MULTIMEDIA GAMES INC
Form 10-Q
February 09, 2009

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

Form 10-Q

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

For the quarterly period ended December 31, 2008
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission File Number: 000-28318

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

Texas	74-2611034
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
206 Wild Basin Road, Building B, Fourth Floor Austin, Texas	78746
(Address of principal executive offices)	(Zip Code)

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

Registrant's website: www.multimediagames.com

None
(Former name, former address and former fiscal year, if changed since last report)

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

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

Large Accelerated Filer ¨ Accelerated Filer ý

Non-Accelerated Filer ¨ Smaller Reporting Company ¨

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

As of February 2, 2009, there were 26,642,942 shares of the Registrant's common stock, par value $0.01 per share, outstanding.

FORM 10-Q

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PART I
FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

MULTIMEDIA GAMES, INC.

CONSOLIDATED BALANCE SHEETS
As of December 31, 2008 and September 30, 2008
(In thousands, except shares)
(Unaudited)

	December 31, 2008	September 30, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,940	$ 6,289
Accounts receivable, net of allowance for doubtful accounts of $1,112 and $1,209, respectively	21,778	23,566
Inventory	5,500	2,445
Deferred contract costs	1,454	998
Prepaid expenses and other	2,032	2,170
Current portion of notes receivable, net	18,688	23,072
Federal and state income tax receivable	4,751	2,198
Deferred income taxes	7,852	6,876
Total current assets	64,995	67,614
Restricted cash and long-term investments	838	868
Leased gaming equipment, net	40,602	36,024
Property and equipment, net	75,509	67,329
Long-term portion of notes receivable, net	48,688	46,690
Intangible assets, net	36,020	37,356
Other assets	3,410	4,157
Deferred income taxes	16,813	16,902
Total assets	$ 286,875	$ 276,940
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 2,675	$ 1,544
Accounts payable and accrued expenses	38,981	29,248
Federal and state income tax payable	—	33
Deferred revenue	3,600	2,640
Total current liabilities	45,256	33,465
Revolving line of credit	25,222	19,000
Long-term debt, less current portion	66,222	66,444
Other long-term liabilities	1,085	1,131
Deferred revenue, less current portion	5,485	6,168
Total liabilities	143,270	126,208

Commitments and contingencies		
Stockholders' equity:		
Preferred stock:		
Series A, \$0.01 par value, 1,800,000 shares authorized, no shares issued and outstanding	—	—
Series B, \$0.01 par value, 200,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.01 par value, 75,000,000 shares authorized, 32,545,809 and 32,511,988 shares issued, and 26,642,392 and 26,608,571 shares outstanding, respectively	325	325

MULTIMEDIA GAMES, INC.
CONSOLIDATED BALANCE SHEETS – (Continued)
As of December 31, 2008 and September 30, 2008
(In thousands, except shares)
(Unaudited)

	December 31, 2008	September 30, 2008
Additional paid-in capital	83,791	83,076
Treasury stock, 5,903,417 common shares at cost	(50,128)	(50,128)
Retained earnings	111,657	117,581
Accumulated other comprehensive loss, net	(2,040)	(122)
Total stockholders' equity	143,605	150,732
Total liabilities and stockholders' equity	$ 286,875	$ 276,940

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

MULTIMEDIA GAMES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended December 31, 2008 and 2007
(In thousands, except per share data)
(Unaudited)

	Three Months Ended December 31, 2008	2007
REVENUES:		
Gaming revenue:		
Class II	$ 5,007	$ 8,040
Oklahoma compact	13,796	11,561
Charity	2,543	3,857
All other	4,940	4,638
Gaming equipment, system sale and lease revenue	1,766	1,771
Other	524	368
Total revenues	28,576	30,235
OPERATING COSTS AND EXPENSES:		
Cost of gaming equipment and systems sold and royalty fees	1,847	790
Selling, general and administrative expenses	20,264	16,101
Amortization and depreciation	14,865	12,523
Total operating costs and expenses	36,976	29,414
Operating income (loss)	(8,400)	821
OTHER INCOME (EXPENSE):		
Interest income	1,290	1,134
Interest expense	(2,135)	(2,140)
Other income	74	338
Income (loss) before income taxes	(9,171)	153
Income tax benefit	3,247	246
Net income (loss)	$ (5,924)	$ 399
Basic earnings (loss) per common share	$ (0.22)	$ 0.02
Diluted earnings (loss) per common share	$ (0.22)	$ 0.01
Shares used in earnings (loss) per common share:		
Basic	26,624	26,254
Diluted	26,624	27,380

