

MAJESCO ENTERTAINMENT CO

Form 10-Q

March 16, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 31, 2009
Commission File No. 000-51128
Majesco Entertainment Company
(Exact name of registrant as specified in its charter)**

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

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

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

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

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

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

As of March 16, 2009, there were 30,288,604 shares of the Registrant's common stock outstanding.

**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY
JANUARY, 31 2009 QUARTERLY REPORT ON FORM 10-Q
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MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	January 31, 2009 (unaudited)	October 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,490	\$ 5,505
Due from factor	4,894	
Accounts and other receivables	728	3,032
Inventory	2,157	5,619
Capitalized software development costs and license fees	6,451	6,812
Prepaid expenses	2,166	1,956
Total current assets	26,886	22,924
Property and equipment net	549	563
Other assets	93	83
Total assets	\$ 27,528	\$ 23,570
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 13,434	\$ 10,697
Share based litigation settlement	1,157	1,250
Due to factor		983
Customer billings due under distribution agreement	954	1,487
Inventory financing payable		1,540
Advances from customers	86	265
Total current liabilities	15,631	16,222
Warrant liability	345	211
Stockholders equity:		
Common stock \$.001 par value; 250,000,000 shares authorized; 30,210,037 and 30,127,950 issued and outstanding at January 31, 2009 and October 31, 2008, respectively	30	30
Additional paid in capital	102,133	101,722
Accumulated deficit	(90,010)	(94,172)
Accumulated other comprehensive loss	(601)	(443)
Total stockholders equity	11,552	7,137
Total liabilities and stockholders equity	\$ 27,528	\$ 23,570

See accompanying notes

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

	Three Months Ended January 31,	
	2009	2008
Net revenues	\$ 32,820	\$ 18,664
Cost of sales		
Product costs	11,831	7,932
Software development costs and license fees	9,130	3,220
	20,961	11,152
Gross profit	11,859	7,512
Operating costs and expenses		
Product research and development	1,293	934
Selling and marketing	4,124	2,372
General and administrative	2,505	2,008
Depreciation and amortization	69	77
Settlement of litigation and related charges, net	140	(322)
	8,131	5,069
Operating income	3,728	2,443
Other expenses (income)		
Interest and financing costs, net	458	199
Change in fair value of warrants	135	(458)
Income before income taxes	3,135	2,702
Income taxes	(1,027)	
Net income	\$ 4,162	\$ 2,702
Net income per share:		
Basic	\$ 0.15	\$ 0.10
Diluted	\$ 0.15	\$ 0.10
Weighted average shares outstanding:		
Basic	27,944,958	27,388,797
Diluted	27,944,958	27,413,681

See accompanying notes

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

	Three Months Ended January 31,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 4,162	\$ 2,702
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	69	77
Change in fair value of warrants	135	(458)
Share-based litigation settlement	140	(322)
Non-cash compensation expense	411	399
Amortization of software development costs and prepaid license fees	3,167	1,366
Changes in operating assets and liabilities		
Due from factor net	(5,877)	(3,342)
Other receivables	2,173	247
Inventory	3,463	1,935
Capitalized software development costs and prepaid license fees	(2,836)	(2,158)
Prepaid expenses and other	(240)	(207)
Accounts payable and accrued expenses	2,550	477
Advances from customers	(695)	397
Net cash provided by operating activities	6,622	1,113
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(56)	(68)
Net cash used in investing activities	(56)	(68)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance cost on equity financing		(40)
Inventory financing	(1,540)	
Net cash used in financing activities	(1,540)	(40)
Effect of exchange rates on cash and cash equivalents	(41)	(38)
Net increase in cash	4,985	967
Cash and cash equivalents beginning of period	5,505	7,277
Cash and cash equivalents end of period	\$ 10,490	\$ 8,244
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Cash paid for interest	\$ 459	\$ 199

See accompanying notes

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

1. PRINCIPAL BUSINESS ACTIVITY AND BASIS OF PRESENTATION

Majesco Entertainment Company, together with its wholly owned UK subsidiary ("Majesco" or the "Company"), is a provider of interactive entertainment products. The Company's offerings include video game software and other digital entertainment products.

