874,270	37,841,453	36,789,337
Common stock options	499,074		309,338	4,484
Non-vested portion of restricted stock grants	1,396,938		1,085,167	
Warrants	479,259		86,936	
Diluted weighted average shares outstanding	40,426,306	36,874,270	39,322,894	36,793,821

Options and warrants to acquire 566,982 and 2,405,304 shares of common stock were not included in the calculation of diluted earnings per common share for the three and six months ended April 30, 2011, respectively as the effect of their inclusion would be anti-dilutive. Options and warrants to acquire 3,685,398 and 3,446,265 shares of common stock were not included in the calculation of diluted earnings per common share for the three and six months ended April 30, 2010, respectively, as the effect of their inclusion would be anti-dilutive.

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The table below provides total potential shares outstanding, including those that are anti-dilutive, at the end of each reporting period:

	<b>April 30, 2011</b>	<b>April 30, 2010</b>
Shares issuable under common stock warrants	1,375,902	2,201,469
Shares issuable under stock options	1,514,730	1,483,929
Non-vested portion of restricted stock grants	1,929,134	1,771,352
	4,819,766	5,456,750

The Company issued 136,153 and 329,484 shares of restricted stock during the three and six months ended April 30, 2011, respectively, and cancelled no shares in either period. The Company issued 57,893 and 115,182 shares of restricted stock during the three and six months ended April 30, 2010, respectively, and cancelled 0 and 21,984 shares during the same respective periods. The Company values shares of restricted stock at fair value as of the grant date.

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The Company issued options to purchase 100,000 shares of common stock during the three and six months ended April 30, 2011, and cancelled no options in the periods. The options have an exercise price of \$1.64 per share, equal to the market value of a share of the Company's stock on the grant date, and expire in 2018. The options have a total grant-date fair value of \$95, based on the Black-Scholes model and estimated share-price volatility of 75.2%, estimated life of 4.3 years and a risk-free rate of 1.8%. The Company did not issue any options to purchase shares of common stock during the three and six months ended April 30, 2010 and cancelled 18,623 options in such periods. The Company values options at fair value as of the grant date.

*Reclassifications.* For comparability, certain 2010 amounts have been reclassified, where appropriate, to conform to the financial statement presentation used in 2011.

*Commitments and Contingencies.* The Company records a liability for commitments and contingencies when the amount is both probable and reasonably estimable.

*Concentrations.* The Company develops and distributes video game software for proprietary platforms under licenses from Nintendo, Sony and Microsoft, which must be periodically renewed. The Company's agreements with these manufacturers also grant them certain control over the supply and manufacturing of the Company's products. In addition, in the three and six months ended April 30, 2011, sales of the Company's Zumba Fitness game accounted for approximately 75% and 67% of revenues, respectively. We license the rights to publish these games from a third party and have rights to publish other Zumba Fitness games. If the new versions are not successful, this may have a significant impact on our revenues. In addition, if these arrangements are disrupted, the Company's operations could be adversely affected.

***Recent Accounting Pronouncements***

*Amendments to Variable Interest Entity Guidance* In June 2009, the Financial Accounting Standards Board, or FASB, issued ASC Topic 860-10-65, *Accounting for Transfers of Financial Assets*. The standard removes the concept of a qualifying special purpose entity from ASC Topic 860, *Transfers and Servicing*, and eliminates the exception for qualifying special purpose entities from consolidation guidance. In addition, the standard establishes specific conditions for reporting a transfer of a portion of a financial asset as a sale. If a transfer does not meet established sale conditions, the transferor and transferee must account for the transaction as a secured borrowing. An enterprise that continues to transfer portions of a financial asset that do not meet the established sale conditions would be eligible to record a sale only after it has transferred all of its interest in that asset. The effective date is fiscal years beginning after November 15, 2009. Accordingly, the Company adopted the provisions in the first quarter of fiscal 2011. The adoption did not have a material impact on the Company's results of operations, financial position or cash flows.

*Multiple-Deliverable Revenue Arrangements* In October 2009, the FASB issued new guidance related to the accounting for multiple-deliverable revenue arrangements. These new rules amend the existing guidance for separating consideration in multiple-deliverable arrangements and establish a selling price hierarchy for determining the selling price of a deliverable. These new rules became effective, on a prospective basis, for the Company on November 1, 2010. The adoption did not have a material impact on the Company's results of operations, financial position or cash flows.

*Certain Revenue Arrangements That Include Software Elements* In October 2009, the FASB issued new guidance that changes the accounting model for revenue arrangements by excluding tangible products containing both software and non-software components that function together to deliver the product's essential functionality and instead have these types of transactions be accounted for under other accounting literature in order to determine whether the software and non-software components function together to deliver the product's essential functionality. These new rules became effective, on a prospective basis, for the Company on November 1, 2010. The adoption did not have a material impact on the Company's results of operations, financial position or cash flows.

*Fair Value* In January 2010, the FASB issued an update to ASC 820-10, *Measuring Liabilities at Fair Values*. The update to ASC 820-10 requires disclosure of significant transfers in and out of Level 1 and Level 2 measurements and the reasons for the transfers, and a gross presentation of activity within the Level 3 rollforward, presenting separately information about purchases, sales issuances and settlements. The update to ASC 820-10 was adopted by the Company in 2010, except for the gross presentation of the Level 3 rollforward, which was adopted by the Company in fiscal year 2011. The adoption did not have a material impact on its financial position, results of operations, and cash

flows.

In May 2011, the FASB issued an update to ASC 820-10, *Measuring Liabilities at Fair Values*. The update to ASC 820-10 clarifies the application of fair value standards in certain circumstances and requires additional disclosures about fair value



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measurements within Level 3, including sensitivity to changes in unobservable inputs. The update will become effective for the Company on November 1, 2012. The Company is currently evaluating the potential impact of the update on its financial position, results of operations, and cash flows.

