

MAJESCO ENTERTAINMENT CO
Form 10-Q
September 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

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

For the quarterly period ended July 31, 2014

Commission File No. 000-51128

Majesco Entertainment Company

(Exact name of registrant as specified in its charter)

DELAWARE **06-1529524**
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

160 Raritan Center Parkway, Edison, NJ 08837

(Address of principal executive offices)

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Registrant's Telephone Number, Including Area Code: **(732) 225-8910**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.4.05 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of September 8, 2014, there were 6,664,093 shares of the Registrant's common stock outstanding.

MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)**

	July 31,	October 31,
	2014	2013
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,937	\$ 13,385
Due from factor, net	-	2,134
Accounts and other receivables	291	1,169
Inventory	1,620	4,859
Advance payments for inventory	12	1,064
Capitalized software development costs and license fees	2,296	7,825
Advances to GMS Entertainment Limited	230	-
Prepaid expenses and other current assets	340	2,827
Total current assets	15,726	33,263
Property and equipment, net	650	817
Investment in GMS Entertainment Limited	1,705	3,500
Other assets	-	69
Total assets	\$ 18,081	\$ 37,649
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,349	\$ 8,994
Due to distribution partner	1,981	-
Customer credits	1,478	-
Inventory financing	-	1,764
Advances from customers and deferred revenue	11	6,838
Total current liabilities	7,819	17,596
Commitments and contingencies		
Stockholders' equity:		
Common stock — \$.001 par value; 250,000,000 shares authorized; 6,641,803 and 6,613,710 shares issued and outstanding at July 31, 2014 and October 31, 2013, respectively	7	7
Additional paid-in capital	125,109	124,187

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Accumulated deficit	(114,354)	(103,530)
Accumulated other comprehensive loss	(500)	(611)
Net stockholders' equity	10,262	20,053
Total liabilities and stockholders' equity	\$ 18,081	\$ 37,649

See accompanying notes to condensed consolidated financial statements

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

	Three months ended		Nine months ended	
	July 31		July 31	
	2014	2013	2014	2013
Net revenues	\$2,911	\$3,998	\$28,085	\$37,190
Cost of sales				
Product costs	1,173	1,666	10,388	13,931
Software development costs and license fees	597	1,097	13,106	11,837
Total cost of sales	1,770	2,763	23,494	25,768
Gross profit	1,141	1,235	4,591	11,422
Operating costs and expenses				
Product research and development	377	1,352	2,043	4,890
Selling and marketing	953	1,015	6,134	6,211
General and administrative	2,004	2,382	5,897	6,848
Workforce reduction	-	-	-	776
Loss on impairment of capitalized software development costs and license fees – cancelled games	-	-	-	175
Depreciation and amortization	117	90	304	296
Total operating costs and expenses	3,451	4,839	14,378	19,196
Operating loss	(2,310)	(3,604)	(9,787)	(7,774)
Other expenses (income)				
Interest and financing costs	79	34	284	291
Loss from equity method investment	1,494	-	1,907	-
Gain on extinguishment of liabilities	(1,159)	-	(1,159)	-
Change in fair value of warrant liability	-	-	-	(17)
Loss before income taxes	(2,724)	(3,638)	(10,819)	(8,048)
Income taxes	3	6	5	8
Net loss	\$(2,727)	\$(3,644)	\$(10,824)	\$(8,056)
Net loss per share:				
Basic	\$(0.44)	\$(0.63)	\$(1.69)	\$(1.39)
Diluted	\$(0.44)	\$(0.63)	\$(1.69)	\$(1.39)
Weighted average shares outstanding:				
Basic	6,206,647	5,802,339	6,397,394	5,792,526
Diluted	6,206,647	5,802,339	6,397,394	5,792,526

See accompanying notes to condensed consolidated financial statements

MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited, in thousands)

	Three months ended		Nine months ended	
	July 31		July 31	
	2014	2013	2014	2013
Net loss	\$ (2,727)	\$ (3,644)	\$ (10,824)	\$ (8,056)
Other comprehensive (loss) income				
Foreign currency translation adjustments	7	(9)	111	(54)
Other comprehensive (loss) income	7	(9)	111	(54)
Comprehensive loss	\$ (2,720)	\$ (3,653)	\$ (10,713)	\$ (8,110)

See accompanying notes to condensed consolidated financial statements

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

	Nine months ended July 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$(10,824)	\$(8,056)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	304	296
Loss from equity method investment	1,907	-
Non-cash compensation expense	928	1,017
Provision for price protection	2,907	1,295
Amortization of capitalized software development costs and license fees	9,654	2,952
Impairment losses	194	175
Provision for excess inventory	561	417
Change in fair value of warrant liability	-	(17)
Gain on extinguishment of liabilities	(1,159)	-
Changes in operating assets and liabilities:		
Due from factor	705	12,368
Accounts and other receivables	878	3,280
Inventory	2,678	4,983
Capitalized software development costs and license fees	(4,125)	(6,903)
Advance payments for inventory	1,052	(601)
Prepaid expenses and other assets	2,557	1,036
Accounts payable and accrued expenses	(1,505)	(6,759)
Advances from customers and deferred revenue	(6,827)	(4,402)
Net cash (used in) provided by operating activities	(115)	1,081
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(331)	(243)
Advances to GMS Entertainment Limited	(230)	-
Net cash used in investing activities	(561)	(243)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of inventory financing	(1,764)	-
Income tax withholding from stock compensation	(7)	-
Net cash used in financing activities	(1,771)	-
Effect of exchange rates on cash and cash equivalents	(1)	(46)
Net (decrease) increase in cash and cash equivalents	(2,448)	792
Cash and cash equivalents — beginning of period	13,385	18,038
Cash and cash equivalents — end of period	\$10,937	\$18,830
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for interest and financing costs	\$300	\$345
Cash paid during the period for income taxes	\$-	\$-

