

MULTIMEDIA GAMES INC
Form 10-Q
May 08, 2009

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 March 31, 2009

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
(State or other jurisdiction of incorporation or organization)

74-2611034
(IRS Employer Identification No.)

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

78746
(Zip Code)

(512) 334-7500
(Registrant's telephone number, including area code)

Registrant's website: www.multimedialogames.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 required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer" "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer

Accelerated Filer

Edgar Filing: MULTIMEDIA GAMES INC - Form 10-Q

Non-Accelerated Filer

Smaller Reporting Company

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

As of May 1, 2009, there were 26,642,942 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 Consolidated Financial Statements (Unaudited)	
	Consolidated Balance Sheets (As of March 31, 2009 and September 30, 2008)	3
	Consolidated Statements of Operations (For the three months ended March 31, 2009 and 2008)	5
	Consolidated Statements of Operations (For the six months ended March 31, 2009 and 2008)	6
	Consolidated Statements of Cash Flows (For the six months ended March 31, 2009 and 2008)	7
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	36
Item 4.	Controls and Procedures	37

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	38
Item 1A.	Risk Factors	38
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	48
Item 3.	Defaults upon Senior Securities	48
Item 4.	Submission of Matters to a Vote of Security Holders	48
Item 5.	Other Information	48
Item 6.	Exhibits	48
	Signatures	49

Exhibit Index

PART I
FINANCIAL INFORMATION

Item 1.

Condensed Financial Statements
MULTIMEDIA GAMES, INC.
CONSOLIDATED BALANCE SHEETS
As of March 31, 2009 and September 30, 2008
(In thousands, except shares)
(Unaudited)

	March 31, 2009	September 30, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 9,249	\$ 6,289
Accounts receivable, net of allowance for doubtful accounts of \$1,359 and \$1,209, respectively	27,076	23,566
Inventory	1,680	2,445
Deferred contract costs, net	2,002	998
Prepaid expenses and other	2,881	2,170
Current portion of notes receivable, net	14,692	23,072
Federal and state income tax receivable	5,964	2,198
Deferred income taxes	8,109	6,876
Total current assets	71,653	67,614
Restricted cash and long-term investments	804	868
Leased gaming equipment, net	42,126	36,024
Property and equipment, net	61,210	67,329
Long-term portion of notes receivable, net	47,301	46,690
Intangible assets, net	32,602	37,356
Deferred income taxes	17,493	16,902
Other assets	2,462	4,157
Total assets	\$ 275,651	\$ 276,940
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 2,569	\$ 1,544
Accounts payable and accrued expenses	26,999	29,248
Federal and state income tax payable	—	33
Deferred revenue	4,584	2,640
Total current liabilities	34,152	33,465
Revolving line of credit	29,000	19,000
Long-term debt, less current portion	65,925	66,444
Other long-term liabilities	1,052	1,131
Deferred revenue, less current portion	5,211	6,168
Total liabilities	135,340	126,208
Commitments and contingencies		
Stockholders' equity:		
Preferred stock:		
Series A, \$0.01 par value, 1,800,000 shares authorized, no shares issued and outstanding		—

Edgar Filing: MULTIMEDIA GAMES INC - Form 10-Q

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,
32,546,359 and 32,511,988 shares issued, and
26,642,942 and 26,608,571 shares outstanding, respectively

—
—
325

—
—
325

-3-

MULTIMEDIA GAMES, INC.

CONSOLIDATED BALANCE SHEETS – (Continued)

As of March 31, 2009 and September 30, 2008

(In thousands, except shares)

(Unaudited)

	March 31, 2009	September 30, 2008
Additional paid-in capital	84,262	83,076
Treasury stock, 5,903,417 common shares at cost	(50,128)	(50,128)
Retained earnings	108,263	117,581
Accumulated other comprehensive loss, net	(2,411)	(122)
Total stockholders' equity	140,311	150,732
Total liabilities and stockholders' equity	\$ 275,651	\$ 276,940

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

MULTIMEDIA GAMES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended March 31, 2009 and 2008
(In thousands, except per share data)
(Unaudited)

	Three Months Ended March 31,	
	2009	2008
REVENUES:		
Gaming revenue:		
Oklahoma compact	\$ 15,333	\$ 14,138
Class II	5,168	7,546
Charity	2,874	4,396
All other	5,438	5,262
Gaming equipment, system sale and lease revenue	4,355	378
Other	702	482
Total revenues	33,870	32,202
OPERATING COSTS AND EXPENSES:		
Cost of gaming equipment and systems sold and royalty fees	2,327	414
Selling, general and administrative expenses	20,473	16,633
Amortization and depreciation	15,639	12,433
Total operating costs and expenses	38,439	29,480
Operating income (loss)	(4,569)	2,722
OTHER INCOME (EXPENSE):		
Interest income	1,246	1,136
Interest expense	(1,891)	(2,491)
Other income	—	872
Income (loss) before income taxes	(5,214)	2,239
Income tax (expense) benefit	1,820	(981)
Net income (loss)	\$ (3,394)	\$ 1,258
Basic earnings (loss) per common share		
	\$ (0.13)	\$ 0.05
Diluted earnings (loss) per common share		
	\$ (0.13)	\$ 0.05
Shares used in earnings (loss) per common share:		
Basic	26,643	26,271
Diluted	26,643	27,243

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

MULTIMEDIA GAMES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Six Months Ended March 31, 2009 and 2008
(In thousands, except per share data)
(Unaudited)

	Six Months Ended March 31,	
	2009	2008
REVENUES:		
Gaming revenue:		
Oklahoma compact	\$ 29,129	\$ 25,699
Class II	10,175	15,586
Charity	5,417	8,253
All other	10,378	9,900
Gaming equipment, system sale and lease revenue	6,121	2,149
Other	1,226	850
Total revenues	62,446	62,437
OPERATING COSTS AND EXPENSES:		
Cost of gaming equipment and systems sold and royalty fees	4,174	1,204
Selling, general and administrative expenses	40,737	32,734
Amortization and depreciation	30,504	24,956
Total operating costs and expenses	75,415	58,894
Operating income (loss)	(12,969)	3,543
OTHER INCOME (EXPENSE):		
Interest income	2,536	2,270
Interest expense	(4,026)	(4,631)
Other income	74	1,210
Income (loss) before income taxes	(14,385)	2,392
Income tax (expense) benefit	5,067	(735)
Net income (loss)	\$ (9,318)	\$ 1,657
Basic earnings (loss) per common share	\$ (0.35)	\$ 0.06
Diluted earnings (loss) per common share	\$ (0.35)	\$ 0.06
Shares used in earnings (loss) per common share:		
Basic	26,633	26,234
Diluted	26,633	27,283

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

MULTIMEDIA GAMES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended March 31, 2009 and 2008

(In thousands)

(Unaudited)

	Six Months Ended March 31,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (9,318)	\$ 1,657
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Amortization	2,698	2,248
Depreciation	27,806	22,708
Accretion of contract rights	2,912	1,944
Provisions for long lived asset impairment	(832)	78
Deferred income taxes	(1,824)	(1,854)
Share-based compensation	1,124	587
Provision for doubtful accounts	397	262
Interest income from imputed interest on development agreements	(2,274)	(1,822)
Changes in operating assets and liabilities:		
Accounts receivable	(6,429)	(4,547)
Inventory	1,583	(2,030)
Deferred contract costs	(1,004)	129
Prepaid expenses and other	984	(1,672)
Federal and state income tax payable/receivable	(3,799)	(795)
Notes receivable	303	(348)
Accounts payable and accrued expenses	(2,399)	(3,215)
Other long-term liabilities	(15)	345
Deferred revenue	987	1,764
NET CASH PROVIDED BY OPERATING ACTIVITIES	10,900	15,439
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Acquisition of property and equipment and leased gaming equipment	(27,319)	(17,317)
Proceeds from disposal of assets	—	323
Acquisition of intangible assets	(1,488)	(2,716)
Advances under development agreements	(1,250)	(35,566)
Repayments under development agreements	11,166	16,007
NET CASH USED IN INVESTING ACTIVITIES	(18,891)	(39,269)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options, warrants, and related tax benefit	62	150
Proceeds from long-term debt	5,257	1,928
Proceeds from revolving lines of credit	10,695	26,512
Payments on long-term debt	(4,751)	(6,203)
Payments on revolving lines of credit	(695)	(3,387)
NET CASH PROVIDED BY FINANCING ACTIVITIES	10,568	19,000
EFFECT OF EXCHANGE RATES ON CASH	383	(16)
Net increase (decrease) in cash and cash equivalents	2,960	(4,846)
Cash and cash equivalents, beginning of period	6,289	5,805
Cash and cash equivalents, end of period	\$ 9,249	\$ 959

SUPPLEMENTAL CASH FLOW DATA:

Interest paid	\$	2,585	\$	3,472
Income tax paid	\$	253	\$	3,505

NON-CASH TRANSACTIONS:

Contract rights resulting from imputed interest on development agreement notes receivable	\$	(176)	6,129
Transfer of leased gaming equipment to inventory		818	—

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

MULTIMEDIA GAMES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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, 2008, as amended by Amendments No. 1 and No. 2 on Form 10-K/A thereto.