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

MULTIMEDIA GAMES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended December 31, 2008 and 2007
(In thousands)
(Unaudited)

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (5,924)	$ 399
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Amortization	1,388	1,202
Depreciation	13,477	11,321
Accretion of contract rights	1,326	996
Provisions for long-lived assets	(1,142)	(5)
Deferred income taxes	(887)	(1,877)
Share-based compensation	654	367
Provision for doubtful accounts	149	161
Interest income from imputed interest	(1,152)	(804)
Changes in operating assets and liabilities:		
Accounts receivable	(572)	847
Inventory	(3,055)	1,157
Deferred contract costs	(456)	(116)
Prepaid expenses and other	885	86
Federal and state income tax payable/receivable	(2,586)	(1,488)
Notes receivable	1,151	(230)
Accounts payable and accrued expenses	9,733	1,075
Other long-term liabilities	(16)	—
Deferred revenue	277	(2,128)
NET CASH PROVIDED BY OPERATING ACTIVITIES	13,250	10,963
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Acquisition of property and equipment and leased gaming equipment	(25,058)	(12,311)
Proceeds from disposal of assets	—	252
Acquisition of intangible assets	(845)	(1,518)
Advances under development agreements	—	(20,162)
Repayments under development agreements	1,819	5,683
NET CASH USED IN INVESTING ACTIVITIES	(24,084)	(28,056)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options, warrants,and related tax benefit	61	134
Proceeds from long-term debt	2,894	424
Principal payments of long-term debt and capital leases	(1,985)	(180)
Proceeds from revolving lines of credit	6,444	14,097
Payments on revolving lines of credit	(222)	(3,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	7,192	11,475
EFFECT OF EXCHANGE RATES ON CASH	293	(1)
Net decrease in cash and cash equivalents	(3,349)	(5,619)
Cash and cash equivalents, beginning of period	6,289	5,805
Cash and cash equivalents, end of period	$ 2,940	$ 186

SUPPLEMENTAL CASH FLOW DATA:				
Interest paid	$	681	$	1,215
Income tax paid	$	208	$	3,366
NON-CASH TRANSACTIONS:				
Contract rights resulting from imputed interest on development agreement notes receivable	$	568	$	3,257

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

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

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and footnotes contained within the Company's Annual Report on Form 10-K for the year ended September 30, 2008, as amended by Amendment No. 1 on Form 10-K/A thereto.

The financial statements included herein as of December 31, 2008, and for each of the three months ended December 31, 2008 and 2007, have been prepared by the Company without an audit, pursuant to accounting principles generally accepted in the United States, and the rules and regulations of the Securities and Exchange Commission, or SEC. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The information presented reflects all adjustments consisting solely of normal recurring adjustments which are, in the opinion of management, considered necessary to present fairly the financial position, results of operations, and cash flows for the periods. Operating results for the three months ended December 31, 2008, are not necessarily indicative of the results which will be realized for the year ending September 30, 2009.

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

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

Accounting Estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Examples include share-based compensation, provisions for doubtful accounts and contract losses, estimated useful lives of property and equipment and intangible assets, impairment of property and equipment and intangible assets, deferred income taxes, and the provision for and disclosure of litigation and loss contingencies. Actual results may differ materially from these estimates in the future.

Revenue Recognition – In accordance with the provision of Staff Accounting Bulleting No. 104, “Revenue Recognition,” or SAB 104, the Company recognizes revenue when all of the following have been satisfied:

§ Persuasive evidence of an arrangement exists;

§ Delivery has occurred;

§ Price to the buyer is fixed or determinable; and

§ Collectibility is probable.