**3. FAIR VALUE**

The table below segregates all financial assets and liabilities that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

	<b>April 30, 2011</b>	<b>Quoted prices in active markets for identical assets (level 1)</b>	<b>Significant other observable inputs (level 2)</b>	<b>Significant unobservable inputs (level 3)</b>
<b>Assets:</b>				
Money market funds	\$ 13,046	\$ 13,046	\$	\$
Bank- deposit	\$ 5,432	\$ 5,432	\$	\$
<b>Total financial assets</b>	<b>\$ 18,478</b>	<b>\$ 18,478</b>	<b>\$</b>	<b>\$</b>
<b>Liabilities:</b>				
Warrant liability	\$ 2,551	\$	\$	\$ 2,551
<b>Total financial liabilities</b>	<b>\$ 2,551</b>	<b>\$</b>	<b>\$</b>	<b>\$ 2,551</b>

The Company has outstanding warrants that may require settlement by transferring assets under certain change of control circumstances. These warrants are classified as liabilities in the accompanying balance sheet. The warrants have an exercise price of \$2.04 per share and expire in September 2012. The Company measures the fair value of the warrants at each balance sheet date, using the Black-Scholes method, and a gain or loss is recorded in earnings each period as change in fair value of warrants.

Assumptions used to determine the fair value of the warrants were:

	<b>Three months ended April 30, 2011</b>	<b>Three months ended April 30, 2010</b>	<b>Six months ended April 30, 2011</b>	<b>Six months ended April 30, 2010</b>
Estimated fair value of stock	\$ 1.21-\$3.75	\$ 0.85-\$0.86	\$ 0.62-\$3.75	\$ 0.85-\$1.02
Expected warrant term	1.9-2.1 years	2.9-3.1 years	1.9-2.4 years	2.9-3.4 years
Risk-free rate	0.6-0.8%	1.4-1.4%	0.4-0.8%	1.4%-1.6%
Expected volatility	75.5-77.9%	75.9-76.1%	73.5-77.9%	75.9-76.1%
Dividend yield	0%	0%	0%	0%

A summary of the changes to the Company's warrant liability, as measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended April 30, 2011 and 2010 is presented below:

**Six months                  Six months**

	<b>Three months ended April 30, 2011</b>	<b>Three months ended April 30, 2010</b>	<b>ended April 30, 2011</b>	<b>ended April 30, 2010</b>
Beginning balance	\$ 560	\$ 424	\$ 144	\$ 626
Warrants exercised	(937)		(937)	
Total loss (gain) included in net income	2,928	(27)	3,344	(229)
Ending balance	\$ 2,551	\$ 397	\$ 2,551	\$ 397

Upon exercise of 537,734 of the warrants outstanding, the warrant liability associated with those warrants, amounting to \$937 was reclassified to additional paid-in capital.

The carrying value of accounts receivable, accounts payable and accrued expenses, due from factor, and advances from customers are reasonable estimates of the fair values because of their short-term maturity.

#### **4. INCOME TAXES**

The only federal income tax provision recorded by the Company for the three and six months ended April 30, 2011 was for alternative minimum taxes. No other provision for income taxes has been recorded because the Company has available net operating loss carryforwards (NOLs) to offset taxable income. NOL carryforwards available for income tax purposes at April 30, 2011 amount to approximately \$75.1 million for federal income taxes and approximately \$28.6 million for state income taxes. Due to the Company's history of losses, a valuation allowance sufficient to fully offset NOLs and other deferred tax assets has been established under current accounting pronouncements and this valuation allowance will be maintained until sufficient positive evidence exists to support its reversal.

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For the six months ended April 30, 2010, the Company recorded an income tax benefit related to proceeds of \$1,656 received in January 2010 from the sale of the rights to approximately \$21,200 of New Jersey state income tax operating loss carryforwards, under the Technology Business Tax Certificate Program administered by the New Jersey Economic Development Authority.

**5. DUE FROM FACTOR**

Due from factor consists of the following:

	<b>April 30, 2011</b>	<b>October 31, 2010</b>
Outstanding accounts receivable sold to factor	\$ 16,245	\$ 13,754
Less: allowances	(5,819)	(3,298)
Less: advances from factor	(4,069)	(9,441)
	<b>\$ 6,357</b>	<b>\$ 1,015</b>

Outstanding accounts receivable sold to factor as of April 30, 2011 and October 31, 2010 for which the Company retained credit risk amounted to \$0.7 million and \$1.4 million, respectively. As of April 30, 2011 and October 31, 2010, there were no allowances for uncollectible accounts.

A summary of the changes in price protection and other customer sales incentive allowances included as a reduction of the amounts due from factor is presented below:

	<b>Six Months Ended April 30,</b>	
	<b>2011</b>	<b>2010</b>
Allowances beginning of period	\$ (3,298)	\$ (4,380)
Provision for price protection	(2,202)	(2,331)
Amounts charged against allowance and other changes	(319)	3,309
Allowances end of period	<b>\$ (5,819)</b>	<b>\$ (3,402)</b>

**6. ACCOUNTS AND OTHER RECEIVABLES**

The following table presents the major components of accounts and other receivables:

	<b>April 30, 2011</b>	<b>October 31, 2010</b>
Trade accounts receivable	\$ 475	\$ 726
Royalties receivable	720	
Allowances		(25)
Other	24	24
	<b>\$ 1,219</b>	<b>\$ 725</b>

**7. PREPAID EXPENSES**

Prepaid expenses consist of the following:

<b>April 30, 2011</b>	<b>October 31, 2010</b>
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Prepaid media advertising	\$ 599	\$ 746
Other	99	175
	\$ 698	\$ 921

**8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued expenses consist of the following:

	<b>April 30, 2011</b>	<b>October 31, 2010</b>
Accounts payable – trade	\$ 4,232	\$ 4,856
Royalties and software development	6,100	5,517
Sales commissions	282	120
Salaries, accrued bonuses and other compensation	2,492	592
Other accruals	757	290
	<b>\$ 13,863</b>	<b>\$ 11,375</b>