The unaudited financial statements included herein as of March 31, 2009, and for each of the three and six month periods ended March 31, 2009 and 2008, have been prepared by the Company pursuant to accounting principles generally accepted in the United States, 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 three and six month periods ended March 31, 2009, are not necessarily indicative of the results which will be realized for the year ending September 30, 2009.

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, 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.

Accounting Estimates – The preparation of consolidated 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, 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 and contract losses, estimated useful lives of property and equipment and intangible assets, impairment of property and equipment and intangible assets, 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.

-8-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Reclassification – Reclassifications were made to the prior-period consolidated statement of cash flows to conform to the current-period financial statement presentation. This reclassification did not have an impact on the Company’s previously reported results of operations.

Revenue Recognition – In accordance with the provision of Staff Accounting Bulletin No. 104, “Revenue Recognition,” or SAB 104, 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.

Gaming Revenue – The Company derives gaming revenue from the following sources:

- Oklahoma Compact – Participation revenue generated from its games placed by the Company under the Oklahoma Compact
- Class II – Participation revenue generated from the Company’s Native American Class II product
- Charity – Participation revenue generated from its charity bingo product
- All Other – Participation revenue from Class III back-office systems, New York Lottery system, Mexico bingo market, and certain other participation-based markets

The majority of the Company’s gaming revenue is of a recurring nature, and 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 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 periodically 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 Statement of Position 97-2, or SOP 97-2, “Software Revenue Recognition,” as amended, and Emerging Issues Task Force, or EITF 00-21, “Revenue Arrangements with Multiple Deliverables.” 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.

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

§ 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 will be recognized on the completed-contract method in accordance with American Institute of Certified Public Accountants Statement of Position 81-1, or SOP 81-1, “Accounting for Performance of Construction-Type and Certain Production-Type Contracts.” In the event that the Company expected a loss on a contract accounted for under SOP 81-1, the Company would record the estimated loss in the quarter in which it was determined that a loss was expected.

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 are classified as current assets under “Deferred contract costs, net.”

At March 31, 2009, the following amounts were recorded in the Company’s consolidated financial statements:

	March 31, 2009 (in thousands)
Costs incurred on uncompleted contracts	\$ 2,654
Billings on uncompleted contracts	(652)
Deferred contract costs	\$ 2,002

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 March 31, 2009, amounted to \$804,000, 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 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 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.

-10-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

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 12 months. Inventories are stated at 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 placed with customers under participation arrangements are included in leased gaming equipment. Leased gaming equipment also includes a “pool” of rental terminals, i.e., the “rental pool.” Rental pool units are those units that have previously been placed in the field under participation arrangements, but are currently back with the Company, being refurbished and/or awaiting redeployment. 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. The Company did not record any impairment charges in the quarter ended March 31, 2009.

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 Income – The Company had no other income for the three months ended March 31, 2009 and \$74,000 for the six months ended March 31, 2009. Historically, other income consisted of distributions from a limited partnership interest, accounted for on the cost basis.

Other Long-Term Liabilities – Other long-term liabilities at March 31, 2009, include investments held at fair value by the Company’s prize-fulfillment firm related to outstanding MegaBingo jackpot-prize-winner annuities of \$804,000. At March 31, 2009, other long term liabilities also included \$248,000 related to amounts due under a separation agreement with a former Chief Executive Officer.

Fair Value of Financial Instruments – The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. At March 31, 2009, the carrying amounts for the Company’s financial instruments, which include accounts and notes receivable, accounts payable, the Revolving Credit Facility, and long-term debt and capital leases, approximated fair value.

Segment and Related Information – Although the Company has a number of operating divisions, separate segment data has not been presented as they meet the criteria for aggregation as permitted by Statement of Financial Accounting Standards, or SFAS No. 131, “Disclosures About Segments of an Enterprise and Related Information.”

Costs of Computer Software – Software development costs have been accounted for in accordance with SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” Under SFAS No. 86, 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 \$477,000 and \$1.1 million during the three and six month periods ended March 31, 2009, respectively, and \$940,000 and \$2.1 million during the three and six month periods ended March 31, 2008, respectively. Software development costs primarily consist of personnel costs and rent for related office space. 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 consolidated statements of operations.

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Income Taxes – The Company accounts for income taxes using the asset and liability method and applies the provisions of SFAS, No. 109, “Accounting for Income Taxes,” as well as the Financial Accounting Standards Board, or FASB, Interpretation No. 48, “Accounting for Uncertainty in Income Taxes,” or FIN 48. Under SFAS No. 109, 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. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109. FIN 48 also 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. The new FASB standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 in the first quarter of fiscal 2008 and recorded a liability of \$295,000 related to uncertain tax positions in the first quarter of fiscal 2008. There have been no additional reserves recorded related to FIN 48.

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

Share-Based Compensation – On October 1, 2005, the Company adopted the provisions of SFAS No. 123(revised), “Share-Based Payment.” SFAS No. 123(R) is a revision of SFAS No. 123 and supersedes Accounting Principles Board Opinion, or APB, No. 25, “Accounting for Stock Issued to Employees”. Among other items, SFAS No. 123(R) eliminated the use of APB No. 25 and the intrinsic value method of accounting, and 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, consistent with the method used for pro forma disclosures under SFAS No. 123. SFAS No. 123(R) permits companies to adopt its requirements using either a “modified prospective” method, or a “modified retrospective” method. 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 of SFAS No. 123(R).

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 661,000 option grants issued during the quarter ended March 31, 2009. Total pretax share-based compensation for the three and six month periods ended March 31, 2009 were \$470,000 and \$1.1 million, respectively. The total income tax benefit recognized in the statement of operations for share-based compensation arrangements was \$152,000 and \$295,000 for the three and six month periods ended March 31, 2009, respectively. As of March 31, 2009, \$5.2 million of unamortized stock compensation expense will be recognized over the vesting periods of the various option grants.

Foreign Currency Translation. The Company accounts for currency translation in accordance with SFAS No. 52, "Foreign Currency Translation." 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 SFAS 130, "Reporting Comprehensive Income."

-12-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Recent Accounting Pronouncements Issued. In March 2008, the FASB issued SFAS No 161, “Disclosures about Derivative Instruments and Hedging Activities—An Amendment of FASB Statement No. 133.” SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how: (a) an entity uses derivative instruments; (b) derivative instruments and related hedged items are accounted for under SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities;” and (c) derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008, though earlier application is encouraged. Accordingly, the Company expects to adopt SFAS No. 161 beginning in fiscal 2010. The Company expects that SFAS No. 161 will have an impact on accounting for derivative instruments and hedging activities once adopted, but the significance of the effect is dependent upon entering into these related transactions, if any, at that time.

