

Galaxy Gaming, Inc.
Form 10-Q
August 14, 2017

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 June 30, 2017

OR

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

For the transition period from to

Commission file number: 000-30653

Galaxy Gaming, Inc.

(Exact name of small business issuer as specified in its charter)

Nevada 20-8143439
(State or other jurisdiction of
incorporation or organization) (IRS Employer
Identification No.)

6767 Spencer Street, Las Vegas, NV 89119
(Address of principal executive offices)

(702) 939-3254

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(Issuer's telephone number)

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

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

Indicate by check mark whether the issuer has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period

for complying with any new or revised financial accounting standard provided pursuant to Section 13(a) of the Exchange Act.

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 39,365,591 common shares as of August 4, 2017.

GALAXY GAMING, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE THREE MONTHS ENDED JUNE 30, 2017

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | |
|--|---|
| <u>Condensed Balance Sheets as of June 30, 2017 (unaudited) and December 31, 2016</u> | 4 |
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GALAXY GAMING, INC.

CONDENSED BALANCE SHEETS

| | June 30, 2017 | December 31, 2016 |
|--|------------------|----------------------|
| ASSETS | | |
| Current assets: | (Unaudited) | |
| Cash and cash equivalents | \$2,934,880 | \$2,304,761 |
| Restricted cash | 93,270 | 84,577 |
| Accounts receivable, net of allowance for bad debts of \$38,015 and \$31,125, respectively | 2,395,061 | 2,137,245 |
| Inventory, net | 466,446 | 427,105 |
| Prepaid expense and other | 233,093 | 194,747 |
| Total current assets | 6,122,750 | 5,148,435 |
| Property and equipment, net | 307,045 | 356,253 |
| Products leased and held for lease, net | 294,496 | 212,131 |
| Goodwill and other intangible assets, net | 12,198,354 | 12,846,019 |
| Deferred tax assets, net | 367,057 | 367,057 |
| Other assets, net | 23,000 | 82,050 |
| Total assets | \$19,312,702 | \$19,011,945 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$505,044 | \$461,913 |
| Accrued expenses | 1,344,382 | 1,109,428 |
| Income taxes payable | 717,841 | 786,430 |
| Deferred revenue | 1,008,592 | 1,014,731 |
| Jackpot liabilities | 78,125 | 90,960 |
| Deferred rent, current portion | 19,309 | 14,938 |
| Current portion of long-term debt and capital lease obligations | 1,207,629 | 1,230,285 |
| Total current liabilities | 4,880,922 | 4,708,685 |
| Deferred rent, net | 28,050 | 37,704 |
| Capital lease obligations, net | 30,815 | 46,978 |
| Common stock warrant liability | 1,247,025 | 923,616 |
| Long-term debt, net | 8,214,183 | 8,669,151 |
| Total liabilities | 14,400,995 | 14,386,134 |
| Commitments and Contingencies (See Note 10) | | |
| Stockholders' equity | | |
| Preferred stock, 10,000,000 shares authorized, \$0.001 par value; | | |
| 0 shares issued and outstanding, respectively | — | — |
| Common stock, 65,000,000 shares authorized; \$0.001 par value; | | |
| 39,365,591 and 39,315,591 shares issued and outstanding, respectively | 39,366 | 39,316 |
| Additional paid-in capital | 3,312,811 | 3,109,473 |
| Accumulated earnings | 1,559,530 | 1,477,022 |
| Total stockholders' equity | 4,911,707 | 4,625,811 |
| Total liabilities and stockholders' equity | \$19,312,702 | \$19,011,945 |

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

GALAXY GAMING, INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| Revenue: | | (Restated) | | (Restated) |
| Product leases and royalties | \$3,650,813 | \$3,057,172 | \$7,124,654 | \$6,038,991 |
| Product sales and service | 7,995 | 6,999 | 9,450 | 9,279 |
| Total revenue | 3,658,808 | 3,064,171 | 7,134,104 | 6,048,270 |
| Costs and expenses: | | | | |
| Cost of ancillary products and assembled components | 62,266 | 29,672 | 83,148 | 51,312 |
| Selling, general and administrative | 2,359,889 | 1,632,584 | 4,446,058 | 3,265,815 |
| Research and development | 126,386 | 101,879 | 264,433 | 181,221 |
| Depreciation and amortization | 447,557 | 417,344 | 883,642 | 833,321 |
| Share-based compensation | 118,551 | 29,459 | 168,388 | 49,931 |
| Total costs and expenses | 3,114,649 | 2,210,938 | 5,845,669 | 4,381,600 |
| Income from operations | 544,159 | 853,233 | 1,288,435 | 1,666,670 |
| Other income (expense): | | | | |
| Interest expense | (438,247) | (255,218) | (883,579) | (513,413) |
| Foreign currency exchange gains | 58,155 | 247,664 | 65,952 | 360,226 |
| Change in estimated fair value of warrant liability | (256,909) | — | (323,409) | — |
| Interest income | — | 90 | — | 146 |
| Total other expense | (637,001) | (7,464) | (1,141,036) | (153,041) |
| (Loss) income before provision for income taxes | (92,842) | 845,769 | 147,399 | 1,513,629 |
| Benefit (provision) for income taxes | 13,083 | (282,330) | (64,891) | (522,355) |
| Net (loss) income | \$(79,759) | \$563,439 | \$82,508 | \$991,274 |
| Net (loss) income per share, basic and diluted | \$(0.00) | \$0.01 | \$0.00 | \$0.03 |
| Weighted-average shares outstanding: | | | | |
| Basic | 39,365,591 | 39,315,591 | 39,335,757 | 39,383,369 |
| Diluted | 39,365,591 | 39,465,676 | 40,773,647 | 39,565,633 |