**Table of Contents****9. COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive income (loss) for the three- and six-month periods ended April 30, 2011 and 2010, are summarized as follows:

	<b>Three Months Ended April 30,</b>		<b>Six Months Ended April 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Net income (loss)	\$ 2,075	\$ (1,607)	\$ 8,837	\$ 2,200
Other comprehensive income (loss) foreign currency translation adjustments	1	(43)	(2)	(79)
Total comprehensive income (loss)	\$ 2,076	\$ (1,650)	\$ 8,835	\$ 2,121

**10. WORKFORCE REDUCTION**

During January 2010, Company management initiated a plan of restructuring to better align its workforce to its revised operating plans. As part of the plan, the Company reduced its personnel count by 16 employees, then representing 17% of its workforce. The Company recorded charges of approximately \$403 in the six months ended April 30, 2010 in connection with the terminations, which consisted primarily of severance and unused vacation payments. The expenses were included in operating costs and expenses as shown in the table below:

	<b>Six Months Ended April 30, 2010</b>
Product research and development	\$ 90
Selling and Marketing	243
General and Administrative	70
Total	\$ 403

These payments were made during the Company's fiscal year ended October 31, 2010. At April 30, 2011 and October 31, 2010, the Company had no remaining liability related to the workforce reduction.

**11. RELATED PARTIES**

The Company currently has an agreement with Morris Sutton, the Company's former Chief Executive Officer and father of the Company's Chief Executive Officer, under which he provides services as a consultant. The agreement provides for a monthly retainer of \$13. Mr. Sutton was also eligible to receive a commission in an amount equal to 2% of net sales to certain accounts before January 1, 2010. Commissions were recorded when the sales occurred, but not paid until collection of the related accounts receivable from customers. Therefore, some of these payments were made to Mr. Sutton in 2010.

The following table summarizes expenses related these agreements with Mr. Sutton:

	<b>Three Months Ended April 30,</b>		<b>Six Months Ended April 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Consulting	\$ 38	\$ 38	\$ 75	\$ 75
Commissions and fees		86		131
Total	\$ 38	\$ 124	\$ 75	\$ 206

MSI Entertainment, a company controlled by Morris Sutton, acted as an agent for the Company in sales to a distributor. The titles, for which the Company had no other planned distribution, were paid for in advance by the distributor. In the six months ended April 30, 2011, the Company paid MSI a fee of \$78 in connection with the sales.

The Company also has an agreement with a member of its board of directors to provide specified strategic consulting services, in addition to his services as a board member, on a month-to-month basis at a monthly rate of \$10. Under this arrangement, fees earned in the three and six months ended April 30, 2011 totaled \$30 and \$60, respectively. Fees earned in the three and six months ended April 30, 2010 totaled \$13 and \$13, respectively.

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**12. SUBSEQUENT EVENT**

On June 3, 2011, the Company acquired selected assets and assumed certain liabilities, consisting of accounts payable, of Quick Hit, Inc., a developer and operator of online games. The assets purchased include substantially all of the assets of Quick Hit, excluding assets related to its online interactive football game (the Game). The Company also entered into an exclusive license agreement with a senior lender to Quick Hit for the source code to the Game, with an option to purchase in the future. The aggregate purchase price paid was \$837 in cash. There was no relationship between the Company and Quick Hit prior to the execution of the agreements.

In connection with the transaction, the Company hired twelve employees of Quick Hit, representing substantially all of its personnel. In addition, the Company issued 170,652 shares of restricted common stock as part of the inducement and retention of employees. The shares of restricted common stock have a transaction-date fair value of \$524 and vest one-third every six months over the 18 month period following June 3, 2011.

Certain detailed financial information for the acquisition and the assets acquired is not yet available and the Company's accounting for the acquisition is not yet complete. Accordingly, certain disclosures under ASC 805, Business Combinations, is currently impractical.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

Statements in this quarterly report on Form 10-Q that are not historical facts constitute forward-looking statements that are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Those factors include, among other things, those listed under "Risk Factors" and elsewhere in our annual report on Form 10-K for the fiscal year ended October 31, 2010 and other filings with the SEC. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continuing, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Moreover, neither we nor any other person assume responsibility for the accuracy or completeness of these statements. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results. References herein to we, us, our, and the Company are to Majesco Entertainment Company.

**Overview**

We are a provider of video game products primarily for the family-oriented, mass-market consumer. We sell our products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors. We publish video games for almost all major current generation interactive entertainment hardware platforms, including Nintendo's DS, DSi and Wii, Sony's PlayStation 3, or PS3, and PlayStation Portable, or PSP, Microsoft's Xbox 360 and the personal computer, or PC. We also publish games for numerous digital platforms, including mobile platforms such as iPhone, iPad and iPod Touch, as well as online platforms such as Facebook.

Our video game titles are targeted at various demographics at a range of price points. Due to the larger budget requirements for developing and marketing premium console titles for core gamers, we focus on publishing more casual games targeting mass-market consumers. In some instances, our titles are based on licenses of well-known properties and, in other cases based on original properties. We collaborate and enter into agreements with content providers and video game development studios for the creation of our video games.

Our operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company is centrally managed and our chief operating decision makers, the chief executive and other officers, use consolidated and other financial information supplemented by sales information by product category, major product title and platform for making operational decisions and assessing financial performance. Accordingly, we operate in a single segment.

*Net Revenues.* Our revenues are principally derived from sales of our video games. We provide video games primarily for the mass market and casual game player. Our revenues are recognized net of estimated reserves for price protection and other allowances.

*Cost of Sales.* Cost of sales consists of product costs and amortization and impairment of software development costs and license fees. A significant component of our cost of sales is product costs. Product costs are comprised primarily of manufacturing and packaging costs of the disc or cartridge media, royalties to the platform manufacturer and manufacturing and packaging costs of peripherals. In cases where we act as a distributor for other publishers products, cost of sales may increase as we acquire products at a higher fixed wholesale price. While product costs as a percentage of revenue are higher on these products, we do not incur upfront development and licensing fees or resulting amortization of software development costs. Commencing upon the related product's release, capitalized software development and intellectual property license costs are amortized to cost of sales. When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales less on impairment of software development costs and license fees on future releases. These expenses may be incurred prior to a game's release.