Effective October 1, 2008, The Company adopted SFAS No. 157, “Fair Value Measurements,” for its financial assets and financial liabilities, but it has not yet adopted SFAS No. 157 as it relates to nonfinancial assets and liabilities based on the February 2008 issuance of FASB Staff Position 157-2, “Effective Date of FASB Statement No. 157,” which permits a one-year deferral of the application of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The adoption of SFAS 157 as it pertains to financial assets and liabilities did not have a material impact on the Company’s results of operations, financial position or liquidity. The Company will adopt SFAS 157 for non-financial assets and non-financial liabilities on October 1, 2009, and the Company is currently evaluating the effect, if any, the adoption may have on its results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115 “Accounting for Certain Investments in Debt and Equity Securities,” which permits entities to choose to measure many financial instruments and certain other items at fair value with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement became effective for the Company beginning in October 2008. The implementation of SFAS No. 159, effective October 1, 2008, did not have a material effect on the consolidated financial statements in the quarter ended March 31, 2009.

In December 2007, the FASB issued SFAS No. 141 (revised), “Business Combinations.” SFAS No. 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer’s income tax valuation allowance. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company is required to adopt SFAS No. 141(R) effective October 1, 2009, and the Company is currently evaluating the effect, if any, the adoption may have on its results of operations or financial position.

In December 2007, the FASB issued SFAS No. 160, “Non Controlling Interests in Consolidated Financial Statements,” an amendment of Accounting Research Bulletin, or ARB No. 51, “Consolidated Financial Statements.” SFAS No. 160 changes the accounting for non controlling (minority) interests in consolidated financial statements, including the requirement to classify non controlling interests as a component of consolidated stockholders’ equity, and the elimination of “minority interest” accounting in results of operations with earnings attributable to non controlling

interests reported as part of consolidated earnings. Additionally, SFAS No. 160 revises the accounting for both increases and decreases in a parent's controlling ownership interest. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company is required to adopt SFAS No. 160 effective October 1, 2009, and the Company is currently evaluating the effect, if any, the adoption may have on its results of operations or financial position.

-13-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

2. DEVELOPMENT AGREEMENTS

The Company enters 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 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.

In the third quarter of fiscal 2008, the Company fulfilled a commitment to a significant, existing Oklahoma tribal customer to provide approximately 43.8%, or \$65.6 million, of the total funding for a facility expansion. Because of the Company's commitment to fund the expansion, it secured the right to place an additional 1,400 gaming units in the expanded facility in southern Oklahoma. The Company recorded all advances as a note receivable and imputed interest on the interest free loan. The discount (imputed interest) was recorded as contract rights, and as of the first quarter of fiscal 2009 is being amortized over the life of the agreement. The repayment period of the note will be based on the performance of the facility. In the second quarter of fiscal 2009, the Company made a commitment of \$7.0 million that consists of both a loan for new unit placements in an expanded facility and a placement fee for certain units to remain at the current facility for an extended period of time. As of March 31, 2009, the Company had advanced \$1.25 million toward this commitment. The remaining commitment of \$5.75 million is expected to be paid over the next three fiscal quarters in the following increments: \$2.75 million, \$1.5 million, and \$1.5 million, respectively.

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 circumstance during the three or six month periods ended March 31, 2009, which would require an impairment charge to the assets' carrying value.

The following net amounts related to advances made under development agreements and were recorded in the following balance sheet captions:

	March 31, 2009	September 30, 2008
(In thousands)		
Included in:		
Notes receivable, net	\$ 54,285	\$ 61,750
Intangible assets – contract rights, net of accumulated amortization	26,278	29,368

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

3. PROPERTY AND EQUIPMENT AND LEASED GAMING EQUIPMENT

The Company's property and equipment and leased gaming equipment consisted of the following:

	March 31, 2009	September 30, 2008	Estimated Useful Lives
(In thousands)			
Gaming equipment and third-party gaming content licenses available for deployment (1)	\$ 20,924	\$ 30,252	
Deployed gaming equipment	102,303	96,584	3-5 years
Deployed third-party gaming content licenses	39,702	34,444	1.5-3 years
Tribal gaming facilities and portable buildings	4,720	4,720	5-7 years
Third-party software costs	7,827	7,732	3-5 years
Vehicles	3,485	3,502	3-10 years
Other	3,162	3,191	3-7 years
Total property and equipment	182,123	180,425	
Less accumulated depreciation and amortization	(120,913)	(113,096)	
Total property and equipment, net	\$ 61,210	\$ 67,329	
Leased gaming equipment	\$ 170,987	\$ 165,903	3 years
Less accumulated depreciation	(128,861)	(129,879)	
Total leased gaming equipment, net	\$ 42,126	\$ 36,024	

(1) Gaming equipment and third-party gaming content licenses begin depreciating when they are placed in service.

In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," 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 six month periods ended March 31, 2009, in the ordinary course of business activities or upon reviewing the account balances, the Company disposed of or wrote off \$39,000 and \$77,000, respectively of third-party gaming content licenses, tribal gaming facilities and portable buildings, vehicles, deployed gaming equipment, or other equipment. In the same periods ended March 31, 2008, the Company disposed of or wrote off \$73,000 and \$130,000, respectively.

Leased gaming equipment includes player terminals placed under participation arrangements that are either at customer facilities or in the rental pool.

4. INTANGIBLE ASSETS

The Company's intangible assets consisted of the following:

	March 31, 2009	September 30, 2008	Estimated Useful Lives
	(In thousands)		
Contract rights under development agreements	\$ 41,147	\$ 41,325	5-7 years
Internally-developed gaming software	27,231	26,473	1-5 years
Patents and trademarks	8,660	8,464	1-5 years
Other	1,054	1,054	3-5 years
Total intangible assets	78,092	77,316	
Less accumulated amortization – all other	(45,490)	(39,960)	
Total intangible assets, net	\$ 32,602	\$ 37,356	

Contract rights are amounts allocated to intangible assets for dedicated floor space resulting from development agreements. For a description of intangible assets related to development agreements, see "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations." The related amortization expense, or accretion of contract rights, is netted against its respective revenue category in the accompanying consolidated statements of operations. In the preceding table, \$157,000 of the \$41.1 million in contract rights is not currently being amortized. The facility is expected to be completed during the quarter ended June 30, 2009. Therefore, the amortization of these contract rights is expected to begin during that quarter.

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Internally developed gaming software is accounted for under the provisions of SFAS No. 86 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 12 month period, gaming engines over an 18 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 six month periods ended March 31, 2009, amortization expense related to internally-developed gaming software was \$1.0 million and \$2.2 million, respectively; \$753,000 and \$1.5 million, respectively, for the three and six month periods ended March 31, 2008. During the three and six month periods ended March 31, 2009, the Company wrote off \$420,000 and \$455,000, respectively, related to internally-developed gaming software and patents and trademarks, compared to write-offs of \$308,000 in the same periods ended March 31, 2008.

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

5.

NOTES RECEIVABLE

The Company's notes receivable consisted of the following:

	March 31, 2009	September 30, 2008
	(In thousands)	
Notes receivable from development agreements	\$ 63,785	\$ 72,706
Less imputed interest discount reclassified to contract rights	(9,500)	(10,956)
Notes receivable from equipment sales and other	7,708	8,012
Notes receivable, net	61,993	69,762
Less current portion	(14,692)	(23,072)
Notes receivable – non-current	\$ 47,301	\$ 46,690

Notes receivable from development agreements are generated from reimbursable amounts advanced under development agreements.

Notes receivable from equipment sales consisted of financial instruments issued by customers for the purchase of player terminals and licenses, and bore interest at 7.47%. 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.

6.

CREDIT FACILITY, LONG-TERM DEBT AND CAPITAL LEASES

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

March 31, 2009	September 30, 2008
-------------------	-----------------------

Edgar Filing: MULTIMEDIA GAMES INC - Form 10-Q

	(In thousands)	
Long-term revolving lines of credit	\$ 29,000	\$ 19,000
Term loan facility	\$ 68,494	\$ 67,988
Less current portion	(2,569)	(1,544)
Long-term debt, less current portion	\$ 65,925	\$ 66,444

-16-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Credit Facility. On April 27, 2007, the Company entered into a \$150 million Revolving Credit Facility which replaced its previous Credit Facility in its entirety. On October 26, 2007, the Company amended the Revolving Credit Facility, transferring \$75 million of the revolving credit commitment to a fully funded \$75 million term loan due April 27, 2012. 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 Revolving Credit Facility 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 Revolving Credit Facility and the term loan.