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

GALAXY GAMING, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2017 | June 30, 2016 |
| Cash flows from operating activities: | | (Restated) |
| Net income | \$82,508 | \$991,274 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 883,642 | 833,321 |
| Amortization of debt issuance costs and debt discount | 146,319 | 104,316 |
| Bad debt expense | 6,000 | — |
| Change in estimated fair value of warrant liability | 323,409 | — |
| Share-based compensation | 168,388 | 49,931 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in restricted cash | (8,693) | 26,786 |
| (Increase) decrease in accounts receivable | (263,815) | 74,071 |
| Increase in inventory | (174,485) | (137,704) |
| (Increase) decrease in prepaid expenses and other current assets | (38,346) | 9,484 |
| Increase (decrease) in accounts payable | 43,130 | (240,634) |
| (Decrease) increase in income tax payable | (109,378) | 516,257 |
| Increase in accrued expenses | 234,954 | 334,901 |
| (Decrease) increase in deferred revenue | (6,139) | 134,169 |
| Decrease in jackpot liabilities | (12,835) | (16,598) |
| Decrease in deferred rent | (5,283) | (913) |
| Net cash provided by operating activities | 1,269,376 | 2,678,661 |
| Cash flows from investing activities: | | |
| Investment in intangible assets | (43,917) | — |
| Acquisition of property and equipment | (31,023) | (28,832) |
| Net cash used in investing activities | (74,940) | (28,832) |
| Cash flows from financing activities: | | |
| Proceeds from stock option exercises | 35,000 | — |
| Debt issuance costs | (17,091) | — |
| Principal payments on capital lease obligations | (15,307) | (35,233) |
| Principal payments on long-term debt | (607,708) | (2,513,096) |
| Net cash used in financing activities | (605,106) | (2,548,329) |
| Effect of exchange rate changes on cash | 40,789 | (29,385) |
| Net increase in cash and cash equivalents | 630,119 | 72,115 |
| Cash and cash equivalents – beginning of period | 2,304,761 | 570,623 |
| Cash and cash equivalents – end of period | \$2,934,880 | \$642,738 |
| Supplemental cash flow information: | | |
| Cash paid for interest | \$739,862 | \$530,660 |
| Inventory transferred to assets held for lease | \$135,144 | \$45,137 |
| Cash paid for income taxes | \$75,000 | \$20,000 |

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

GALAXY GAMING, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. NATURE OF OPERATIONS AND RESTATEMENT

Unless the context indicates otherwise, references to “Galaxy Gaming, Inc.,” “we,” “us,” “our,” or the “Company,” refer to Galaxy Gaming, Inc., a publicly reporting Nevada corporation (“Galaxy Gaming”).

Nature of operations. We are an established global gaming company specializing in the design, development, manufacturing, marketing and acquisition of proprietary casino table games and associated technology, platforms and systems for the casino gaming industry. We are a leading supplier of gaming entertainment products worldwide and provide a diverse offering of quality products and services at competitive prices designed to enhance the player experience.

Restatement. The financial statements as of and for the three and six months ended June 30, 2016 have been restated to correct the following errors noted during the preparation of the financial statements for the year ended December 31, 2016: (i) the amortization of original issue discount related to notes payable to Prime Table Games LLC and Prime Table Games UK (the “PTG Notes”) was not previously deducted from taxable income in our federal tax returns from 2011 through 2015 or to derive the income tax provision for the three and six months ended June 30, 2016, which resulted in an understatement of deferred tax assets and an overstatement of the income tax provision in those periods; and (ii) foreign currency exchange gains and losses related to the PTG Notes were incorrectly reported as other comprehensive income instead of earnings (i.e., non-operating income). The restatements to reflect the correction of both errors are referred to herein collectively as the “Restatement.”

The table below sets forth the amounts as originally reported for the categories presented in the condensed statements of operations that were affected by the Restatement, the effect of the Restatement and the restated amounts for the three and six months ended June 30, 2016:

| | Three Months Ended June 30, 2016 | | | Six Months Ended June 30, 2016 | | |
|-------------------------------------|----------------------------------|-----------------------|--------------|--------------------------------|-----------------------|--------------|
| | As originally reported | Impact of restatement | As restated | As originally reported | Impact of restatement | As restated |
| Selling, general and administrative | \$ 1,622,105 | \$ 10,479 | \$ 1,632,584 | \$ 3,274,304 | \$ (8,489) | \$ 3,265,815 |
| Provision for income taxes | (231,057) | (51,273) | (282,330) | (388,020) | (134,335) | (522,355) |
| Foreign currency exchange gains | — | 247,664 | 247,664 | — | 360,226 | 360,226 |
| Net income | 377,527 | 185,912 | 563,439 | 756,894 | 234,380 | 991,274 |

The table below sets forth the amounts as originally reported for the categories presented in the condensed statements of cash flows that were affected by the Restatement, the effect of the Restatement and the restated amounts for the six months ended June 30, 2016:

| | As originally reported | Impact of restatement | As restated |
|---|------------------------|-----------------------|-------------|
| Net income | \$ 756,894 | \$ 234,380 | \$ 991,274 |
| Deferred income tax provision | 388,020 | (388,020) | — |
| Decrease in accounts receivable | 71,287 | 2,784 | 74,071 |
| Decrease in accounts payable | (241,190) | 556 | (240,634) |
| Increase in income taxes payable | 349,450 | 166,807 | 516,257 |
| Increase in accrued expenses | 327,090 | 7,811 | 334,901 |
| Net cash provided by operating activities | 2,654,343 | 24,318 | 2,678,661 |
| Principal payments on notes payable | (2,488,778) | (24,318) | (2,513,096) |
| Net cash used in financing activities | (2,524,011) | (24,318) | (2,548,329) |

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation. The accompanying condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) and the rules of the Securities and Exchange Commission (“SEC”). In the opinion of management, all adjustments necessary in order for the financial statements to be not misleading have been reflected herein. As permitted by the rules and regulations of the SEC, certain information and footnote disclosures normally included

in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to those rules and regulations. The operating results for interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year.

In the opinion of management, the accompanying unaudited interim condensed financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly our financial position and the results of its operations and cash flows for the periods presented. These unaudited interim condensed financial statements should be read in conjunction with the financial statements and the related notes thereto included in our Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on April 14, 2017 (the “2016 10-K”).

Basis of accounting. The financial statements have been prepared on the accrual basis of accounting in conformity with U.S. GAAP. Revenues are recognized when earned and expenses are recognized when they are incurred. We do not have significant cost of revenue, as most of our revenue is derived from the licensing of intellectual properties. As a result, we do not separately present cost of revenue and gross profit in our statements of operations.

Significant Accounting Policies. See Note 2 in Item 8. “Financial Statements and Supplementary Data” included in our 2016 10-K.

Use of estimates and assumptions. We are required to make estimates, judgments and assumptions that we believe are reasonable based on our historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect reported amounts for assets, liabilities, revenues, expenses and related disclosures. Actual results may differ from initial estimates.

Reclassifications. Certain accounts and financial statement captions in the prior periods have been reclassified to conform to the current period financial statement presentations.

Recently adopted accounting standards

Inventory. In July 2015, the FASB issued ASU No. 2015-11, Inventory: Simplifying the Measurement of Inventory. Inventory is now required to be measured at the lower of cost or net realizable value, while the concept of market value will be eliminated. The ASU defines net realizable value as the estimated selling process in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with earlier adoption permitted. We adopted ASU 2015-11 effective January 1, 2017 using the required prospective adoption approach, which did not have a material effect on our financial condition, results of operations or cash flows.