*Gross Profit.* Gross profit is the excess of net revenues over product costs and amortization and impairment of software development and license fees. Development and license fees incurred to produce video games are generally incurred up front and amortized to cost of sales. The recovery of these costs and total gross profit is dependent upon



achieving a certain sales volume, which varies by title.

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*Product Research and Development Expenses.* Product research and development expenses relate principally to costs of third-party video game developers and related supervision, testing new products and conducting quality assurance evaluations during the development cycle not allocated to games for which technological feasibility has been established. Costs incurred are employee-related, may include equipment, and are not allocated to cost of sales. These costs also include the cost to develop and maintain free to play online games which are still considered to be in the planning stage, or for which costs cannot be reasonably expected to be recovered through future revenues.

*Selling and Marketing Expenses.* Selling and marketing expenses consist of marketing and promotion expenses, including television advertising, the cost of shipping products to customers and related employee costs. Credits to retailers for trade advertising are a component of these expenses.

*General and Administrative Expenses.* General and administrative expenses primarily represent employee-related costs, including corporate executive and support staff, general office expenses, professional fees and various other overhead charges. Professional fees, including legal and accounting expenses, typically represent the second largest component of our general and administrative expenses. These fees are partially attributable to our required activities as a publicly traded company, such as filings with the Securities and Exchange Commission, or SEC.

*Loss on Impairment of Software Development Costs and License Fees – Cancelled Games.* Loss on impairment of software development costs and license fees – cancelled games consists of contract termination costs, and the write-off of previously capitalized costs, for games that were cancelled prior to their release to market. We periodically review our games in development and compare the remaining cost to complete each game to projected future net cash flows expected to be generated from sales. In cases where we don't expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete the game, we cancel the game, and record a charge to operating expenses. While we incur a current period charge on these cancellations, we believe we are limiting the overall loss on a game project that is no longer expected to perform as originally expected due to changing market conditions or other factors. Significant management estimates are required in making these assessments, including estimates regarding retailer and customer interest, pricing, competitive game performance, and changing market conditions. The Company recorded losses of \$1.4 million and \$0.2 million on impairment for cancelled games in the six months ended April 30, 2011 and 2010, respectively.

*Interest and Financing Costs.* Interest and financing costs are directly attributable to our factoring and our purchase-order financing arrangements.

*Income Taxes.* Income taxes consists of our provision for income taxes and proceeds from the sale of rights to certain net operating loss carryforwards in the state of New Jersey. Utilization of our net operating loss, or NOL, carryforwards may be subject to a substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code. The annual limitation may result in the expiration of net operating loss carryforwards before utilization. Due to our history of losses, a valuation allowance sufficient to fully offset our NOL and other deferred tax assets has been established under current accounting pronouncements, and this valuation allowance will be maintained until sufficient positive evidence exists to support its reversal.

**Seasonality and Variations in Interim Quarterly Results**

Our quarterly net revenues, gross profit, and operating income are impacted significantly by the seasonality of the retail selling season, and the timing of the release of new titles. Sales of our catalog and other products are generally higher in the first and fourth quarters of our fiscal year (ending January 31 and October 31, respectively) due to increased retail sales during the holiday season. Sales and gross profit as a percentage of sales also generally increase in quarters in which we release significant new titles because of increased sales volume as retailers make purchases to stock their shelves and meet initial demand for the new release. These quarters also benefit from the higher selling prices that we are able to achieve early in the product's life cycle. Therefore, sales results in any one quarter are not necessarily indicative of expected results for subsequent quarters during the fiscal year.

**Critical Accounting Estimates**

Our discussion and analysis of the financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP.

The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. We base our estimates

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on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from these estimates under different assumptions or conditions.

We have identified the policies below as critical to our business operations and to the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed throughout management's discussion and analysis of financial condition and results of operations when such policies affect our reported and expected financial results.

*Revenue Recognition.* We recognize revenue upon the shipment of our product when: (1) title and the risks and rewards of ownership are transferred; (2) persuasive evidence of an arrangement exists; (3) we have no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. Certain products are sold to customers with a street date (the earliest date these products may be resold by retailers). Revenue for sales of these products is not recognized prior to their street date. Some of our software products provide limited online features at no additional cost to the consumer. Generally, we have considered such features to be incidental to our overall product offerings and an inconsequential deliverable. Accordingly, we do not defer any revenue related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying our revenue recognition policy. In addition, some of our software products are sold exclusively as downloads of digital content for which the consumer takes possession of the digital content for a fee. Revenue from product downloads is generally recognized when the download is made available (assuming all other recognition criteria are met).

When we enter into license or distribution agreements that provide for multiple copies of games in exchange for guaranteed amounts, revenue is recognized in accordance with the terms of the agreements, generally upon delivery of a master copy, assuming our performance obligations are complete and all other recognition criteria are met, or as per-copy royalties are earned on sales of games.

*Price Protection and Other Allowances.* We generally sell our products on a no-return basis, although in certain instances, we provide price protection or other allowances on certain unsold products in accordance with industry practices. Price protection, when granted and applicable, allows customers a partial credit with respect to merchandise unsold by them. Revenue is recognized net of estimates of these allowances. Sales incentives and other consideration that represent costs incurred by us for benefits received, such as the appearance of our products in a customer's national circular advertisement, are generally reflected as selling and marketing expenses. We estimate potential future product price protection and other discounts related to current period product revenue.