The Credit Facility provides the Company with the ability to finance development agreements and acquisitions and working capital for general corporate purposes. Amounts under the \$75 million revolving credit commitment and the \$75 million term loan mature in five years, and advances under the term loan and revolving credit commitment bear interest at the Eurodollar rate plus the applicable spread, tied to various levels of interest pricing determined by total debt to EBITDA (EBITDA is defined as earnings before interest, taxes, amortization, depreciation, and accretion of contract rights). As of March 31, 2009, the \$29.0 million drawn under the revolving credit commitment bore interest at 4.75% and two tranches of the term loan of \$50.0 million and \$17.1 million bore interest at 8.5% and 5.5%, respectively, also included in the March 31, 2009 and 2008 balances are approximately \$1.2 million and \$585,000, respectively, of accrued interest.

The Credit Facility is collateralized by substantially all of the Company's assets, and also contains financial covenants as defined in the agreement. These covenants include (i) a minimum fixed-charge coverage-ratio of not less than 1.50 : 1.0; (ii) a maximum total debt to EBITDA ratio of not more than 2.25 : 1.00 through June 30, 2008, and 1.75 : 1.00 from September 30, 2008 thereafter; and (iii) a minimum trailing twelve-month EBITDA of not less than \$60 million for each quarter. As of March 31, 2009, the Company is in compliance with its loan covenants. The Credit Facility 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). In the second quarter of 2008, the Company made a mandatory prepayment of the term loan in the amount of \$4.5 million, due to an early prepayment of a development agreement note receivable. As of March 31, 2009, the Credit Facility had availability of \$44.8 million, subject to covenant restrictions.

The Credit Facility also required that the Company enter into hedging arrangements covering at least \$50 million of the term loan for a three-year period by June 1, 2008. Therefore, on May 29, 2008, the Company purchased, for \$390,000, an interest rate cap (5% cap rate) covering \$50 million of the term loan. The Company accounts for this hedge in accordance with SFAS No. 133 which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet, at their respective fair values. The Company records changes on a mark to market basis, changes to the fair value of the interest rate cap on a quarterly basis. These changes in fair value are recorded in interest expense in the consolidated statement of operations.

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

7. EARNINGS (LOSS) PER COMMON SHARE

Earnings (loss) per common share is computed in accordance with SFAS No. 128, “Earnings per Share.” Presented below is a reconciliation of net income (loss) available to common stockholders 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.

	Three months ended March 31,		Six months ended March 31,	
	2009	2008	2009	2008
Income (loss) available to common stockholders (in thousands)	\$ (3,394)	\$ 1,258	\$ (9,318)	\$ 1,657
Weighted average common shares outstanding	26,642,911	26,271,074	26,633,136	26,233,574
Effect of dilutive securities:				
Options	-	972,391	-	1,049,300
Weighted average common and potential shares outstanding	26,642,911	27,243,465	26,633,136	27,282,874
Basic earnings (loss) per share	\$ (0.13)	\$ 0.05	\$ (0.35)	\$ 0.06
Diluted earnings (loss) per share	\$ (0.13)	\$ 0.05	\$ (0.35)	\$ 0.06

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 March 31,		Six months ended March 31,	
	2009	2008	2009	2008
Common Stock Options	7,154,893	2,482,083	6,949,306	2,437,274
Range of exercise price	\$ 1.00-18.71	\$ 7.40-21.53	\$ 1.00-\$21.53	\$ 7.61-21.53

In the three and six month periods ended March 31, 2009, options to purchase approximately 6.7 million and 6.5 million shares of common stock, with exercise prices ranging from \$1.61 to \$18.71 per share and \$1.61 to \$21.53 per share, respectively, were not included in the computation of dilutive earnings per share, due to the antidilutive effect, and approximately 452,000 and 462,000 equivalent shares were not included, due to the loss generated in the current periods.

8. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to the possibility of loss contingencies arising in its business and such contingencies are accounted for in accordance with SFAS No. 5, “Accounting for 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.

-18-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Cory Investments Ltd. On May 7, 2008, Cory Investments, LTD., or Cory Investments, filed suit in the state court in Oklahoma City, Oklahoma against the Company, along with others, including Clifton Lind; Robert Lannert; Gordon Graves; Video Gaming Technologies, Inc. or VGT and its president, Jon Yarbrough, and a former VGT representative, John Marley; Worldwide Gaming Technologies, or WGT; AGS, LLC, d/b/a American Gaming Systems; AGS Partners, LLC; Ronald Clapper, the owner of WGT, AGS, LLC and AGS Partners; Sierra Design Group; and Bally Technologies, Inc. The case asserts that the Company offered allegedly illegal Class III games on the MegaNanza® and Reel Time Bingo® gaming systems to Native American tribes in Oklahoma, which had a severely negative impact on Cory Investments' market for its legal Class II games. Cory Investments also alleges that the defendants conspired to drive it and other Class II competitors out of the Class II market in Oklahoma and other states. In addition to the conspiracy allegations, Cory Investments alleges six causes of action: (i) deceptive trade practices; (ii) common law unfair competition; (iii) wrongful interference with business; (iv) malicious wrong/prima facie tort; (v) intentional interference with contract; and (vi) unreasonable restraint of trade. Cory Investments is seeking unspecified actual and punitive damages and equitable relief.

All of the defendants have filed motions to dismiss which are currently set for hearing on May 13, 2009. The Company believes that the claims of Cory Investments are without merit and intends to defend the case vigorously. Given the inherent uncertainties in this litigation, the Company is unable to make any prediction as to the ultimate outcome.

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, Oasis 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.

The Company has 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 the Company 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 the Company. On January 28, 2008, the Company filed an answer to the complaint denying liability. The Company 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 have filed a motion to dismiss and a motion for summary judgment as to these claims. The Company has filed a motion for partial summary judgment on its breach of contract and specific performance claims seeking to enforce the terms of the Sublicense Agreement. The Company has also moved for summary judgment on Gamco's complaint on the ground that it is a licensee. On February 25, 2009, on its own motion, the court continued the hearing on these motions. All motions to dismiss and motions for summary judgment are now set to be heard on July 16, 2009.

On January 13, 2009, the court held a Markman hearing to construe the claims of the '035 Patent. The Court also heard argument on the Company's motion for partial summary judgment to invalidate all of the means-plus-function claims of the '035 Patent under 35 U.S.C. § 112¶ 6. On January 15, 2009, the court issued an order granting Gamco leave to amend its proposed constructions on the means-plus function claims and setting a schedule for supplemental briefing on amended claims construction, stating that none of the structures proposed by Gamco in the claim chart considered by the court referenced an algorithm that was needed to satisfy federal circuit court standards. The court has not yet issued a claim construction ruling or a decision on the Company's motion for partial summary judgment. A telephonic status conference is currently scheduled to take place on June 23, 2009. A trial date has not yet been set by the court.

The Company continues to vigorously defend this matter. Given the inherent uncertainties in this litigation, the Company is unable to make any prediction as to the ultimate outcome.

-19-

MULTIMEDIA GAMES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Other Litigation. 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.

The Alabama Governor's office and the Alabama Attorney General's office have issued conflicting public statements regarding the legality of certain types of equipment commonly used to play charity bingo within the state of Alabama. On March 9, 2009, the Governor's Task Force on illegal games raided the Whitehall Entertainment Center and confiscated games from various gaming manufacturers, including approximately 34 of the Company's games. While no legal proceedings have been initiated against the Company at this point, it is possible that such proceedings are being contemplated by the Governor's Office.

Other. Existing federal and state regulations may also impose civil and criminal sanctions for various activities prohibited in connection with gaming operations, including but not limited to: (i) false statements on applications; (ii) failure or refusal to obtain required licenses; and / or (iii) the placement of gaming devices, terminals, player stations, and / or units.