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

Gaming Revenue

The Company derives gaming revenue from the following sources:

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

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

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

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

Gaming equipment and system sales

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

For sales arrangements with multiple deliverables, the Company applies the guidance from Statement of Position, or SOP 97-2, "Software Revenue Recognition," as amended, and Emerging Issues Task Force, or EITF 00-21, "Revenue Arrangements with Multiple Deliverables." Deliverables are divided into separate units of accounting if: (i) each item has value to the customer on a stand-alone basis; (ii) there is objective and reliable evidence of the fair value of the undelivered items; and (iii) delivery of the undelivered item is considered probable and substantially in the Company's control.

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

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

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

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

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

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

Costs and Billings on Uncompleted Contract - During fiscal 2008, the Company entered into a fixed-price contract with a customer, pursuant to which it will deliver an electronic bingo system. Revenues from this fixed-price contract will be recognized on the completed-contract method in accordance with American Institute of Certified Public Accountants Statement of Position 81-1, or SOP 81-1, “Accounting for Performance of Construction-Type and Certain Production-Type Contracts.” In the event that the Company expected a loss on a contract accounted for under SOP 81-1, the Company would record the estimated loss in the quarter in which it was determined that a loss was expected.

Contract costs include all direct material and labor costs, and those indirect costs related to contract performance, such as indirect labor, supplies and tools. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined.

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

At December 31, 2008, the following amounts were recorded in the Company’s consolidated financial statements:

	December 31, 2008 (in thousands)
Costs incurred on uncompleted contracts	$ 2,091
Billings on uncompleted contracts	(637)
Deferred contract costs	$ 1,454

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

Restricted Cash and Long-Term Investments – Restricted cash and long-term investments at December 31, 2008, were $838,000, representing the fair value of investments held by the Company’s prize fulfillment firm related to outstanding MegaBingo® jackpot prizes.

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

Inventory – The Company's inventory consists primarily of completed player terminals, related component parts and back-office computer equipment expected to be sold over the next 12 months. Inventories are stated at the lower of cost (first in, first out) or market.

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

Property and Equipment and Leased Gaming Equipment – Property and equipment and leased gaming equipment are stated at cost. The cost of property and equipment and leased gaming equipment is depreciated over their estimated useful lives, generally using the straight-line method for financial reporting, and regulatory acceptable methods for income tax reporting purposes. Player terminals placed with customers under participation arrangements are included in leased gaming equipment. Leased gaming equipment includes a “pool” of rental terminals, i.e., the “rental pool.” Rental pool units are those units that have previously been placed in the field under participation arrangements, but are currently back with the Company, being refurbished and/or awaiting redeployment. Routine maintenance of property and equipment and leased gaming equipment is expensed in the period incurred, while major component upgrades are capitalized and depreciated over the estimated remaining useful life of the component. Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains or losses on sales and retirements of property are reflected in the Company’s results of operations.

Management reviews long-lived asset classes for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to its fair value, which considers the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs of disposal. The Company did not record any impairment changes in the quarter ended December 31, 2008.

Equipment under Capital Lease – Equipment under capital leases is recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. The cost of leased property and equipment is amortized using the Company’s normal amortization policy, described under “Property and Equipment and Leased Gaming Equipment.”

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

Other Income - Other income was $74,000 for the three months ended December 31, 2008. Other income consisted of distributions from a limited partnership interest, accounted for on the cost basis.

Other Long-Term Liabilities – Other long-term liabilities at December 31, 2008, include investments held at fair value by the Company’s prize-fulfillment firm related to outstanding MegaBingo jackpot-prize-winner annuities of $838,000. At December 31, 2008, other long term liabilities also included $248,000 related to a separation agreement with a former Chief Executive Officer.

Fair Value of Financial Instruments – The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. At December 31, 2008, the carrying amounts for the Company’s financial instruments, which include accounts and notes receivable, accounts payable, the Revolving Credit Facility, and long-term debt and capital leases, approximated fair value.

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

Costs of Computer Software – Software development costs have been accounted for in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Under SFAS No. 86, capitalization of software development costs begins upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. We capitalized software development costs of approximately $640,000 during the period ended December 31, 2008 and $1.2 million during the period ended December 31, 2007. Software development costs primarily consist of personnel costs and rent for related office space. We begin to amortize capitalized costs when a product is available for general release to customers. Amortization expense is determined on a product-by-product basis at a rate not less than straight-line basis over the product's remaining estimated economic life, not to exceed five years. Amortization of software development costs was approximately $1.1 million in the period ended December 31, 2008, and $716,000 in the period ended December 31, 2007, and is included in amortization and depreciation in the accompanying consolidated statements of operations.