Stock-based compensation. In March 2016, the FASB issued No. ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 addresses several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. This standard is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. We adopted ASU 2016-09 effective January 1, 2017 using the prospective adoption approach, which did not have a material impact on our financial condition, results of operations or cash flows.

New accounting standards not yet adopted

Revenue Recognition. In May 2014, the FASB issued ASU No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which is a comprehensive new revenue recognition standard that will supersede virtually all existing revenue guidance, including industry-specific guidance. Under the new standard, revenue will be recognized when control of the promised goods or services is transferred to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods and services. The standard creates a five-step model that

will generally require companies to use more judgment and make more estimates than under current guidance when considering the terms of contracts along with all relevant facts and circumstances. These include the identification of customer contracts and separating performance obligations, the determination of transaction price that potentially includes an estimate of variable consideration, allocating the transaction price to each separate performance obligation, and recognizing revenue in line with the pattern of transfer.

In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 by one year to now be effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2017. Early adoption of the standard is permitted but not before the original effective date of December 15, 2016. The ASU may be adopted using a full retrospective approach or reporting the cumulative effect as of the date of adoption. We are currently evaluating the impact of adopting this guidance; however, we expect to adopt using the modified retrospective approach.

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Leases. In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amended guidance is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The adoption of this guidance is expected to result in a significant portion of our operating leases being recognized on our balance sheets. The guidance requires lessees and lessors to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years with earlier adoption permitted. We are currently evaluating the impact of adopting this guidance.

Restricted Cash. In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This ASU requires amounts generally described as restricted cash and cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years with early adoption permitted. Upon the adoption of ASU 2016-08, restricted cash will be included within beginning and ending cash and cash equivalents amounts on our statements of cash flows, which we do not expect will have a material impact on our financial statements.

Goodwill Impairment. In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. This guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, if any. This guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the impact of adopting this guidance.

NOTE 3. INVENTORY

Inventory, net consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|-----------------------------------|-----------|-----------|
| Raw materials and component parts | \$272,228 | \$171,478 |
| Finished goods | 114,575 | 128,956 |
| Work-in-process | 104,643 | 151,671 |
| Inventory, gross | 491,446 | 452,105 |
| Less: inventory reserve | (25,000) | (25,000) |
| Inventory, net | \$466,446 | \$427,105 |

NOTE 4. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following at June 30, 2017 and December 31, 2016:

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| | 2017 | 2016 |
|--------------------------------|-----------|-----------|
| Furniture and fixtures | \$279,367 | \$269,471 |
| Automotive vehicles | 202,143 | 202,143 |
| Leasehold improvements | 156,843 | 156,843 |
| Computer equipment | 113,125 | 105,114 |
| Office equipment | 50,985 | 37,871 |
| Property and equipment, gross | 802,463 | 771,442 |
| Less: accumulated depreciation | (495,418) | (415,189) |
| Property and equipment, net | \$307,045 | \$356,253 |

For the six months ended June 30, 2017 and 2016, depreciation expense related to property and equipment of \$80,231 and \$64,478, respectively, is included in depreciation and amortization expense.

Accumulated depreciation of leasehold improvements totaled \$97,609 and \$82,183 as of June 30, 2017 and December 31, 2016, respectively.

NOTE 5. PRODUCTS LEASED AND HELD FOR LEASE

Products leased and held for lease, net consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|---|-----------|-----------|
| Enhanced table systems | \$508,971 | \$424,364 |
| Less: accumulated depreciation | (214,475) | (212,233) |
| Products leased and held for lease, net | \$294,496 | \$212,131 |

For the six months ended June 30, 2017 and 2016, depreciation expense related to products leased and held for lease of \$52,779 and \$24,218, respectively, is included in depreciation and amortization expense.

NOTE 6. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and finite-lived intangible assets, net consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|---|--------------|--------------|
| Goodwill | \$1,091,000 | \$1,091,000 |
| Finite-lived intangible assets: | | |
| Patents | 13,615,967 | 13,615,967 |
| Customer relationships | 3,400,000 | 3,400,000 |
| Trademarks | 2,740,000 | 2,740,000 |
| Non-compete agreements | 660,000 | 660,000 |
| Internally-developed software | 102,968 | — |
| Other intangible assets, gross | 20,518,935 | 20,415,967 |
| Less: accumulated amortization | (9,411,581) | (8,660,948) |
| Other intangible assets, net | 11,107,354 | 11,755,019 |
| Goodwill and other intangible assets, net | \$12,198,354 | \$12,846,019 |

Included in amortization expense was \$750,632 and \$744,625 related to the above intangible assets for the six months ended June 30, 2017 and 2016, respectively.

Estimated amortization expense to be recorded for the twelve months ending June 30, 2018 through 2022 and thereafter is as follows:

| June 30, | Total |
|----------|-------------|
| 2018 | \$1,499,233 |

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| | |
|--------------------|--------------|
| 2019 | 1,499,233 |
| 2020 | 1,488,540 |
| 2021 | 1,409,551 |
| 2022 | 1,390,947 |
| Thereafter | 3,819,850 |
| Total amortization | \$11,107,354 |

NOTE 7. ACCRUED EXPENSES

Accrued expenses consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|---------------------------|-------------|-------------|
| TableMAX license fee | \$638,965 | \$470,512 |
| Payroll and related | 427,654 | 405,553 |
| Professional fees | 123,232 | 59,567 |
| Commissions and royalties | 92,805 | 54,551 |
| Other | 61,726 | 119,245 |
| Total accrued expenses | \$1,344,382 | \$1,109,428 |

TableMAX license fee. Under the terms of a five-year licensing agreement (the “TMAX Agreement”) with TableMAX Corporation (“TMAX”), a provider of electronic table games and platforms headquartered in Las Vegas, Nevada, we previously had exclusive worldwide rights (excluding one international territory and two U.S. states) to the TMAX electronic gaming platform and certain related game titles. Pursuant to the terms of the TMAX Agreement, the licensee fee payable to TMAX is dependent upon our generating profitable operating results specifically from the use of TMAX products. To the extent there are net profits (as defined in

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the TMAX Agreement), a percentage of such net profits is payable to TMAX depending on the number of TMAX product installations. The TMAX Agreement expired during 2016, and we are currently negotiating the licensing fee (if any) that is payable to TMAX.