9. SUBSEQUENT EVENTS

On May 1, 2009, the Company entered into a comprehensive settlement agreement with Diamond Game Enterprises, Inc., or Diamond Game, to resolve all claims arising from a November, 2004 lawsuit filed by Diamond Game against the Company and several former officers, including Clifton Lind, Robert Lannert and Gordon Graves. This settlement agreement was reached while the parties were engaged in federal mediation and the Company did not admit any wrongdoing in relation to the underlying litigation. The Company incurred an additional \$4.2 million in legal fees and settlement costs, net of expected insurance proceeds, related to the settlement agreement; these costs are appropriately included in the Company's financial statements as of March 31, 2009.

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

We are a developer and distributor of comprehensive systems, content, electronic games and gaming player terminals for the casino, charity, international bingo, and video lottery markets. Initially, our customers were located primarily in the Native American gaming sector; however, beginning around 2003, we began diversifying into broader domestic and international gaming markets.

Although we continue to develop systems and products for Native American tribes throughout the United States, we now intend to further expand our efforts to include the development and marketing of products and services for: (i) the various commercial casino markets; (ii) video lottery systems and other products for various domestic and international lotteries; and (iii) products for various charity and international bingo and other emerging markets.

Our products cover a broad spectrum of the gaming industry, including: interactive systems for both server-based and stand-alone gaming operations; interactive electronic bingo games for the Native American Class II and charity gaming markets and for the Class III, stand-alone and video lottery markets; proprietary gaming player terminals in multiple configurations and formats; electronic instant lottery scratch ticket systems; casino management systems, including player tracking, cash and cage, slot accounting, and slot management modules; unified currency systems; and other electronic and paper bingo systems. In addition, we provide maintenance, operations support and other services for our customers and products.

We design and develop networks, software and content that provide our customers with, among other things, comprehensive gaming systems, some of which are delivered through a telecommunications network that links our player terminals with one another, both within a single gaming facility or among several gaming facilities.

We derive the majority of our gaming revenue from participation (revenue sharing) agreements, pursuant to which we place systems, player terminals, proprietary and licensed content operated on player terminals, and back-office systems and equipment (collectively referred to as gaming systems) into gaming facilities. To a lesser degree, we earn revenue from the sale or placement of gaming systems (e.g., the opening of a new casino, or a change in the law that allows existing casinos to increase the number of player terminals permitted under prior law) on a lease-purchase basis and from the back-office fees generated by video lottery systems, principally in the Washington State, Class III market. We also generate gaming revenue as consideration for providing the central determinant system for a network of player terminals operated by the New York State Division of the Lottery. In addition, we earn a small portion of our

revenue from the sale of lottery systems and the placement of nontraditional gaming products, such as electronic scratch tickets, or linked interactive paper bingo systems. In fiscal 2006, we entered the international electronic bingo market and currently supply bingo systems to four customers in Mexico, whereby we receive fees based on the net earnings of each system. During fiscal 2009, we intend to generate revenue from the sale of non-linked Class III player terminals to Class III Native American markets.

-21-

Class III Games and Systems for Oklahoma

During 2004, the Oklahoma Legislature passed legislation authorizing certain forms of gaming at racetracks, and additional types of games at tribal gaming facilities, pursuant to a tribal-state compact. The Oklahoma gaming legislation allows the tribes to sign a compact with the state of Oklahoma to operate an unlimited number of electronic instant bingo games, electronic bonanza-style bingo games, electronic amusement games, and non-house-banked tournament card games. In addition, certain horse tracks in Oklahoma are allowed to operate a limited number of instant and bonanza-style bingo games and electronic amusement games. All vendors placing games at any of the racetracks under the compact are required to be licensed by the state of Oklahoma. Pursuant to the compacts, vendors placing games at tribal facilities have to be licensed by each tribe. All electronic games placed under the compact have to be certified by independent testing laboratories to meet technical specifications. These technical specifications were published by the Oklahoma Horse Racing Commission and the individual tribal gaming authorities in the first calendar quarter of 2005. We are fully licensed in Oklahoma and as of March 31, 2009, we had placed 6,647 player terminals at 42 facilities that are operating under the Oklahoma gaming compact. We generally receive a 20% revenue share for the games played under the Oklahoma Gaming Compact.

Class III Games and Systems for Native American and Commercial Casino Markets

During fiscal 2007, we began designing and developing stand-alone Class III player terminals to be sold or placed on a revenue share basis in the large Class III stand-alone gaming market for Native American casinos as well as domestic and international commercial casinos. All player terminals delivered to these markets will have to receive specific jurisdictional approvals from the appropriate testing laboratory and from the appropriate regulatory agency. Our first stand-alone player terminals outside of Oklahoma have been placed in Rhode Island. We believe that additions to our key senior management personnel will help accelerate our entrance into new Class III markets and that we will deliver additional player terminals to other Class III markets this fiscal year.

As a prerequisite to conducting business in the major commercial gaming markets, we, our directors, officers, and key employees are required to secure various licenses. It is difficult to properly estimate the amount of time and expense that will be necessary to complete the required licensing process. We are not currently licensed to conduct business in any major gaming market (international or domestic).

Class II Market

We derive our Class II gaming revenues from participation arrangements with our Native American customers. Under these arrangements, we retain ownership of the gaming equipment installed at our customers' tribal gaming facilities, and receive revenue based on a percentage of the win per unit generated by each gaming system. Our portion of the win per unit is reported by us as "Gaming revenue – Class II" and represents the total amount that end users wager, less the total amount paid to end users for prizes, the amounts retained by the facilities for their share of the hold and the accretion of contract rights.

As the Class II market has matured, we have seen new competitors with significant gaming experience and financial resources enter the market. New tribal-state compacts, such as the Oklahoma gaming legislation passed by referendum in 2004, have also led to increased competition. In addition, there has been what we believe to be an extended period of non enforcement by regulators of existing restrictions on non-Class II devices, which has forced us to continue competing against games that do not appear to comply with the published regulatory restrictions on Class II games. Due to this increased competition in Oklahoma, and because of continued conversion to games played under the compact, we have and may continue to experience pressure on our pricing model and win per unit, with the result that gaming providers, including us, are competing on the basis of price as well as the entertainment value and technological quality of their products. We have also experienced and expect to continue to experience a decline in the number of our Class II games deployed in Oklahoma, in accordance with our conversion strategy. While we will

continue to compete by regularly introducing new and more entertaining games with technological enhancements that we believe will appeal to end users, we believe that the level of revenue retained by our customers from their installed base of player terminals will become a more significant competitive factor, one that may require us to change the terms of our participation arrangements with customers. We will continue the deployment of one-touch, compact-compliant Class III games in Oklahoma, which could reduce the number of our Class II machines in play in that same jurisdiction.

Charity Market

Charity bingo and other forms of charity gaming are operated by or for the benefit of nonprofit organizations for charitable, educational and other lawful purposes. These games are typically only interconnected within the gaming facility where the terminals are located. Regulation of charity gaming is vested with each individual state, and in some states, regulatory authority is delegated to county or municipal governmental units.

-22-

In Alabama, our largest charity market, constitutional amendments have been passed authorizing charity bingo in certain locations. The regulation of charity bingo in Alabama is typically vested with a local governmental authority. However, the Alabama Governor's office has recently commissioned a task force to review the types of games placed in the charitable bingo halls in the state. The Alabama Governor's office and the Alabama Attorney General's office have issued conflicting public statements regarding the legality of certain types of equipment commonly used to play charity bingo within the state of Alabama.

We ordinarily place player terminals under participation arrangements in the charity market and receive a percentage of the win per unit generated by each of the player terminals. As of March 31, 2009, we had 2,273 high-speed, standard bingo games installed for the charity market in three Alabama facilities.