Our provisions for price protection and other allowances fluctuate over periods as a result of a number of factors including analysis of historical experience, current sell-through of retailer inventory of our products, current trends in the interactive entertainment market, the overall economy, changes in customer demand and acceptance of our products and other related factors. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. However, actual allowances granted could materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions, technological obsolescence due to new platforms, product updates or competing products. For example, the risk of requests for allowances may increase as consoles pass the midpoint of their lifecycle and an increasing number of competitive products heighten pricing and competitive pressures. While management believes it can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, this will result in a change in our reserves, which would impact the net revenues and/or selling and marketing expenses we report. For the six-month periods ended April 30, 2011 and 2010, we provided allowances for future price protection and other allowances of \$2.2 million and \$2.3 million, respectively. The fluctuations in the provisions reflect fluctuations in gross sales and our estimates of future price protection based on the factors discussed above.

We limit our exposure to credit risk by factoring a portion of our receivables to a third party that primarily buys them without recourse. For receivables that are not sold without recourse, we analyze our aged accounts receivables,

payment history and other factors to make a determination if collection of receivables is likely, or a provision for uncollectible accounts is necessary.

*Capitalized Software Development Costs and License Fees.* Software development costs include development fees, in the form of milestone payments made to independent software developers. Software development costs are capitalized once technological feasibility of a product is established and management expects such costs to be recoverable against future revenues. For products where proven game engine technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Amounts related to software development that are not capitalized are charged immediately to product research and development costs. Commencing upon a related product's release, capitalized software development costs are amortized to cost of sales based upon the higher of (i) the ratio of current revenue to total projected revenue or (ii) straight-line charges over the expected marketable life of the product.

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Prepaid license fees represent license fees to holders for the use of their intellectual property rights in the development of our products. Minimum guaranteed royalty payments for intellectual property licenses are initially recorded as an asset (capitalized license fees) and a current liability (accrued royalties payable) at the contractual amount upon execution of the contract or when specified milestones or events occur and when no significant performance commitment remains with the licensor. Licenses are expensed to cost of sales at the higher of (i) the contractual royalty rate based on actual sales or (ii) an effective rate based upon total projected revenue related to such license.

Capitalized software development costs are classified as non-current if they relate to titles for which we estimate the release date to be more than one year from the balance sheet date.

The amortization period for capitalized software development costs and license fees is usually no longer than one year from the initial release of the product. If actual revenues or revised forecasted revenues fall below the initial forecasted revenue for a particular license, the charge to cost of sales may be larger than anticipated in any given quarter. The recoverability of capitalized software development costs and license fees is evaluated quarterly based on the expected performance of the specific products to which the costs relate.

When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales—loss on impairment of software development costs and license fees future releases, in the period such a determination is made. These expenses may be incurred prior to a game's release for games that have been developed. If a game is cancelled prior to completion of development and never released to market, the amount is expensed to operating costs and expenses—loss on impairment of capitalized software development costs and license fees—cancelled games. As of April 30, 2011, the net carrying value of our licenses and software development costs was \$5.6 million. If we were required to write off licenses or software development costs, due to changes in market conditions or product acceptance, our results of operations could be materially adversely affected.

License fees and milestone payments made to our third-party developers are typically considered non-refundable advances against the total compensation they can earn based upon the sales performance of the products. Any additional royalty or other compensation earned beyond the milestone payments is expensed to cost of sales as incurred.

We have expensed as research and development all costs associated with the development of social games for Facebook. We have launched one Facebook game, in the six months ended April 30, 2011, which has not earned significant revenues to date, and are continuing to evaluate alternatives for future development and monetization. In connection with its June 2011 acquisition of assets, we have added the development team of Quick Hit, Inc., to enhance our abilities in the development and operation of our social games.

*Inventory.* Inventory, which consists principally of finished goods, is stated at the lower of cost or market. Cost is determined by the first-in, first-out method. We estimate the net realizable value of slow-moving inventory on a title-by-title basis and charge the excess of cost over net realizable value to cost of sales. Some of our inventory items are packaged with accessories, such as belts for our *Zumba* games and dolls for our *Babysitting Mama* game. The purchase of these accessories involves longer lead times and minimum purchase amounts, which require us to maintain higher levels of inventory than for other games. Therefore, these items have a higher risk of obsolescence, which we review periodically based on inventory and sales levels. As of April 30, 2011, our net inventory balance includes an aggregate of approximately \$3.6 million of accessories and games bundled with accessories.

*Accounting for Stock-Based Compensation.* Stock-based compensation expense is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including, in the case of stock option awards, estimating expected stock volatility. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

*Commitments and Contingencies.* We record a liability for commitments and contingencies when the amount is both probable and reasonably estimable.



**Table of Contents****Results of operations****Three months ended April 30, 2011 versus three months ended April 30, 2010**

*Net Revenues.* Net revenues for the three months ended April 30, 2011 increased to \$32.1 million from \$10.9 million in the comparable quarter last year. The increase was due to sales of *Zumba Fitness* released in the first quarter of fiscal 2011 on three platforms, the Nintendo Wii, Kinect for the Xbox 360, and Sony's Move for the Playstation. In addition, we recognized royalty revenue from sales of *Zumba Fitness* in Europe and sales of accessories to our distribution partner. Sales of *Zumba Fitness* accounted for approximately 75% of total revenue in the period. Sales of our line of products based on Cooking Mama accounted for approximately 50% of our sales for the three months ended April 30, 2010.