NOTE 8. CAPITAL LEASE OBLIGATIONS

Capital lease obligations consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|---|----------|----------|
| Capital lease obligation – leasehold improvements | \$62,701 | \$78,008 |
| Less: Current portion | (31,886) | (31,030) |
| Total capital lease obligations - long-term | \$30,815 | \$46,978 |

For the years ending June 30, future annual payments for capital leases obligations are as follows:

| June 30, | Total |
|------------------------------|----------|
| 2018 | \$31,886 |
| 2019 | 30,815 |
| Total minimum lease payments | \$62,701 |

NOTE 9. LONG-TERM DEBT

Long-term debt consisted of the following at June 30, 2017 and December 31, 2016:

| | 2017 | 2016 |
|---|--------------|--------------|
| Term loan | \$9,975,000 | \$10,500,000 |
| Notes payable, related party | 472,206 | 509,135 |
| Equipment notes payable | 143,482 | 162,274 |
| Insurance notes payable | 9,077 | 36,063 |
| Notes payable, gross | 10,599,765 | 11,207,472 |
| Less: | | |
| Unamortized debt issuance costs | (545,907) | (595,462) |
| Unamortized contra debt associated with the Warrants issued | (663,932) | (743,604) |
| Notes payable, net | 9,389,926 | 9,868,406 |
| Less: Current portion | (1,175,743) | (1,199,255) |
| Long-term debt, net | \$8,214,183 | \$8,669,151 |

Term loan. In August 2016, we entered into a term loan agreement (the "Term Loan Agreement") for an aggregate principal amount of \$10,500,000 (the "Term Loan"). Proceeds of the Term Loan were primarily used to prepay in full the outstanding notes payable to unrelated parties. The remainder of the proceeds from the Term Loan was used for general corporate purposes and working capital needs. The Term Loan is secured by a senior lien on substantially all of our assets. In conjunction with the Term Loan, we also entered into a warrant agreement (the "Warrant Agreement"), pursuant to which we issued the lenders a six-year warrant to purchase 1,965,780 shares of our common stock (the "Warrants"). See Note 13. The estimated fair value of the Warrants on the grant date was determined to be \$809,632 using the Black-Scholes option pricing model, and was recorded as a reduction of the related debt. The estimated fair value of the Warrants on the grant date is being amortized ratably over the term of the Warrants to interest expense.

Under the Term Loan, we are subject to quarterly financial covenants that, among other things, limit our annual capital expenditures (as defined in the Term Loan Agreement), and require us to maintain a specified leverage ratio and minimum EBITDA amounts, each of which are defined in the Term Loan agreement. We were in compliance with the financial covenants of the Term Loan Agreement as of June 30, 2017.

During the initial twelve-month period of the Term Loan, the outstanding principal will accrue interest at the rate of 14.0% per annum. Thereafter, the outstanding principal will accrue interest at the lesser of 14.0% per annum or 12.5% per annum for any quarterly period in which we achieve a specified leverage ratio.

The Term Loan required quarterly interest-only payments through December 31, 2016, after which we are required to make quarterly principal payments of \$262,500 plus accrued interest. The remaining principal and any unpaid interest will be payable in full on

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August 29, 2021. Voluntary prepayments of the Term Loan, in full or in part, are permitted after the first anniversary of the Term Loan, subject to certain premiums. The Term Loan also requires certain mandatory prepayments in the amount of 100% of the proceeds from certain asset dispositions (other than in the ordinary course of business) and certain other extraordinary events, and 25% of the proceeds from the sale and issuance of capital stock. Substantially all of our assets are pledged as collateral for the Term Loan.

The foregoing summary of the Term Loan Agreement and the Warrant Agreement is qualified in its entirety by reference to the respective agreements, which are found as Exhibits 99.1 and 99.2, respectively, to our Form 8-K filed with the SEC on August 29, 2016.

Notes payable, related party. In connection with an asset purchase agreement executed in December 2007, we executed a note payable to an entity owned and controlled by our former Chief Executive Officer, Mr. Robert B. Saucier (the "Related Party Note Payable"). This note requires annual principal and interest payments of \$109,908, at a fixed interest rate of 7.3% through December 2018, at which time there is a balloon payment due of \$354,480. This note was repaid in full on August 11, 2017. See Note 15.

As of June 30, 2017, maturities of our long-term debt obligations are as follows:

| June 30, | Total |
|---|-------------|
| 2018 | \$1,175,743 |
| 2019 | 1,484,089 |
| 2020 | 1,081,407 |
| 2021 | 1,072,243 |
| 2022 | 5,786,283 |
| Total notes payable | 10,599,765 |
| Less: | |
| Unamortized debt issuance costs | (545,907) |
| Unamortized contra debt associated with the Warrants issued | (663,932) |
| Notes payable, net | \$9,389,926 |

NOTE 10. COMMITMENTS AND CONTINGENCIES

Concentration of risk. We are exposed to risks associated with clients who represent a significant portion of total revenues. For the six months ended June 30, 2017 and 2016, respectively, we had the following client revenue concentration:

| Location | 2017 | 2016 |
|----------|------|------|
|----------|------|------|

| | Revenue | Revenue |
|------------------------|---------|---------|
| Client A North America | 14.1% | 14.0% |

We are also exposed to risks associated with the expiration of our patents. In 2015, domestic and international patents for two of our products expired, which accounted for approximately \$3,141,418 or 44% of our revenue for the six months ended June 30, 2017, as compared to \$2,880,782 or 48% of our revenue for the six months ended June 30, 2016. We continue to generate higher revenue from these products despite the expiration of the underlying patents. As a result, we do not expect the expiration of these patents to have a significant adverse impact on our financial statements.

Operating lease. In February 2014, we entered into a lease (the “Spencer Lease”) for a new corporate office with an unrelated third party. The five-year Spencer Lease is for an approximately 24,000 square foot space, which is comprised of approximately 16,000 square feet of office space and 8,000 square feet of warehouse space. The property is located in Las Vegas, Nevada.

The initial term of the Spencer Lease commenced on April 1, 2014. We were obligated to pay approximately \$153,000 in annual base rent in the first year, and the annual base rent is scheduled to increase by approximately 4% each year. We are also obligated to pay real estate taxes and other building operating costs. Subject to certain conditions, we have certain rights under the Spencer Lease, including rights of first offer to purchase the premises if the landlord elects to sell. We also have an option to extend the term of the Spencer Lease for two consecutive terms of three years each, at the then current fair market value rental rate determined in accordance with the terms of the Spencer Lease.

In connection with the commencement of the Spencer Lease, the landlord agreed to finance tenant improvements (“TI Allowance”) of \$150,000. The base rent is increased by an amount sufficient to fully amortize the TI Allowance through the initial Spencer Lease term upon equal monthly payments of principal and interest, with interest imputed on the outstanding principal balance at the rate of 5.5% per annum. The TI Allowance has been classified as a capital lease on the condensed balance sheet.

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Total rent expense was \$144,059 and \$141,834 for the six months ended June 30, 2017 and 2016, respectively.