See accompanying notes to condensed consolidated financial statements

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MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except per-share amounts)

1. PRINCIPAL BUSINESS ACTIVITY AND BASIS OF PRESENTATION

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

The Company is a provider of video game products primarily for the mass-market consumer. It sells its products primarily to large retail chains, specialty retail stores, and distributors. It publishes video games for major current generation interactive entertainment hardware platforms, including Nintendo’s DS, 3DS, Wii and WiiU, Sony’s PlayStation 3, or PS3, and PlayStation Portable, or PSP®, Microsoft’s Xbox 360 and Xbox One and the personal computer, or PC. It also publishes games for digital platforms, including mobile platforms like the iPhone, iPad and Android devices, as well as online sites such as Facebook and Steam.

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

The Company’s operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company may also enter into agreements with licensees, particularly for sales of its products internationally. The Company is centrally managed and its chief operating decision makers, the chief executive and other officers, use consolidated and other financial information supplemented by sales information by product category, major product title and platform for making operational decisions and assessing financial performance. Accordingly, the Company operates in a single reportable segment. In fiscal 2013, the Company acquired an interest in GMS Entertainment Limited, which is focused on the development and operation of real money online games, social casinos and lottery systems.

Geographic regions. Net revenues by geographic region were as follows:

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	Three months ended July 31,				Nine months ended July 31,			
	2014	%	2013	%	2014	%	2013	%
United States	\$2,654	91	\$3,562	89	\$24,768	88	\$29,155	78
Europe	257	9	436	11	3,317	12	8,035	22
Total net revenues	\$2,911	100	\$3,998	100	\$28,085	100	\$37,190	100

The accompanying interim condensed consolidated financial statements of the Company are unaudited, but in the opinion of management, reflect all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim period. Accordingly, they do not include all information and notes required by generally accepted accounting principles for complete financial statements. The Company's financial results are impacted by the seasonality of the retail selling season and the timing of the release of new titles. The results of operations for interim periods are not necessarily indicative of results to be expected for the entire fiscal year. The balance sheet at October 31, 2013 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended October 31, 2013 filed with the Securities and Exchange Commission on Form 10-K on January 14, 2014.

Reverse Stock Split. In 2013, the Company received a notification letter from NASDAQ notifying it that it was not in compliance with its \$1.00 minimum bid price requirement because the bid price for the Company's common stock closed below \$1.00 over the prior 30 consecutive business days. To regain compliance with this requirement, we completed a reverse stock split, which was effected on June 13, 2014 at a ratio of one-for-seven with no change in par value. All share information presented in this Quarterly Report on Form 10-Q gives effect to the reverse stock split.

Going Concern Basis. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered losses that raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. As of July 31, 2014, management believes that there may not be sufficient capital resources from operations and existing financing arrangements in order to meet operating expenses and working capital requirements for the next twelve months. Accordingly, the Company is evaluating various alternatives, including reducing operating expenses and personnel costs, securing additional financing for future business activities and other strategic alternatives including a sale or merger of the Company. There can be no assurance that the Company will be able to generate the level of operating revenues in its business plan, or if additional sources of financing will be available on acceptable terms, if at all. If no additional sources of financing are available, it could have a material effect on future operating prospects.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation. The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary located in the United Kingdom. Significant intercompany accounts and transactions have been eliminated in consolidation. The Company has 50% of the voting control of GMS Entertainment Limited (“GMS”) and the right to appoint one-half of the directors of GMS. All business activities and transactions that significantly impact GMS must be approved by both equity owners. Accordingly, the Company accounts for GMS on the equity method as a corporate joint venture.

Revenue Recognition. The Company recognizes revenue upon the shipment of its products when: (1) title and the risks and rewards of ownership are transferred; (2) persuasive evidence of an arrangement exists; (3) there are no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. Certain products are sold to customers with a street date (the earliest date these products may be resold by retailers). Revenue for sales of these products is not recognized prior to their street date. Some of the Company’s software products provide limited online features at no additional cost to the consumer. Generally, such features have been considered to be incidental to the Company’s overall product offerings and an inconsequential deliverable. Accordingly, the Company does not defer any revenue related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying the Company’s revenue recognition policy.

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

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

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

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

When the Company operates hosted online games in which players can play for free and purchase virtual goods for use in the games, it recognizes revenues from the sale of virtual goods as service revenues over the estimated period in which players use the game. It currently estimates these periods of use to be three to four months. The Company periodically assesses its estimates for this period of use and future increases or decreases in these estimates and adjusts recognized revenues prospectively. The Company also recognizes advertising revenue as ads are served. The Company has not earned significant revenue to date related to its online games.