The following table sets forth our net revenues by platform:

	Three Months Ended April 30,				Six Months Ended April 30,			
	2011	%	2010	%	2011	%	2010	%
	(thousands)		(thousands)		(thousands)		(thousands)	
Nintendo Wii	\$ 17,242	54%	\$ 2,678	25%	\$ 43,141	54%	\$ 10,651	27%
Microsoft Xbox 360	6,779	21%	1	%	17,563	22%	177	%
Nintendo DS	3,343	10%	8,002	73%	12,361	15%	28,257	70%
Sony Playstation 3	1,158	4%			3,490	4%		
Other	3,620	11%	225	2%	4,053	5%	1,027	3%
<b>TOTAL</b>	<b>\$ 32,142</b>	<b>100%</b>	<b>\$ 10,906</b>	<b>100%</b>	<b>\$ 80,608</b>	<b>100%</b>	<b>\$ 40,112</b>	<b>100%</b>

*Gross Profit.* Gross profit for the three months ended April 30, 2011 was \$13.7 million compared to a gross profit of \$3.1 million in the same quarter last year. The increase in gross profit was primarily attributable to increased net revenues for the three months ended April 30, 2011, as discussed above. Gross profit as a percentage of net sales was 42% for the three months ended April 30, 2011, compared to 29% for the three months ended April 30, 2010. The increase in gross profit as a percentage of sales was primarily due to higher pricing on *Zumba Fitness* and the effects of royalty revenues recognized from sales of *Zumba Fitness* in Europe. We license the rights to publish *Zumba Fitness* in Europe to another video game publisher and receive a royalty based on net revenues of the product. We record these revenues net in accordance with ASC 605-45, Revenue Recognition – Principal Agent Considerations.

*Product Research and Development Expenses.* Research and development costs increased \$1.3 million to \$2.0 million for the three months ended April 30, 2011, from \$0.7 million for the comparable period in 2010. The increase was primarily due to costs related to our online games business, increased production headcount, and charges incurred for development of console game prototypes prior to reaching technological feasibility. We contract with third parties to develop and operate our social games. We expense these amounts as incurred for these games as they are still in the planning stage and future revenues cannot be reliably predicted. During 2011, we opened a second production facility in San Francisco and increased the number of producers we have managing game development due to an increase in the number and quality of games we are developing. In connection with its June 2011 acquisition of assets, we have added the development team of Quick Hit, Inc., to enhance our abilities in the development and operation of our social games. Accordingly, periodic research and development expenses are expected to increase.

*Selling and Marketing Expenses.* Total selling and marketing expenses were approximately \$2.6 million for the three months ended April 30, 2011, compared to \$1.5 million for the three months ended April 30, 2010. The increase was primarily due to increased media advertising and other marketing costs associated with *Zumba Fitness* as well as increased sales commissions and warehousing and freight costs associated with higher sales activities.

*General and Administrative Expenses.* For the three-month period ended April 30, 2011, general and administrative expenses were approximately \$2.3 million in each of the 2011 and 2010 periods as increases in employee and consultant compensation were largely offset by decreases in other expenses.



*Loss on Impairment of Software Development Costs and License Fees - Cancelled Games.* For the three-month period ended April 30, 2011, loss on impairment of software development costs and license fees - cancelled games, amounted to \$1.3 million compared to \$0.2 million in the prior-year period, reflecting a greater number of projects cancelled. Our games in development are subject to periodic reviews to assess game design and changing market conditions. When we do not expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete a game, we cancel the game, and

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record a charge to operating expenses for the carrying amount of the game. During the three months ended April 30, 2011, we cancelled several games in development for the Sony Move platform, resulting in a charge of \$0.6 million, and cancelled several other game projects resulting in charges totaling \$0.7 million.

*Operating Income.* Operating income for the three months ended April 30, 2011 was approximately \$5.3 million, compared to a loss of \$1.6 million in the comparable period in 2010. As discussed above, increased revenues and gross profits during the three months ended April 30, 2011 more than offset increased operating expenses and losses on impaired games during the period.

*Change in Fair Value of Warrant Liability.* We have outstanding warrants that contain a provision that may require settlement by transferring assets and are, therefore, recorded at fair value as liabilities. We recorded a loss of \$2.9 million for the three months ended April 30, 2011, which reflected an increase in the fair value of the warrants primarily based upon the increased market price of a share of our common stock during the period, compared to a modest gain for the three months ended April 30, 2010. In the three months ended April 30, 2011, 537,734 of the 1,697,735 previously-outstanding warrants subject to remeasurement were exercised. The warrants expire in September 2012.

*Income Taxes.* In the three months ended April 30, 2011, our income tax expense represented our current alternative minimum tax provision. In the three months ended April 30, 2010, the recorded income tax benefit represented the reversal, based on losses in the period, of alternative minimum taxes provided in the three months ended January 31, 2010.

*Net Income.* Net income for the three months ended April 30, 2011 was \$2.1 million compared to \$1.6 million loss for the three months ended April 30, 2010. As discussed above, increased revenues and gross profits more than offset increased operating expenses, impairments and the change in the fair value of our warrant liability.

**Six months ended April 30, 2011 versus six months ended April 30, 2010**

*Net Revenues.* Net revenues for the six months ended April 30, 2011 increased to \$80.6 million from \$40.1 million in the comparable period last year. Fluctuations in sales for the first six months of the year reflect the performance of new releases in the holiday selling season. During the six months ended April 30, 2011, we released *Babysitting Mama* for the Nintendo Wii and *Zumba Fitness* on three platforms, the Nintendo Wii, Kinect for the Xbox 360, and Sony's Move for the Playstation3. The strong performance of the *Zumba* titles in the first two quarters of the fiscal year was primarily responsible for the increased revenues over the prior-year period. Sales of *Zumba Fitness* accounted for approximately 67% of total revenue in the period. Sales from our series of products based on *Cooking Mama* accounted for approximately 50% of revenue in the six months ended April 30, 2010.

*Gross Profit.* Gross profit for the six months ended April 30, 2011 was \$33.3 million compared to a gross profit of \$11.8 million in the same period last year. The increase in gross profit was primarily attributable to increased net revenues for the six months ended April 30, 2011, as discussed above. Gross profit as a percentage of net sales was 41% for the six months ended April 30, 2011, compared to 29% for the six months ended April 30, 2010. The increase in gross profit as a percentage of sales was primarily due to higher pricing on some of our products when compared to the same period in the prior year, particularly *Zumba Fitness*. In addition, the six months ended April 30, 2010 were affected by higher sales allowances as a percentage of revenues and by \$1.0 million of losses on impairment of software development costs and license fees.