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

Income Taxes – The Company accounts for income taxes using the asset and liability method and applies the provisions of SFAS, No. 109, “Accounting for Income Taxes.” Under SFAS No. 109, deferred tax liabilities or assets arise from differences between the tax basis of liabilities or assets and their bases for financial reporting, and are subject to tests of recoverability in the case of deferred tax assets. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets to the extent realization is not judged to be more likely than not.

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

Share-Based Compensation – On October 1, 2005, the Company adopted the provisions of SFAS No. 123(revised), “Share-Based Payment.” SFAS No. 123(R) is a revision of SFAS No. 123 and supersedes APB No 25. Among other items, SFAS No. 123(R) eliminated the use of APB No. 25 and the intrinsic value method of accounting, and requires the Company to recognize in the financial statements, the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards. To measure the fair value of stock options granted to employees, the Company currently utilizes the Black-Scholes-Merton option-pricing model, consistent with the method used for pro forma disclosures under SFAS No. 123. SFAS No. 123(R) permits companies to adopt its requirements using either a “modified prospective” method, or a “modified retrospective” method. The Company applied the “modified prospective” method, under which compensation cost is recognized in the financial statements beginning with the adoption date for all share-based payments granted after that date, and for all unvested awards granted prior to the adoption date of SFAS No. 123(R).

The Black-Scholes-Merton model incorporates various assumptions, including expected volatility, expected life, and risk-free interest rates. The expected volatility is based on the historical volatility of the Company’s common stock over the most recent period commensurate with the estimated expected life of the Company’s stock options, adjusted for the impact of unusual fluctuations not reasonably expected to recur. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees.

There were 277,000 option grants issued during the quarter ended December 31, 2008. Total pretax share-based compensation for the quarter ended December 31, 2008 was $644,000. The total income tax benefit recognized in the statement of operations for share-based compensation arrangements was $143,000 for the three months ended December 31, 2008. As of December 31, 2008, $5.2 million of unamortized stock compensation expense will be recognized over the vesting periods of the various option grants.

Foreign Currency Translation. The Company accounts for currency translation in accordance with SFAS No. 52, “Foreign Currency Translation.” Balance sheet accounts are translated at the exchange rate in effect at each balance sheet date. Income statement accounts are translated at the average rate of exchange prevailing during the period. Translation adjustments resulting from this process are charged or credited to other comprehensive income (loss) in accordance with SFAS 130, “Reporting Comprehensive Income.”

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

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

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

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

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

In December 2007, the FASB issued SFAS No. 160, “Non Controlling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin, or ARB No. 51, “Consolidated Financial Statements.” SFAS No. 160 changes the accounting for non controlling (minority) interests in consolidated financial statements, including the requirement to classify non controlling interests as a component of consolidated stockholders’ equity, and the elimination of “minority interest” accounting in results of operations with earnings attributable to non controlling interests reported as part of consolidated earnings. Additionally, SFAS No. 160 revises the accounting for both increases and decreases in a parent’s controlling ownership interest. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company is required to adopt SFAS No. 160 effective October 1, 2009, and it is currently evaluating the effect, if any, on its results of operations or financial position.

2. DEVELOPMENT AGREEMENTS

The Company enters into development agreements to provide financing for new gaming facilities or for the expansion of existing facilities. In return, the facility dedicates a percentage of its floor space to placement of the Company’s player terminals, and the Company receives a fixed percentage of those player terminals’ hold per day over the term of the agreement. The agreements typically provide for some or all of the advances to be repaid by the customer to the

Company. Amounts advanced in excess of those to be reimbursed by the customer are allocated to intangible assets and are generally amortized over the life of the contract, which is recorded as a reduction of revenue generated from the gaming facility. Certain of the agreements contain player terminal performance standards that could allow the facility to reduce a portion of the Company’s floor space. In the past and in the future, the Company may by mutual agreement and for consideration, amend these contracts to reduce its floor space at the facilities. Any proceeds received for the reduction of floor space is first applied as a recovery against the intangible asset or property and development for that particular development agreement, if any.