There are currently no operating lease commitments that extend beyond April 1, 2020. As of June 30, 2017, the amounts shown in the accompanying table reflect our estimates of annual future minimum lease obligations:

| June 30, | Annual Obligation |
|-------------------|-------------------|
| 2018 | \$ 230,184 |
| 2019 | 238,920 |
| Total obligations | \$ 469,104 |

Legal proceedings. In the ordinary course of conducting our business, we are, from time to time, involved in various legal proceedings, administrative proceedings, regulatory government investigations and other matters, including those in which we are a plaintiff or defendant, that are complex in nature and have outcomes that are difficult to predict. We record accruals for such contingencies to the extent we conclude that it is probable that a liability will be incurred and the amount of the related loss can be reasonably estimated. Our assessment of each matter may change based on future unexpected events. An unexpected adverse judgment in any pending litigation could cause a material impact on our business operations, intellectual property, results of operations or financial position. Unless otherwise expressly stated, we believe costs associated with litigation will not have a material impact on our financial position or liquidity, but may be material to the results of operations in any given period. We assume no obligation to update the status of pending litigation, except as may be required by GAAP, applicable law, statute or regulation. For a complete description of the facts and circumstances surrounding material litigation to which we are a party, see Note 12 in Item 8. "Financial Statements and Supplementary Data" included in our 2016 10-K.

NOTE 11. STOCKHOLDERS' EQUITY

In February 2017, a former employee forfeited 100,000 shares of unvested restricted stock and paid us \$35,000 in connection with the exercise of 150,000 fully-vested stock options.

NOTE 12. INCOME TAXES

Our forecasted annual effective tax rate at June 30, 2017 was 45.1%, as compared to 34.0% at June 30, 2016. For the six months ended June 30, 2017 and 2016, our effective tax rate was 39.7% and 34.2%, respectively. The increase in the effective tax rate was primarily due to the permanent book-to-tax difference generated by changes in the estimated fair value of the warrant liability as of and for the six months ended June 30, 2017.

NOTE 13. STOCK WARRANTS, OPTIONS AND GRANTS

Stock options. For the six months ended June 30, 2017 and 2016, we issued 785,000 and 315,000 options to purchase our common stock, respectively, to members of our Board of Directors (the “Board”), independent contractors, executive officers and employees.

On May 1, 2017, we entered into an employment agreement (the “Hagerty Employment Agreement”) with Harry C. Hagerty, pursuant to which Mr. Hagerty will serve as our Secretary, Treasurer and Chief Financial Officer through April 30, 2020. Pursuant to the Hagerty Employment Agreement, Mr. Hagerty receives a base salary of \$120,000 per annum and is eligible for bonuses if and as approved by the Compensation Committee of the Board. In addition, Mr. Hagerty has been granted stock options to purchase 400,000 shares of our Common Stock at an exercise price per share of \$0.60, subject to vesting and other conditions.

The fair value of all stock options granted for the six months ended June 30, 2017 and 2016 was determined to be \$329,508 and \$61,602, respectively, using the Black-Scholes option pricing model with the following assumptions:

| | Options issued six months ended June 30, 2017 | Options issued six months ended June 30, 2016 |
|-------------------------|--|--|
| Dividend yield | 0% | 0% |
| Expected volatility | 83% - 87% | 89% - 90% |
| Risk free interest rate | 1.84% - 1.94% | 1.01% - 1.21% |
| Expected life (years) | 5.00 | 5.00 |

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A summary of stock option activity is as follows:

| | Common stock options | Weighted- average exercise price | Aggregate intrinsic value | Weighted-average remaining contractual term (years) |
|---------------------------------|-------------------------|--|---------------------------------|---|
| Outstanding – December 31, 2016 | 1,496,250 | \$ 0.32 | \$ 385,017 | 3.57 |
| Issued | 785,000 | 0.63 | — | — |
| Exercised | (150,000) | 0.23 | — | — |
| Expired | — | — | — | — |
| Outstanding – June 30, 2017 | 2,131,250 | \$ 0.44 | \$ 722,942 | 3.84 |
| Exercisable – June 30, 2017 | 1,589,026 | \$ 0.40 | \$ 600,963 | 3.60 |

A summary of unvested stock option activity is as follows:

| | Common stock options | Weighted-average exercise price | Aggregate intrinsic value | Weighted-average remaining contractual term (years) |
|------------------------------|-------------------------|------------------------------------|---------------------------------|---|
| Unvested – December 31, 2016 | 128,889 | \$ 0.34 | \$ 30,933 | 3.99 |
| Granted | 785,000 | 0.63 | — | — |
| Vested | (371,665) | 0.63 | — | — |
| Forfeited or expired | — | — | — | — |
| Unvested – June 30, 2017 | 542,224 | \$ 0.56 | \$ 121,979 | 4.55 |

As of June 30, 2017, our unrecognized stock-based compensation expense was \$184,075, which will be amortized over a weighted average of 2.63 years.

Warrants. On August 29, 2016, in connection with the Term Loan Agreement, we issued the lenders the Warrants to purchase 1,965,780 shares of our common stock at an initial exercise price of \$0.30 per share. The number of shares of common stock issuable upon exercise of the Warrants, and/or the exercise price of such shares, is subject to standard anti-dilution adjustments in the event of stock splits, reorganizations, stock dividends, and similar events. As of the date of the Warrant Agreement, the shares of common stock issuable upon a full exercise of the Warrants would represent 5.0% of the total issued and outstanding shares of our common stock. The lenders were also granted the right, but not the obligation, to purchase up to 5.0% of the total number of new securities that we may, from time to time, sell and issue.

The Warrants expire on August 29, 2022, and may not be exercised prior to the earliest of (a) the fifth anniversary of the Term Loan Agreement, (b) the date on which the obligations described in the Term Loan Agreement are repaid in

full, or (c) the date on which the lenders declare all or any portion of the outstanding amount of the Term Loan to be due and payable under the terms of the Term Loan Agreement (collectively, the "Trigger Date"). Exercise of the Warrants requires a sixty (60) day prior written notice, during which time we may exercise our Call Right described below.

The Warrant Agreement includes a call right (the "Call Right") whereby we can purchase the Warrants for a fixed sum of \$1,333,333 upon providing the Warrant holders with a thirty (30) day prior written notice. Furthermore, the Warrant Agreement also includes a put right (the "Put Right") whereby the lenders may require us to purchase from the lenders all or any portion of the Warrants at a purchase price equal to the lesser of (a) the fair market value of the underlying shares of common stock as of the date of exercise of the Put Right, or (b) \$1,333,333. The Put Right may not be exercised prior to the Trigger Date (as defined above), and the Put Right expires on August 29, 2022. The foregoing summary of the Term Loan Agreement and the Warrant Agreement is qualified in its entirety by reference to the respective agreements, which are found as Exhibits 99.1 and 99.2, respectively, to our Form 8-K filed with the SEC on August 29, 2016.