*Product Research and Development Expenses.* Research and development costs increased \$1.6 million to \$3.2 million for the six months ended April 30, 2011, from \$1.6 million for the comparable period in 2010. The increase was primarily due to costs related to our online games business, increased production headcount, and charges incurred for development of console game prototypes prior to reaching technological feasibility. We contract with third parties to develop and operate our social games. We expensed these amounts as incurred for these games as they are still in the planning stage and future revenues cannot be reliably predicted. During 2011 we opened a second production facility in San Francisco and increased the number of producers we have managing game development due to an increase in the number and quality of games we are developing. In addition, increased production staff and the recognition of increased profit-based compensation to existing personnel was partially offset by the effects of \$0.1 million severance charges recorded in the prior year.

*Selling and Marketing Expenses.* Total selling and marketing expenses were approximately \$9.6 million for the six months ended April 30, 2011, compared to \$4.6 million for the three months ended April 30, 2010. The increase was primarily due to increased media advertising and other marketing costs associated with the launch of *Zumba Fitness* and *Babysitting Mama*, including several television and internet advertising campaigns. Variable costs including commissions, warehousing and freight also increased due to higher volume and, were partially offset by lower costs incurred in Europe following our shift from a publishing and distribution model to a licensing approach, including the effects of severance charges recorded in the prior year.

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*General and Administrative Expenses.* For the six-month period ended April 30, 2011, general and administrative expenses were \$5.6 million, an increase of \$1.2 million from \$4.4 million in the comparable period in 2010. The increase was primarily due to a \$1.4 million increase in profit-based bonus compensation recognized in the current period.

*Loss on Impairment of Software Development Costs and License Fees – Cancelled Games.* For the six-month period ended April 30, 2011, loss on impairment of software development costs and license fees – cancelled games, amounted to \$1.4 million compared to \$0.2 million in the prior-year period, reflecting a greater number of projects cancelled. Our games in development are subject to periodic reviews to assess game design and changing market conditions. When we do not expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete a game, we cancel the game, and record a charge to operating expenses for the carrying amount of the game. During the six months ended April 30, 2011 we cancelled several games in development for the Sony Move platform, resulting in a charge of \$0.6 million, and several other game projects resulting in charges totaling \$0.7 million.

*Operating Income.* Operating income for the six months ended April 30, 2011 was approximately \$13.4 million, an increase of \$12.5 million from \$0.9 million in the comparable period in 2010. As discussed above, increased revenues and gross profits during the six months ended April 30, 2011 more than offset increased sales, marketing and other operating expenses and impairments during the period.

*Change in Fair Value of Warrant Liability.* We have outstanding warrants that contain a provision that may require settlement by transferring assets and are, therefore, recorded at fair value as liabilities. We recorded a loss of \$3.3 million for the six months ended April 30, 2011, which reflected an increase in the fair value of the warrants during the period primarily as a result of the increased market price for a share of our common stock, compared to a gain of \$0.2 million for the six months ended April 30, 2010, which reflected a decrease in the fair value of warrants during the period.

*Income Taxes.* For the six months ended April 30, 2010, we received proceeds of approximately \$1.7 million from the sale of approximately \$21.2 million of New Jersey state income tax net operating loss carryforwards under the state's Technology Business Tax Certificate Program and recorded the proceeds as an income tax benefit in the period. In the six months ended April 30, 2011, our income tax expense represented our current alternative minimum tax provision. We did not sell New Jersey loss carryforwards in the period. Any potential future sales of New Jersey loss carryforwards that the Company may pursue will be subject to the provisions of the tax certificate program, including an application and qualification process, and the availability of approved funding.

*Net Income.* Net income for the six months ended April 30, 2011 was \$8.8 million compared to \$2.2 million for the six months ended April 30, 2010. As discussed above, increased revenues and gross profits more than offset increased operating expenses, impairments and the change in the fair market value of our warrant liability.

**Liquidity and Capital Resources**

Our current plan is to fund our operations through product sales. However, our operating results may vary significantly from period to period and we have previously incurred operating losses. We may be required to modify our plan, or seek outside sources of financing, and/or equity sales, if our operating plan and sales targets are not met. There can be no assurance that such funds will be available on acceptable terms, if at all. In the event that we are unable to negotiate alternative financing, or negotiate terms that are acceptable to us, we may be forced to modify our business plan materially, including making reductions in game development and other expenditures. Additionally, we are dependent on our purchase order financing and account receivable factoring agreement to finance our working capital needs, including the purchase of inventory. If the current level of financing was reduced or we fail to meet our operational objectives, it could create a material adverse change in the business.

As of April 30, 2011, our cash and cash equivalents balance was \$18.5 million and funds available to us under our factoring and purchase order financing agreements were \$7.9 million and \$10.0 million, respectively. We expect continued fluctuations in the use and availability of cash due to the seasonality of our business, timing of receivables collections and working capital needs necessary to finance our business.

*Factoring and Purchase Order Financing.*

To satisfy our liquidity needs, we factor our receivables. Under our factoring agreement, we have the ability to take cash advances against accounts receivable and inventory of up to \$20.0 million, and the availability of up to \$2.0 million in letters of credit. The factor, in its sole discretion, can reduce the availability of financing at any time. We had outstanding advances against accounts receivable of approximately \$4.1 million under our factoring agreement at April 30, 2011. We also utilize financing to provide

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funding for the manufacture of our products. Under an agreement with a finance company, we have up to \$10.0 million of availability for letters of credit and purchase order financing. In connection with these arrangements, the finance company and the factor have a security interest in substantially all of our assets.

Under the terms of our factoring agreement, we sell our accounts receivable to the factor. The factor, in its sole discretion, determines whether or not it will accept the credit risk associated with a receivable. If the factor does not accept the credit risk on a receivable, we may sell the accounts receivable to the factor while retaining the credit risk. In both cases we surrender all rights and control over the receivable to the factor. However, in cases where we retain the credit risk, the amount can be charged back to us in the case of non-payment by the customer. The factor is required to remit payments to us for the accounts receivable purchased from us, provided the customer does not have a valid dispute related to the invoice. The amount remitted to us by the factor equals the invoiced amount, adjusted for allowances and discounts we have provided to the customer, less factor charges of 0.45 to 0.5% of the invoiced amount.