The Company has recently fulfilled a commitment to a significant, existing tribal customer to provide approximately 43.8%, or $65.6 million, of the total funding for a facility expansion. Because of the Company’s commitment to fund the expansion, it secured the right to place an additional 1,400 gaming units in the expanded facility in southern Oklahoma. The Company recorded all advances as a note receivable and imputed interest on the interest free loan. The discount (imputed interest) was recorded as contract rights and will be amortized over the life of the agreement. The repayment period of the note will be based on the performance of the facility. As of December 31, 2008, the Company had installed the additional 1,400 units in the expanded facility.

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Management reviews intangible assets related to development agreements for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. There were no events or changes in circumstance during the three months ended December 31, 2008, which would require an impairment change to the assets' carrying value.

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

	December 31, 2008	September 30, 2008
	(In thousands)	
Included in:		
Notes receivable, net	$ 60,514	$ 61,750
Intangible assets – contract rights, net of accumulated amortization	28,610	29,368

3. PROPERTY AND EQUIPMENT AND LEASED GAMING EQUIPMENT

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

	December 31, 2008	September 30, 2008	Estimated Useful Lives
	(In thousands)		
Gaming equipment and third-party gaming content licenses available for deployment (1)	$ 36,480	$ 30,252	
Deployed gaming equipment	97,278	96,584	3-5 years
Deployed third-party gaming content licenses	37,868	34,444	1.5-3 years
Tribal gaming facilities and portable buildings	4,720	4,720	5-7 years
Third-party software costs	7,817	7,732	3-5 years
Vehicles	3,501	3,502	3-10 years
Other	3,162	3,191	3-7 years
Total property and equipment	190,826	180,425	
Less accumulated depreciation and amortization	(115,317)	(113,096)	
Total property and equipment, net	$ 75,509	$ 67,329	
Leased gaming equipment	$ 173,384	$ 165,903	3 years
Less accumulated depreciation	(132,782)	(129,879)	
Total leased gaming equipment, net	$ 40,602	$ 36,024	

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

During the three months ended December 31, 2008, the Company disposed of or wrote off $38,000 of third-party gaming content licenses, tribal gaming facilities and portable buildings, vehicles, deployed gaming equipment, and other equipment.

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

In accordance with SFAS 144, "Accounting for the impairment or Disposal of Long-Lived Assets," the Company (i) recognizes an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows; and (ii) measures an impairment loss as the difference between the carrying amount and fair value of the asset. There were no impairment charges recorded during the three months ended December 31, 2008.

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4. INTANGIBLE ASSETS

The Company's intangible assets consisted of the following:

	December 31, 2008	September 30, 2008	Estimated Useful Lives
	(In thousands)		
Contract rights under development agreements	$ 41,892	$ 41,325	5-7 years
Internally-developed gaming software	27,078	26,473	1-5 years
Patents and trademarks	8,670	8,464	1-5 years
Other	1,054	1,054	3-5 years
Total intangible assets	78,694	77,316	
Less accumulated amortization – all other	(42,674)	(39,960)	
Total intangible assets, net	$ 36,020	$ 37,356	

Contract rights are amounts allocated to intangible assets for dedicated floor space resulting from development agreements. For a description of intangible assets related to development agreements, see "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations." The related amortization expense, or accretion of contract rights, is netted against its respective revenue category in the accompanying consolidated statements of operations. In the preceding table, $5.7 million of the $41.8 million in contract rights is not currently being amortized. The facility was completed on December 31, 2008. Therefore, the amortization of the contracts began on January 1, 2009.

Internally developed gaming software is accounted for under the provisions of SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed," and is stated at cost, which is amortized over the estimated useful life of the software, generally using the straight-line method. The Company amortizes internally-developed games over a 12 month period, gaming engines over an 18 month period, gaming systems over a three-year period and its central management systems over a five-year period. Software development costs are capitalized once technological feasibility has been established, and are amortized when the software is placed into service. Any subsequent software maintenance costs, such as bug fixes and subsequent testing, are expensed as incurred. Discontinued software development costs are expensed when the determination to discontinue is made. For the three months ended December 31, 2008 and 2007, amortization expense related to internally-developed gaming software was $1.1 million and $716,000, respectively. During the three months ended December 31, 2008, the Company wrote off $35,000 related to internally-developed gaming software, compared to no write off in the same period of 2007.