NOTE 14. FAIR VALUE OF FINANCIAL INSTRUMENTS

We estimate fair value for financial assets and liabilities in accordance with Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurement ("ASC 820"). ASC 820 defines fair value, provides guidance for measuring fair value, requires certain disclosures and discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). ASC 820 utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The estimated fair value of cash equivalents, restricted cash, accounts receivable and accounts payable approximates their carrying amount due to their short-term nature. The estimated fair value of our long-term debt and capital lease obligations approximates their carrying value based upon our expected borrowing rate for debt with similar remaining maturities and comparable risk. As of June 30, 2017, the Warrants were the only financial instrument measured at estimated fair value on a recurring basis based on level 2 inputs.

NOTE 15. SUBSEQUENT EVENTS

Resignation of Chairman, CEO and President. On July 24, 2017, Robert B. Saucier submitted a letter of resignation to the Board. Mr. Saucier resigned from his positions as Chairman of the Board, CEO and President in order to aid us in our expanded regulatory jurisdictional ambitions. Mr. Saucier will remain a member of the Board. On July 24, 2017, the Board accepted Mr. Saucier's resignations and appointed Mr. Saucier to serve as Executive Vice President of Business Development and Chief Product Officer. In these new positions, he will receive an annual salary of \$225,000 and is eligible to receive performance-based bonuses and incentives, as well as employee benefits and other perquisites. There were no disputes between Mr. Saucier and us that caused Mr. Saucier to resign.

Appointment of new President and CEO. Following the acceptance of Mr. Saucier's resignation, on July 24, 2017, the Board appointed Todd P. Cravens to serve as CEO and President, effective immediately. Mr. Cravens, age 45, was previously serving as our Vice President of Business Development, a position he had held since January 1, 2017.

Mr. Cravens' employment agreement related to his position as Vice President of Business Development was terminated and superseded with a new employment agreement to reflect his new positions and responsibilities.

Pursuant to the new employment agreement (the "Cravens Employment Agreement"), Mr. Cravens will receive an annual base salary of \$230,000, and is eligible for bonuses if and as approved by the Compensation Committee of the Board. In addition, pursuant to the Cravens Employment Agreement, Mr. Cravens was granted options to purchase up to 450,000 shares of our restricted common stock, which vest as follows: as to the first 150,000 shares of stock, on July 26, 2017, (ii) as to the next 150,000 shares of stock, on August 1, 2018, and (iii) as to the next 150,000 shares of stock, on August 1, 2019, all pursuant to the terms of a Stock Option Grant Agreement by and between us and Mr. Cravens. Provided that Mr. Cravens is a full-time employee on August 1, 2020, we agreed to grant to Mr. Cravens an option to purchase an additional 150,000 shares of our restricted common stock (the "2020 Annual Grant") with a strike price equal to the price per share of our common stock as reported on OTC Markets on August 1, 2020 (or the nearest trading date thereafter), which option will vest on August 1, 2020 (or the nearest trading date thereafter). The term of the Cravens Employment Agreement is through July 26, 2020. His duties include those commonly undertaken by the CEO and President of a public company in the same industry as us. Mr. Cravens is entitled to certain severance payments in the event his employment with us is terminated by us without cause following a change of control, or following termination of the Cravens Employment Agreement by Mr. Cravens.

Appointment of New Director. On July 26, 2017, the Board appointed Mark A. Lipparelli as a member of the Board to fill a newly-created board seat and elected Mr. Lipparelli to serve as Chairman of the Board.

Repayment of related party note payable. On August 11, 2017, we repaid in full the then-outstanding principal balance along with accrued and unpaid interest (in the aggregate amount of \$459,683) on the Related Party Note Payable. See Note 9 for further detail on the Related Party Note Payable. This payment constituted a Restricted Payment as defined in our Term Loan, and we received a waiver with respect to the payment from the administrative agent for the Term Loan.

Since we were not contractually required to retire the Related Party Note Payable until December 2018 and the full repayment was not contemplated as of June 30, 2017, no reclassification between the current and long-term portions of this note was recorded as of June 30, 2017.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the Securities Act, and is subject to the safe harbors created by those sections. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "may," variations of these words or similar expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements.

Due to possible uncertainties and risks, readers are cautioned not to place undue reliance on the forward-looking statements contained in this Quarterly Report, which speak only as of the date of this Quarterly Report, or to make predictions about future performance based solely on historical financial performance. We disclaim any obligation to update forward-looking statements contained in this Quarterly Report.

OVERVIEW

We develop, acquire, manufacture and market technology and entertainment-based products and services for the gaming industry for placement on the casino floor. Our products and services primarily relate to licensed casino operators' table games activities and focus on either increasing their profitability, productivity and security or expanding their gaming entertainment offerings in the form of proprietary table games, electronically enhanced table game platforms, fully-automated electronic tables and other ancillary equipment. Our products and services are offered in highly regulated markets throughout the world. Our products and services are manufactured at our headquarters and manufacturing facility in Las Vegas, Nevada, as well as outsourced for certain sub-assemblies in the United States.

Additional information regarding our products and product categories may be found in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2016 10-K and on our web site, www.galaxygaming.com. Information found on the web site should not be considered part of this report.

As discussed in Note 1 to our condensed financial statements included in Item 1 of this report, financial statements for the three and six months ended June 30, 2016 have been restated to correct certain errors noted during the preparation of the financial statements for the year ended December 31, 2016. The restatements to reflect the correction of these errors are referred to herein collectively as the "Restatement." For further information regarding the Restatement, see our Current Report on Form 8-K filed with the SEC on April 3, 2017.

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Results of operations for the three months ended June 30, 2017. For the three months ended June 30, 2017, our continuing operations generated gross revenues of \$3,658,808 compared to gross revenues of \$3,064,171 for the comparable prior-year period, representing an increase of \$594,637, or 19%. This increase was primarily attributable to our focus on Premium Games such as High Card Flush and Heads Up Hold 'em, which command a higher price point per unit, and the improved performance of side bet games such as 21+3 and Bonus Craps. Selling, general and administrative expenses for the three months ended June 30, 2017 were \$2,359,889 compared to \$1,632,584 for the comparable prior period, representing an increase of \$727,305, or 45%. Significant quarter-over-quarter changes in selling, general and administrative expenses consisted of the following categories:

| | Three Months Ended June 30, | |
|-----------------------------------|--------------------------------|------------|
| | 2017 | 2016 |
| Employee compensation and related | \$ 1,112,626 | \$ 657,809 |
| Professional and compliance fees | 524,624 | 383,000 |

Employee compensation and related expenses increased as a result of our investments in personnel as we continue to grow and attract new talent, as well as higher sales commissions due to increased revenues in 2017. Professional and compliance fees have increased due to on-going regulatory applications in various jurisdictions.