All Other Gaming Markets

Class III Washington State Market. The majority of our Class III gaming equipment in Washington State has been sold to customers outright, for a one-time purchase price, which is reported in our results of operations as "Gaming equipment, system sale and lease revenue" at the time of proper revenue recognition. Certain game themes we use in the Class III market have been licensed from third parties and are resold to customers along with our Class III player terminals. Historically, revenue from the sale of Class III gaming equipment is recognized when the units are delivered to the customer, and the licensed games installed, or over the contract term when the fair value of undelivered products has not been established. Because we sell new products, systems and services for which fair value has not been established, beginning in the third fiscal quarter of 2009, revenue generated from this market will be recognized over the terms of the contracts. To a considerably lesser extent, we also enter into either participation arrangements or lease-purchase arrangements for our Class III player terminals, on terms similar to those used for our player terminals in the Class II market.

We also receive a small back-office fee from both leased and sold gaming equipment in Washington State. Back-office fees cover the service and maintenance costs for back-office servers installed in each facility to run our Class III games, as well as the cost of related software updates.

State Video Lottery Market. In January 2004, we installed our central determinant system for the video lottery terminal network that the New York Lottery operates at licensed New York State racetrack casinos. As payment for providing and maintaining the central determinant system, we receive a small portion of the network-wide win per unit. Our contract with the New York Lottery provides for a three-year term with an additional three one-year automatic renewal under certain conditions. We are seeking to take advantage of the recently passed legislation in New York State that allows the New York Lottery to extend its vendor contracts at its sole discretion, notwithstanding the automatic renewal provision. We are working to significantly extend the current contract which is set to expire in the second fiscal quarter of 2010.

International Commercial Bingo Market. In March 2006, we entered into a contract with Apuestas Internacionales, S.A. de C.V., or Apuestas, a subsidiary of Grupo Televisa, S.A., to provide traditional and electronic bingo gaming, technical assistance, and related services for Apuestas' locations in Mexico. Apuestas currently has a permit issued by the Mexican Ministry of the Interior (Secretaria de Gobernación) to open and operate 65 bingo parlors. Apuestas is projecting that all 65 bingo parlors will be open by May 2014. As of March 31, 2009, we had installed 4,755 player terminals at 22 bingo parlors in Mexico under this contract with Apuestas. At March 31, 2009, all player terminals placed by us in the Apuestas bingo parlors were pursuant to a revenue share arrangement that is comparable to our Oklahoma market arrangements.

As of March 31, 2009, we had entered into separate contracts with three other companies incorporated in Mexico to provide traditional and electronic bingo gaming, technical assistance, and related services for bingo parlors in Mexico. As of March 31, 2009, we had installed 370 player terminals at three parlors in Mexico under these contracts.

Development Agreements

As we seek to continue the growth in our customer base and to expand our installed base of player terminals, a key element of our strategy has become entering into development agreements with various Native American tribes to assist in the funding of new or expansion of existing tribal gaming facilities. Pursuant to these agreements, we advance funds to the tribes for the construction of new tribal gaming facilities or for the expansion of existing facilities.

-23-

Amounts advanced that are in excess of those to be reimbursed by such tribes for real property and land improvements are allocated to intangible assets and are generally amortized over the life of the contract on a straight-line basis.

In return for the amounts advanced by us, we receive a commitment for a fixed number of player terminal placements in the facility or a fixed percentage of the available gaming floor space, and a fixed percentage of the win per unit from those terminals over the term of the development agreement. Certain of the agreements contain player terminal performance standards that could allow the facility to reduce a portion of our 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.

We have in the past, and may in the future, reduce the number of player terminals in certain of our facilities as a result of ongoing competitive pressures faced by our customers from alternative gaming facilities and pressures faced by our machines from competitors' products. We have in the past, and in the future may also, by mutual agreement and for consideration, amend these contracts in order to reduce the number of player terminals at these facilities.

In the third quarter of fiscal 2008, we fulfilled a commitment to a significant, existing Oklahoma tribal customer to provide approximately 43.8%, or \$65.6 million, of the total funding for a facility expansion. Because of our commitment to fund the expansion, we secured the right to place an additional 1,400 gaming units in the expanded facility in southern Oklahoma. We recorded all advances as a note receivable and imputed interest on the interest free loan. The discount (imputed interest) was recorded as contract rights, and as of the first quarter of fiscal 2009 is being amortized over the life of the agreement. The repayment period of the note will be based on the performance of the facility. In the quarter ended March 31, 2009, we made a commitment of \$7.0 million that consists of both a loan for new unit placements in an expanded facility and a placement fee for certain units to remain at the current facility for an extended period of time. As of March 31, 2009, we had advanced \$1.25 million toward this commitment. The remaining commitment of \$5.75 million is expected to be paid over the next three fiscal quarters in the following increments: \$2.75 million, \$1.5 million and \$1.5 million, respectively.

As of March 31, 2009, we have placed approximately 4,956 units in eight facilities in Oklahoma pursuant to development agreements.

Third-Party Software and Technology

Our Manufacturing and License Agreement with WMS Gaming, Inc., which was originally entered into on May 17, 2004 and amended and restated on June 29, 2005 (the "Agreement"), will expire under operation of its terms on June 30, 2009. The Agreement enabled us to distribute, at a discount, WMS licensed products (i) on an exclusive (except as to WMS) basis in the Class II and Class III Native American market in Oklahoma; (ii) on a limited exclusive basis (except as to WMS and subject to WMS' existing commitments) in the Class II Native American market in North America, the pull tab and Class II-style bingo market in Mexico, and in the Charity markets in Alabama; and (iii) on a non exclusive basis for the Class III market in Washington. After June 30, 2009, we may continue to distribute WMS products pursuant to certain sell-off rights in Oklahoma and Mexico and certain limited distribution rights in Washington; however, we will not have the benefits of a contractual discount or a grant of exclusivity.

Recent Developments

In January 2009, we executed a reduction of 77 full-time and part-time employees, including two engaged in field operations and business development, 66 in system and game development, and nine in other general administrative and executive functions. Severance and other benefits of approximately \$1.1 million were paid in the quarter ended March 31, 2009.

RESULTS OF OPERATIONS

The following tables outline our end-of-period and average installed base of player terminals for the three and six months ended March 31, 2009 and 2008.

	At March 31,	
	2009	2008
End-of-period installed player terminal base		
Oklahoma compact games	6,647	5,119
Class II player terminals		
New Generation system - Reel Time Bingo®	2,153	2,223
Legacy system	289	311
Mexico	5,125	4,039
Other player terminals(1)	2,575	2,771

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2009	2008	2009	2008
Average installed player terminal base:				
Oklahoma compact games	6,463	4,564	6,179	4,411
Class II player terminals				
New Generation System - Reel Time Bingo	2,184	3,084	2,197	3,389
Legacy system	296	340	299	343
Mexico	5,259	3,688	5,315	3,400
Other player terminals(1)	2,637	2,774	2,670	2,755

(1) Other player terminals include charity, Rhode Island Lottery and Malta.

Three Months Ended March 31, 2009, Compared to Three Months Ended March 31, 2008

Total revenues for the three months ended March 31, 2009, were \$33.9 million, compared to \$32.2 million for the three months ended March 31, 2008, a \$1.7 million or 5.2% increase.

Gaming Revenue – Oklahoma Compact

§The Oklahoma compact games generated revenue of \$15.3 million in the three months ended March 31, 2009, compared to \$14.1 million during the same period of 2008, an increase of \$1.2 million, or 8.5%. The average installed base of the Oklahoma compact games increased 41.6%, as the conversion of Class II player terminals to compact games continues, while the win per unit decreased 13.5%, due to general economic downturn causing a reduction in play. We expect the rate of conversion from Class II to compact games to decline in the future, as over 87% of the Oklahoma installed base at March 31, 2009, consisted of Oklahoma compact units. Accretion of contract rights related to development agreements, which is recorded as a reduction of revenue, increased \$684,000, or 117.9%, to \$1.3 million, in the three months ended March 31, 2009, compared to \$581,000 in the same period of 2008.

Gaming Revenue – Class II

§Class II gaming revenue was \$5.2 million in the three months ended March 31, 2009, compared to \$7.5 million in the three months ended March 31, 2008, a \$2.3 million or 31.5% decrease. We expect the number of Class II

terminals to continue to decrease as they are replaced with higher-earning Oklahoma compact player terminals.