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

5. NOTES RECEIVABLE

The Company's notes receivable consisted of the following:

	December 31,	September 30,

	2008	2008
	(In thousands)	
Notes receivable from development agreements	$ 70,887	$ 72,706
Less imputed interest discount reclassed to contract rights	(10,372)	(10,956)
Notes receivable from equipment sales and other	6,861	8,012
Notes receivable, net	67,376	69,762
Less current portion	(18,688)	(23,072)
Notes receivable – non-current	$ 48,688	$ 46,690

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

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Notes receivable from equipment sales outstanding as of September 30, 2008 consisted of financial instruments issued by customers for the purchase of player terminals and licenses, and bore interest at 7.99%. All of the Company's notes receivable from equipment sales are collateralized by the related equipment sold, although the value of such equipment, if repossessed, may be less than the note receivable outstanding.

6. CREDIT FACILITY, LONG-TERM DEBT AND CAPITAL LEASES

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

	December 31, 2008	September 30, 2008
	(In thousands)	
Long-term revolving lines of credit	$ 25,222	$ 19,000
Term loan facility	$ 68,897	$ 67,988
Less current portion	(2,675)	(1,544)
Long-term debt, less current portion	$ 66,222	$ 66,444

Credit Facility. On April 27, 2007, the Company entered into a $150 million Revolving Credit Facility which replaced its previous Credit Facility in its entirety. On October 26, 2007, the Company amended the Revolving Credit Facility, transferring $75 million of the revolving credit commitment to a fully funded $75 million term loan due April 27, 2012. The Term Loan is amortized at an annual amount of 1% per year, payable in equal quarterly installments beginning January 1, 2008, with the remaining amount due on the maturity date. The Company entered into a second amendment to the Revolving Credit Facility on December 20, 2007. The second amendment (i) extended the hedging arrangement date related to a portion of the term loan to June 1, 2008; and (ii) modified the interest rate margin applicable to the Revolving Credit Facility and the term loan.

The Credit Facility provides the Company with the ability to finance development agreements and acquisitions and working capital for general corporate purposes. Amounts under the $75 million revolving credit commitment and the $75 million term loan mature in five years, and advances under the term loan and revolving credit commitment bear interest at the Eurodollar rate plus the applicable spread (7.81% and 8.56%, respectively, as of December 31, 2008) tied to various levels of interest pricing determined by total debt to EBITDA.

The Credit Facility is collateralized by substantially all of the Company's assets, and also contains financial covenants as defined in the agreement. These covenants include (i) a minimum fixed-charge coverage-ratio of not less than 1.50 : 1.0; (ii) a maximum total debt to EBITDA ratio of not more than 2.25 : 1.00 through June 30, 2008, and 1.75 : 1.00 from September 30, 2008 thereafter; and (iii) a minimum trailing twelve-month EBITDA of not less than $57 million for the quarter ended September 30, 2007, and $60 million for each quarter thereafter. As of December 31, 2008, the Company is in compliance with its loan covenants. The Credit Facility requires certain mandatory prepayments be made on the term loan from the net cash proceeds of certain asset sales and condemnation proceedings (in each case to the extent not reinvested, within certain specified time periods, in the replacement or acquisition of property to be used in its businesses). In the second quarter of 2008, the Company made a mandatory prepayment of the term loan in the amount of $4.5 million due to an early prepayment of a development agreement note receivable. As of December 31, 2008, the Credit Facility had availability of $48.1 million, subject to covenant restrictions.

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

7. EARNINGS (LOSS) PER COMMON SHARE

Earnings (loss) per common share is computed in accordance with SFAS No. 128, “Earnings per Share.” Presented below is a reconciliation of net income (loss) available to common stockholders and the differences between weighted average common shares outstanding, which are used in computing basic earnings (loss) per share, and weighted average common and potential shares outstanding, which are used in computing diluted earnings (loss) per share.

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