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Research and development expenses for the three months ended June 30, 2017 were \$126,386, compared to \$101,879 for the comparable prior-year period, representing an increase of \$24,507, or 24.1%. This increase was primarily due to increased costs associated with testing our products.

Income from operations decreased \$309,074, or 36.2%, to \$544,159 for the three months ended June 30, 2017, compared to \$853,233 for the comparable prior-year period. This decrease was primarily attributable to higher selling, general and administrative expenses.

Total interest expense increased \$183,029, or 72%, to \$438,247 for three months ended June 30, 2017, compared to \$255,218 for the comparable prior-year period. The increase in interest expense was primarily due to the Term Loan refinance transaction completed in August 2016.

The change in estimated fair value of warrants issued in connection with the Term Loan was \$256,909 for the three months ended June 30, 2017, compared to zero for the comparable prior-year period. The estimated fair value is determined using the Black-Scholes pricing model.

Income tax benefit was \$13,083 for the three months ended June 30, 2017, compared to a provision of \$282,330 for the comparable prior-year period. This change was primarily attributable to the decrease in income before provision for income taxes and the permanent book-to-tax difference generated by changes in the estimated fair value of the warrant liability as of and for the three months ended June 30, 2017.

Results of operations for the six months ended June 30, 2017. For the six months ended June 30, 2017, our continuing operations generated gross revenues of \$7,134,104 compared to gross revenues of \$6,048,270 for the comparable prior-year period, representing an increase of \$1,085,834, or 18%. This increase was primarily attributable to our focus on Premium Games such as High Card Flush and Heads Up Hold 'em, which command a higher price point per unit, and the improved performance of side bet games such as 21+3 and Bonus Craps. Selling, general and administrative expenses for the six months ended June 30, 2017 were \$4,446,058 compared to \$3,265,815 for the comparable prior period, representing an increase of \$1,180,243, or 36%. Significant year-over-year changes in selling, general and administrative expenses consisted of the following categories:

| | Six Months Ended June 30, | |
|-----------------------------------|------------------------------|-------------|
| | 2017 | 2016 |
| Employee compensation and related | \$1,942,397 | \$1,189,730 |
| Professional and compliance fees | 981,874 | 909,759 |

Employee compensation and related expenses increased as a result of our investments in personnel as we continue to grow and attract new talent, as well as higher sales commissions due to increased revenues in 2017. Professional and compliance fees have increased due to on-going regulatory applications in various jurisdictions.

Research and development expenses for the six months ended June 30, 2017 were \$264,433, compared to \$181,221 for the comparable prior-year period, representing an increase of \$83,212, or 46%. This increase was primarily due to increased costs associated with testing our products.

Income from operations decreased \$378,235, or 23%, to \$1,288,435 for the six months ended June 30, 2017, compared to \$1,666,670 for the comparable prior-year period. This decrease was primarily attributable to higher selling, general and administrative expenses.

Total interest expense increased \$370,166, or 72%, to \$883,579 for the six months ended June 30, 2017, compared to \$513,413 for the comparable prior-year period. The increase in interest expense was primarily due to the Term Loan refinance transaction completed in August 2016.

The change in estimated fair value of warrants issued in connection with the Term Loan was \$323,409 for the six months ended June 30, 2017, compared to zero for the comparable prior-year period. The estimated fair value is determined using the Black-Scholes pricing model.

Income tax provision decreased \$457,464 or 88%, to \$64,891 for the six months ended June 30, 2017, compared to \$522,355 for the comparable prior-year period. This was attributable to the decrease in income before provision for income taxes and the permanent book-to-tax difference generated by changes in the estimated fair value of the warrant liability as of and for the six months ended June 30, 2017.

Adjusted EBITDA. Adjusted EBITDA includes adjustment to net income to exclude interest, taxes, depreciation, amortization, share based compensation, loss on extinguishment of debt, foreign currency exchange gains, change in estimated fair value of warrant liability, and settlement income. Adjusted EBITDA is not a measure of performance defined in accordance with U.S. generally

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accepted accounting principles ("U.S. GAAP"). However, Adjusted EBITDA is used by management to evaluate our operating performance. Management believes that disclosure of the Adjusted EBITDA metric offers investors, regulators and other stakeholders a view of our operations in the same manner management evaluates our performance. When combined with U.S. GAAP results, management believes Adjusted EBITDA provides a comprehensive understanding of our financial results. Adjusted EBITDA should not be considered as an alternative to net income or to net cash provided by operating activities as a measure of operating results or of liquidity. It may not be comparable to similarly titled measures used by other companies, and it excludes financial information that some may consider important in evaluating our performance. A reconciliation of U.S. GAAP net income from operations to Adjusted EBITDA is as follows:

| Adjusted EBITDA Reconciliation: | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------------------|------------------------------|--------------------|
| | 2017 | 2016 (Restated) | 2017 | 2016 (Restated) |
| Net (loss) income | \$(79,759) | \$563,439 | \$82,508 | \$991,274 |
| Interest income | — | (90) | — | (146) |
| Interest expense | 438,247 | 255,218 | 883,579 | 513,413 |
| Income tax (benefit) provision | (13,083) | 282,330 | 64,891 | 522,355 |
| Depreciation and amortization | 447,557 | 417,344 | 883,642 | 833,321 |
| Share based compensation expense | 118,551 | 29,459 | 168,388 | 49,931 |
| Foreign currency exchange gains | (58,155) | (247,664) | (65,952) | (360,226) |
| Change in estimated fair value of warrant liability | 256,909 | — | 323,409 | — |
| Adjusted EBITDA | \$1,110,267 | \$1,300,036 | \$2,340,465 | \$2,549,922 |

Liquidity and capital resources. As of June 30, 2017, we had total current assets of \$6,122,750 and total assets of \$19,312,702. This compares to \$5,148,435 and \$19,011,945, respectively as of December 31, 2016. The increase in current assets as of June 30, 2017 was primarily impacted by an increase in cash and cash equivalents and accounts receivable. Cash increased significantly due to reduced principal payments on the Term Loan as compared to the PTG Notes. Our total current liabilities as of June 30, 2017 were \$4,880,922 and \$4,708,685 as of December 31, 2016. This increase was primarily driven by the increase in accrued expenses (primarily due to the increase in TableMAX license fee accrual). Our business model continues to be highly profitable and we have several options to ensure we are able to meet our short-term and long-term obligations.