§ Reel Time Bingo revenue was \$4.7 million for the three months ended March 31, 2009, compared to \$6.9 million in the three months ended March 31, 2008, a \$2.2 million or 32.5% decrease. The decrease is primarily attributable to a decrease in the average installed base of player terminals of 29.2%. Accretion of contract rights related to development agreements, which is recorded as a reduction of revenue, decreased \$50,000 or 14.4%, to \$294,000 in the three months ended March 31, 2009, compared to \$344,000 in the three months ended March 31, 2008. The reduction in accretion of contract rights is the result of allocating the total accretion rights across all product lines with the majority being allocated against Oklahoma compact revenue.

-25-

§ Legacy revenue decreased \$126,000, or 20.2%, to \$497,000 in the three months ended March 31, 2009, from \$622,000 in the three months ended March 31, 2008. The average installed base of Legacy player terminals decreased 12.9%, and the win per unit decreased by 7.0%, due to general economic downturn causing a reduction in play.

Gaming Revenue – Charity

§ Charity gaming revenues decreased \$1.5 million, or 34.6%, to \$2.9 million for the three months ended March 31, 2009, compared to \$4.4 million for the same period of 2008. The average installed base of charity player terminals decreased 6.3%, and the win per unit decreased 31.6%. The decrease in the win per unit is primarily attributable to competitive factors and to a lesser extent, economic factors. Competitive factors would include, but not be limited to, a significant increase of competitor units added to the gaming floor of our largest charity operation, players reward programs not offered on our player terminals and location of our player terminals on the gaming floor.

Gaming Revenue – All Other

§ Class III back-office fees decreased \$69,000, or 7.9%, to \$813,000 in the three months ended March 31, 2009, from \$882,000 during the same period of 2008.

§ Revenues from the New York Lottery system increased \$133,000, or 7.9%, to \$1.9 million in the three months ended March 31, 2009, from \$1.7 million in the three months ended March 31, 2008. Currently, eight of the nine planned racetrack casinos are operating, with approximately 13,000 total terminals. At the current placement levels, we have obtained near break-even operations for the New York Lottery system and expect to achieve profitable operations after all of the facilities are operating.

§ Revenues from the Mexico bingo market increased \$231,000, or 9.4% to \$2.7 million in the three months ended March 31, 2009, from \$2.5 million during the same period of 2008. As of March 31, 2009, we had installed 5,125 player terminals at 25 bingo parlors in Mexico compared to 4,039 terminals installed at 16 bingo parlors at March 31, 2008. Our revenue share is in the range of the other electronic bingo markets in which we operate.

Gaming Equipment and System Sale and Lease Revenue and Cost of Sales

§ Gaming equipment and system sale and lease revenue increased \$4.0 million, or 1,051.8%, to \$4.4 million for the three months ended March 31, 2009, from \$378,000 for the same period of 2008. Gaming equipment and system sale revenue of \$4.3 million for the three months ended March 31, 2009, includes the sale of \$2.7 million for 360 player terminals. The sale of these units will result in a quarterly reduction of recurring Oklahoma Compact revenue of approximately \$850,000. Gaming equipment and system sale revenue of \$205,000 for the three months ended March 31, 2008, did not include player terminal or system sales. License revenues for the three months ended March 31, 2009, were \$19,000, compared to \$173,000 for the three months ended March 31, 2008, a decrease of \$154,000. Total cost of sales, which includes cost of royalty fees, increased \$1.9 million, to \$2.3 million in the three months ended March 31, 2009, from \$414,000 in the three months ended March 31, 2008. The increase primarily relates to the increase in revenue discussed above.

Other Revenue

§ Other revenues increased \$220,000, or 45.6%, to \$702,000 for the three months ended March 31, 2009, from \$482,000 during the same period of 2008. The increase is primarily due to increased maintenance income in the three months ended March 31, 2009.

Selling, General and Administrative Expenses

§ Selling, general and administrative expenses, or SG&A, increased approximately \$3.8 million, or 23.1%, to \$20.5 million for the three months ended March 31, 2009, from \$16.6 million in the same period of 2008. This increase was primarily a result of (i) an increase due to legal fees and settlement costs, net of expected insurance proceeds of approximately \$4.2 million, related to the Diamond Game legal matter; (ii) a net increase in personnel costs of \$405,000; including an increase in stock compensation, an accrual under an annual incentive plan and other employee benefits; offset by a decrease in salaries and wages due to a reduction in force in January 2009; and (iii) an increase in allowance for accounts receivable and the write-off of project and patent costs totaling \$281,000. These increases in expenses were offset by decreases in consulting and contract labor of \$278,000, travel and entertainment of \$299,000 and repairs and maintenance of \$209,000.

Amortization and Depreciation

§ Amortization expense increased \$264,000, or 25.2%, to \$1.3 million for the three-months ended March 31, 2009, compared to \$1.0 million for the same period of 2008. Depreciation expense increased \$2.9 million, or 25.8%, to \$14.3 million for the three months ended March 31, 2009, from \$11.4 million for the corresponding three months ended March 31, 2008, primarily as a result of additional player terminals for the Oklahoma market.

Other Income and Expense

§ Interest income increased \$110,000, or 9.7%, to \$1.2 million for the three months ended March 31, 2009, from \$1.1 million in the same period of 2008. We entered into development agreements with a customer under which approximately \$63.8 million has been advanced and is outstanding at March 31, 2009, and for which we impute interest on these interest-free loans. For the three months ended March 31, 2009, we recorded imputed interest of \$1.1 million relating to development agreements with an imputed interest rate range of 5.5% to 9.0%, compared to \$1.0 million for the three months ended March 31, 2008.

§ Interest expense decreased \$600,000, or 24.1%, to \$1.9 million for the three months ended March 31, 2009, from \$2.5 million in the same period of 2008. During April 2007, we entered into a \$150 million Revolving Credit Facility which replaced our previous Credit Facility in its entirety. On October 26, 2007, we amended the Revolving Credit Facility, transferring \$75 million of the revolving credit commitment to a fully funded \$75 million term loan. We entered into a second amendment to the Revolving Credit Facility 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 Revolving Credit Facility and the term loan.

§ We had no other income for the three months ended March 31, 2009, compared to \$872,000 in the same period of 2008. Other income primarily decreased due to the last distribution from a partnership interest.

Income tax decreased by \$2.8 million to a benefit of \$1.8 million for the three months ended March 31, 2009, from an income tax expense of \$1.0 million in the same period of 2008. These figures represent effective income tax rates of 34.9% and 43.8% for the three months ended March 31, 2009 and 2008, respectively. The effective tax rate has been impacted by the tax treatment of stock compensation expense. To the extent that we experience volatility in tax deductibility of certain stock compensation expense, there will remain volatility in the effective tax rate.

Six Months Ended March 31, 2009, Compared to Six Months Ended March 31, 2008

Total revenues for the six months ended March 31, 2008 and 2009, were \$62.4 million.

Gaming Revenue – Oklahoma Compact

§ The Oklahoma compact games generated revenue of \$29.1 million in the six months ended March 31, 2009, compared to \$25.7 million during the same period of 2008, an increase of \$3.4 million, or 13.4%. The average installed base of the Oklahoma compact games increased 40.1%, as the conversion of Class II player terminals to compact games continues, while the win per unit decreased 11.5%, due to general economic downturn causing a reduction in play. We expect the rate of conversion from Class II to compact games to decline in the future, as over 87% of the Oklahoma installed base at March 31, 2009, consisted of Oklahoma compact units. Accretion of contract rights related to development agreements, which is recorded as a reduction of revenue, increased \$1.1 million, or 90.5%, to \$2.3 million, in the six months ended March 31, 2009, compared to \$1.2 million in the same period of 2008.

Gaming Revenue – Class II

§ Class II gaming revenue was \$10.2 million in the six months ended March 31, 2009, compared to \$15.6 million in the six months ended March 31, 2008, a \$5.4 million or 34.7% decrease. We expect the number of Class II terminals to continue to decrease as they are replaced with higher-earning Oklahoma compact player terminals.