In addition, we may request that the factor provide us with cash advances based on our accounts receivable and inventory. The factor may either accept or reject our request for advances at its discretion. Generally, the factor allowed us to take advances in an amount equal to 70% of net accounts receivable, plus 60% of our inventory balance, up to a maximum of \$2.5 million of our inventory balance. Occasionally, the factor allows us to take advances in excess of these amounts for short-term working capital needs. These excess amounts are typically repaid within a 30-day period. At April 30, 2011, we had no excess advances outstanding.

Amounts to be paid to us by the factor for any accounts receivable are offset by any amounts previously advanced by the factor. The interest rate is prime plus 1.5%, annually, subject to a 5.5% floor. In certain circumstances, an additional 1.0% annually is charged for advances against inventory.

Manufacturers require us to present a letter of credit, or pay cash in advance, in order to manufacture the products required under a purchase order. We utilize letters of credit either from a finance company or our factor. The finance company charges 1.5% of the purchase order amount for each transaction for 30 days, plus administrative fees. Our factor provides purchase order financing at a cost of 0.5% of the purchase order amount for each transaction for 30 days. Additional charges are incurred if letters of credit remain outstanding in excess of the original time period and/or the financing company is not paid at the time the products are received. When our liquidity position allows, we will pay cash in advance instead of utilizing purchase order financing. This results in reduced financing and administrative fees associated with purchase order financing.

*Advances from Customers.* On a case by case basis, distributors and other customers have agreed to provide us with cash advances on their orders. These advances are then applied against future sales to these customers. In exchange for these advances, we offer these customers beneficial pricing or other considerations.

*Contingencies and Commitments.* At times, we may be a party to routine claims and suits in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the outcome of any current such routine claims would not have a material adverse effect on the Company's business, financial condition, and results of operations or liquidity.

**Off-Balance Sheet Arrangements**

As of April 30, 2011, we had no off-balance sheet arrangements.

**Cash Flows**

Cash and cash equivalents were \$18.5 million as of April 30, 2011 compared to \$8.0 million at October 31, 2010. Working capital as of April 30, 2011 was \$25.7 million compared to \$11.6 million at October 31, 2010.

*Operating Cash Flows.* Our principal operating source of cash is sales of our interactive entertainment products. Our principal operating uses of cash were for payments associated with third-party developers of our software, costs incurred to manufacture, sell and market our video games and general and administrative expenses.

For the three months ended April 30, 2011, we generated approximately \$14.7 million in cash flow from operating activities, compared to \$4.6 million in the same period last year. The increase in cash provided by operating activities was primarily due to increased operating income in the period, which increased \$12.5 million from \$0.9 million in the six months ended April 30, 2010 to \$13.4 million in the six months ended April 30, 2011. Operating income excludes the non-cash effects of the change in our warrant liability and interest and financing costs.



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*Investing Cash Flows.* Cash used in investing activities for the six months ended April 30, 2011 and 2010 were primarily related to purchases of computer equipment.

Subsequent to April 30, 2011, we used \$0.8 million of cash for the acquisition of assets of Quick Hit, Inc.

*Financing Cash Flows.* Net cash used in financing activities for the six months ended April 30, 2011 and 2010 primarily consisted of cash used to reduce outstanding borrowings under our purchase order financing agreement for seasonal inventory purchases and increased \$0.7 million in the period due to a higher level of prior-year-end purchasing activity. In addition, in the six months ended April 30, 2011, we received \$1.7 million of proceeds from the exercise of outstanding units and warrants.

**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

Not Applicable.

**Item 4. Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in the Securities Exchange Act of 1934 Rule 13a-15(e) and 15d-15(e), as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

While we believe our disclosure controls and procedures and our internal control over financial reporting are adequate, no system of controls can prevent errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur. Controls can also be circumvented by individual acts of some people, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Subject to the limitations above, management believes that the consolidated financial statements and other financial information contained in this report, fairly present in all material respects our financial condition, results of operations, and cash flows for the periods presented.

Based on the evaluation of the effectiveness of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective at a reasonable assurance level.

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.



**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

A description of the risks associated with our business, financial condition, and results of operations is set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended October 31, 2010. These factors continue to be meaningful for your evaluation of the Company and we urge you to review and consider the risk factors presented in the Form 10-K. There have been no material changes to these risks.

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

Pursuant to previously issued warrants and unit purchase options, we issued shares of our common stock and received gross proceeds on the dates shown below.

Common stock issued pursuant to exercise of warrants at an exercise price of \$2.04 per share:

Date	Common Shares Issued	Gross Proceeds Received
3/28/11	400,000	\$ 816,000
3/30/11	169,307	345,386
4/6/11	22,213	45,315
4/8/11	22,213	45,315
4/26/11	26,667	54,401

Common stock and warrants issued pursuant to exercise of unit purchase options at an exercise price of \$1.50 per share,:

Date	Common Shares Issued	Warrants Issued	Gross Proceeds Received
3/25/11	201,134	80,453	\$ 301,701
4/6/11	55,533	22,213	83,300

The issuance of the shares of common stock and warrants issued upon exercise of such previously issued outstanding warrants and unit purchase options were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The resale by the holders of the shares issued is covered by an effective registration statement on Form S-3 previously filed with the Securities and Exchange Commission on September 21, 2007.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. (Removed and Reserved)****Item 5. Other Information**

None.

**Item 6. Exhibits**

- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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**SIGNATURE**

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.

**MAJESCO ENTERTAINMENT  
COMPANY**

/s/ Jesse Sutton  
Jesse Sutton  
Chief Executive Officer  
Date: June 14, 2011