We have undertaken certain growth initiatives to expand our recurring revenue base. As such we have made investments in personnel and research related to the development of our enhanced table systems. Additionally, we increased our sales and marketing budget and spent monies on regulatory efforts for the purpose of expanding our distribution network. We are also subject to several regulatory investigations and proceedings which may result in significant future legal and regulatory expenses. A significant increase in such expenses may require us to postpone growth initiatives or investments in personnel, inventory and research and development of our products. It is our intention to continue such initiatives and investments. However, to the extent we are not able to achieve our growth objectives or raise additional capital, we will need to evaluate the reduction of operating expenses.

At June 30, 2017, we do not have any available third-party lines or letters of credit or any written or oral commitments from officers or shareholders to provide us with loans or advances to support our operations or fund potential acquisitions.

Our operating activities provided \$1,269,376 in cash for the six months ended June 30, 2017, compared to \$2,678,661 for the six months ended June 30, 2016. The decrease in operating cash flow was primarily due to the decreases in net

income, income taxes payable and deferred revenue, partially offset by increases in accrued expenses.

Additionally, investing activities used cash of \$74,940 for the six months ended June 30, 2017. The cash flows from investing activities are due to the acquisition of software and property and equipment. Cash used in financing activities during the six months ended June 30, 2017 was \$605,106, which was primarily due to principal payments towards long-term debt and capital leases.

We intend to fund our continuing operations through increased sales and cash flow. However, the issuance of debt or equity financing arrangements may be required to fund expenditures or other cash requirements. There can be no assurance that we will be successful in raising additional funding, if necessary, and even if we are successful, it may not be on advantageous terms to us. If we are not able to secure additional funding, the implementation of our business plan could be impaired. In addition, we may incur higher capital expenditures in the future to expand our operations. We may from time to time acquire products and businesses complementary to our business. We may also incur significant expenses when applying for new licenses or in complying with current jurisdictional requirements. As a public entity, we may issue shares of our common stock and preferred stock in private or public offerings to obtain financing, capital or to acquire other businesses that can improve our performance and growth. To the extent that we seek to acquire other businesses in exchange for our common stock, fluctuations in our stock price could have a material adverse effect on our ability to complete acquisitions.

Critical accounting policies. The discussion of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with U.S. GAAP. Critical accounting policies are those policies that, in management's view, are most important in the portrayal of our financial condition and results of operations. See Note 2 of our financial statements included in Item 8. "Financial Statements and Supplementary Data" of our 2016 10-K for further detail on these critical accounting policies.

Off balance sheet arrangements. As of June 30, 2017, there were no off balance sheet arrangements.

Recently issued accounting pronouncements. We do not expect the adoption of recently issued accounting pronouncements to have a significant impact on our results of operations, financial position or cash flow.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A smaller reporting company is not required to provide the information required by this Item.

ITEM 4. CONTROLS AND PROCEDURES

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2017 our disclosure controls and procedures were effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

No change in our internal control over financial reporting occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the effectiveness of internal controls. Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material error. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving our objectives and our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at that reasonable assurance level. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more

people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting our business, we are, from time to time, involved in various legal proceedings, administrative proceedings, regulatory government investigations and other matters, including those in which we are a plaintiff, that are complex in nature and have outcomes that are difficult to predict. In accordance with topic ASC Topic 450, we record accruals for such contingencies to the extent that we conclude that it is probable that a liability will be incurred and the amount of the related loss can be reasonably estimated. Our assessment of each matter may change based on future unexpected events. An unexpected adverse judgment in any pending litigation could cause a material impact on our business operations, intellectual property, results of operations or financial position. Unless otherwise expressly stated, we believe costs associated with litigation will not have a material impact on our financial position or liquidity, but may be material to the results of operations in any given period. We assume no obligation to update the status of pending litigation, except as may be required by GAAP, applicable law, statute or regulation. For a complete description of the facts and circumstances surrounding material litigation to which we are a party, see Note 12 in Item 8. “Financial Statements and Supplementary Data” included in our See Note 2 in Item 8. “Financial Statements and Supplementary Data” included in our 2016 10-K. There are no material updates to matters previously reported on our 2016 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On June 30, 2017, we issued options to purchase up to 75,000 shares of our common stock to three members of our Board in consideration of their service on the Board, at an exercise price of \$0.78 per share. In addition, on June 30, 2017, we issued an option to purchase up to 37,500 shares of our common stock to an independent contractor in consideration of consulting services to us, at an exercise price of \$0.78 per share. Each of the aforementioned options to purchase common stock was exercisable as of the date of grant. The options must be exercised within five years from the date of grant or 90 days from the date of the recipient’s departure from the Board. In each of the transactions listed above, the securities were issued pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, (the “Securities Act”) and rules and regulations promulgated thereunder.

As previously disclosed, on May 1, 2017, in connection with his employment agreement, we granted Mr. Hagerty an option to purchase up to 400,000 shares of our common stock, with an exercise price of \$0.60 per share, which option vests as follows: (i) immediately as to the first 100,000 shares of stock, (ii) as to the next 300,000 shares of stock, 100,000 shares on each of the first, second and third anniversary of the effective date of Mr. Hagerty’s employment agreement. The option must be exercised within five years from the date of grant or 90 days from the date of Mr. Hagerty’s separation from us. The option was issued pursuant to Section 4(a)(2) of the Securities Act and rules and regulations promulgated thereunder.

Our reliance upon Section 4(a)(2) of the Securities Act in granting the aforementioned options to purchase shares of our common stock was based in part upon the following factors: (a) each of the issuances of the securities was in connection with an isolated private transaction which did not involve any public offering; (b) there were a limited number of offerees; (c) there were no subsequent or contemporaneous public offerings of the securities by us; and (d) the negotiations for the issuance of the securities took place directly between the offeree and us.

ITEM 6. EXHIBITS

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| Exhibit Number | Description of Exhibit |
|----------------|--|
| 10.1 | Employment agreement of Todd Cravens, dated July 27, 2017 |
| 31.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002* |
| 101 | Financials in XBRL format |

* In accordance with Item 601(b)(32)(ii) of Regulation S-K, this exhibit shall not be deemed “filed” for the purposes of Section 18 of the Securities and Exchange Act of 1934 or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Galaxy Gaming, Inc.

Date: August 14, 2017

By: /s/ TODD P. CRAVENS
Todd P. Cravens
President and Chief Executive Officer (Principal Executive Officer)

Galaxy Gaming, Inc.

Date: August 14, 2017

By: /s/ HARRY C. HAGERTY
Harry C. Hagerty
Chief Financial Officer (Principal Accounting Officer)