§ Reel Time Bingo revenue was \$9.2 million for the six months ended March 31, 2009, compared to \$14.3 million in the six months ended March 31, 2008, a \$5.2 million or 36.0% decrease. The decrease is primarily attributable to a decrease in the average installed base of player terminals of 35.2%. Accretion of contract rights related to development agreements, which is recorded as a reduction of revenue, decreased \$123,000 or 17.6%, to \$572,000 in the six months ended March 31, 2009, compared to \$695,000 in the six months ended March 31, 2008. The reduction in accretion of contract rights is the result of allocating the total accretion rights across all product lines with the majority being allocated against Oklahoma compact revenue. During fiscal 2009, we will continue to convert Reel Time Bingo player terminals to games played under the compact, which are included in “Gaming revenue – Oklahoma compact,” and we expect this trend to continue in the future as Reel Time Bingo competes with the higher win per unit of compact games.

§ Legacy revenue decreased \$244,000, or 19.6%, to \$1.0 million in the six months ended March 31, 2009, from \$1.2 million in the six months ended March 31, 2008. The average installed base of Legacy player terminals decreased 12.8%, and the win per unit decreased by 8.5%, due to general economic downturn causing a reduction in play.

Gaming Revenue – Charity

§ Charity gaming revenues decreased \$2.8 million, or 34.4%, to \$5.4 million for the six months ended March 31, 2009, compared to \$8.3 million for the same period of 2008. The average installed base of charity player terminals decreased 6.4%, and the win per unit decreased 31.7%. The decrease in the win per unit is primarily attributable to competitive factors and to a lesser extent, economic factors. Competitive factors would include, but not be limited to, a significant increase of competitor units added to the gaming floor of our largest charity operation, players reward programs not offered on our player terminals and location of our player terminals on the gaming floor.

Gaming Revenue – All Other

§ Class III back-office fees decreased \$ 176,000, or 10%, to \$1.6 million in the six months ended March 31, 2009, from \$1.8 million during the same period of 2008.

§ Revenues from the New York Lottery system increased \$220,000, or 6.8%, to \$3.5 million in the six months ended March 31, 2009, from \$3.2 million in the six months ended March 31, 2008. Currently, eight of the nine planned racetrack casinos are operating, with approximately 13,000 total terminals. At the current placement levels, we have obtained near break-even operations for the New York Lottery system and expect to achieve profitable operations after all of the facilities are operating.

§ Revenues from the Mexico bingo market increased \$495,000, or 10.8% to \$5.1 million in the six months ended March 31, 2009, from \$4.6 million during the same period of 2008. As of March 31, 2009, we had installed 5,125 player terminals at 25 bingo parlors in Mexico compared to 4,039 terminals installed at 16 bingo parlors at March 31, 2008. Our revenue share is in the range of the other electronic bingo markets in which we operate.

-28-

Gaming Equipment and System Sale and Lease Revenue and Cost of Sales

§ Gaming equipment and system sale and lease revenue increased \$4.0 million, or 184.7%, to \$6.1 million for the six months ended March 31, 2009, from \$2.1 million for the same period of 2008. Gaming equipment and system sale revenue of \$6.0 million for the six months ended March 31, 2009, includes 460 player terminals sold. The sale of these units will result in a quarterly reduction of recurring Oklahoma Compact revenue of approximately \$850,000. Gaming equipment and system sale revenue of \$1.3 million for the six months ended March 31, 2008, included the sale of 50 player terminals and one system. License revenues for the six months ended March 31, 2009, were \$96,000, compared to \$637,000 for the six months ended March 31, 2008, a decrease of \$541,000. Total cost of sales, which includes cost of royalty fees, increased \$3.0 million, to \$4.2 million in the six months ended March 31, 2009, from \$1.2 million in the six months ended March 31, 2008. The increase primarily relates to the increase in cost of sales associated with the revenue discussed above.

Other Revenue

§ Other revenues increased \$376,000, or 44.2%, to \$1.2 million for the six months ended March 31, 2009, from \$850,000 during the same period of 2008. The increase is primarily due to increased maintenance income in the six months ended March 31, 2009.

Selling, General and Administrative Expenses

§ Selling, general and administrative expenses, or SG&A, increased approximately \$8.0 million, or 24.5%, to \$40.7 million for the six months ended March 31, 2009, from \$32.7 million in the same period of 2008. This increase was primarily a result of (i) an increase due to legal fees and settlement costs, net of expected insurance proceeds of approximately \$7.9 million, related to the Diamond Game legal matter; (ii) an increase in salaries and wages and the related employee benefits of approximately \$1.6 million, including increases in stock compensation, an accrual under an annual incentive plan and other employee benefits; and (iii) an increase in allowance for accounts receivable and the write-off of project and patent costs totaling \$261,000. These increases in expenses were offset by decreases in travel and entertainment of \$543,000, consulting and contract labor of \$452,000, and lobbying fees of \$283,000.

Amortization and Depreciation

§ Amortization expense increased \$450,000, or 20.0%, to \$2.7 million for the six months ended March 31, 2009, compared to \$2.2 million for the same period of 2008. Depreciation expense increased \$5.1 million, or 22.5%, to \$27.8 million for the six months ended March 31, 2009, from \$22.7 million for the corresponding six months ended March 31, 2008, primarily as a result of additional player terminals for the Oklahoma market.

Other Income and Expense

§ Interest income increased \$266,000, or 11.7%, to \$2.5 million for the six months ended March 31, 2009, from \$2.3 million in the same period of 2008. We entered into development agreements with a customer under which approximately \$63.8 million has been advanced and is outstanding at March 31, 2009, and for which we impute interest on these interest-free loans. For the six months ended March 31, 2009, we recorded imputed interest of \$2.3 million relating to development agreements with an imputed interest rate range of 5.5% to 9.0%, compared to \$1.8 million for the six months ended March 31, 2008.

§ Interest expense decreased \$605,000, or 13.1%, to \$4.0 million for the six months ended March 31, 2009 from \$4.6 million in the same period of 2008. During April 2007, we entered into a \$150 million Revolving Credit

Facility which replaced our previous Credit Facility in its entirety. On October 26, 2007, we amended the Revolving Credit Facility, transferring \$75 million of the revolving credit commitment to a fully funded \$75 million term loan. We entered into a second amendment to the Revolving Credit Facility 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 Revolving Credit Facility and the term loan.

§ Other income decreased \$1.1 million, or 93.9%, to \$74,000 for the six months ended March 31, 2009, compared to \$1.2 million in the same period of 2008. Other income primarily decreased due to the last distribution from a partnership interest.

Income tax decreased by \$5.8 million to a benefit of \$5.1 million for the six months ended March 31, 2009, from an income tax expense of \$735,000 in the same period of 2008. These figures represent effective income tax rates of 35.2% and 30.7% for the six months ended March 31, 2009 and 2008, respectively. The effective tax rate has been impacted by the tax treatment of stock compensation expense. To the extent that we experience volatility in tax deductibility of certain stock compensation expense, there will remain volatility in the effective tax rate.

RECENT ACCOUNTING PRONOUNCEMENTS

We monitor new, generally accepted accounting principle 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, 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.

Revenue Recognition. As further discussed in the discussion of our revenue recognition policy in Note 1 of our consolidated financial statements, revenue from the sale of software is accounted for under Statement of Position 97-2, "Software Revenue Recognition," or SOP 97-2, and its various interpretations. 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 products or services are 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 \$9.8 million being recorded as deferred revenue at March 31, 2009. 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 March 31, 2009.

Share-Based Compensation Expense. Effective October 1, 2005, we adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method, and therefore have not restated prior periods' results. Under this method, 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 SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), 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. Prior to SFAS 123(R) adoption, we accounted for share-based payments under Accounting Principles Board Opinion, or APB, No. 25, "Accounting for Stock Issued to Employees," and accordingly generally recognized compensation expense only if options were granted to outside consultants with a discounted exercise price.

-30-

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.