The Company's products provide it with opportunities to capitalize on the large and growing installed base of interactive entertainment platforms and an increasing number of interactive entertainment enthusiasts. The Company sells its products directly and through resellers, primarily to U.S. retail chains, including Best Buy, GameStop/Electronics Boutique, Target, Toys "R Us and Wal-Mart. Majesco also sells products internationally through partnerships with international publishers. The Company has developed retail and distribution network relationships over its more than 22-year history.

Majesco provides offerings for most major interactive entertainment hardware platforms, including Nintendo's Wii, DS, Game Boy Advance, or GBA, Sony's PlayStation 3, or PS3, PlayStation 2, or PS2, and PlayStation Portable, or PSP, Microsoft's Xbox and Xbox 360, and the personal computer, or PC.

Majesco's offerings include video game software and other digital entertainment products. The Company's operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company is centrally managed and the chief operating decision makers, the chief executive and other officers, use consolidated and other financial information supplemented by sales information by product category, major product title and platform for making operational decisions and assessing financial performance. Accordingly, the Company operates in a single segment. Net sales by geographic region were as follows:

	Three Months Ended January 31,			
	2009	%	2008	%
United States	\$ 31,746	96.7%	\$ 18,446	98.8%
Europe	1,074	3.3%	218	1.2%
Total	\$ 32,820	100.0%	\$ 18,664	100.0%

The accompanying interim consolidated financial statements of the Company are unaudited, but in the opinion of management, reflect all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim period. Accordingly, they do not include all information and notes required by generally accepted accounting principles for complete financial statements. The Company's financial results are impacted by the seasonality of the retail selling season and the timing of the release of new titles. The results of operations for interim periods are not necessarily indicative of results to be expected for the entire fiscal year. The balance sheet at October 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes for the year ended October 31, 2008 filed with the Securities and Exchange Commission on Form 10-K on January 29, 2009. Certain prior-year amounts have been reclassified to conform to the 2009 presentation. Such reclassifications have no impact on net income or stockholders' equity.

The statements contained in this Report on Form 10-Q that are not purely historical are forward-looking information and statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These include statements regarding management's

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expectations, intentions, or strategies regarding future matters. All forward-looking statements included in this document are based on available information as of the date hereof. It is important to note that actual results could differ materially from those projected in such forward-looking statements contained in this Form 10-Q. The forward-looking statements contained herein are based on current expectations that involve numerous risks and uncertainties. Assumptions relating to the foregoing involve judgments regarding among other things, the Company's ability to secure financing or investment for capital expenditures, future economic and competitive market conditions, and future business decisions. All these matters are difficult or impossible to predict accurately, many of which may be beyond Majesco's control. Although management believes that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report on Form 10-Q will prove to be accurate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition. The Company recognizes revenue upon the shipment of its products when: (1) title and risk of loss are transferred; (2) persuasive evidence of an arrangement exists; (3) there are no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. Some of the Company's software products provide limited online features at no additional cost to the consumer. Generally, such features have been considered to be incidental to our overall product offerings and an inconsequential deliverable. Accordingly, the Company does not defer any revenue related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying the Company's revenue recognition policy.

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

Earnings Per Share. Basic earnings per common share is computed by dividing net income by the weighted-average number of shares of common stock outstanding for the period. Basic earnings per share excludes the impact of unvested shares of restricted stock issued under the Company's incentive stock compensation plan. Diluted earnings per share reflects the potential impact of common stock options and unvested shares of restricted stock issued under the Company's incentive stock compensation plan, and outstanding common stock purchase warrants. Diluted and basic earnings per share for the three months ended January 31, 2009 are the same because the impact of shares and options issued under the incentive stock compensation plan and common stock purchase warrants are antidilutive after applying the treasury stock method, as is required by SFAS 128 *Earnings per Share*. Diluted earnings per share for the three months ended January 31, 2008 includes the net addition of 24,884 shares representing the impact of 1,316,926 weighted average unvested shares of stock outstanding under the Company's incentive stock compensation plan, after applying the treasury stock method, as previously noted. The table below provides total potential shares outstanding at the end of each reporting period:

	January 31, 2009	January 31, 2008
Shares issuable under common stock warrants	2,311,469	2,318,611
Shares issuable under stock options	1,352,610	1,167,191
Non-vested portion of restricted stock grants	2,163,951	1,316,927
	5,828,030	4,802,729

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Recent Accounting Pronouncements. In September 2006, FASB issued SFAS No. 157 *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Management is currently evaluating the effect of this pronouncement on its financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), which establishes principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) requires contingent consideration to be recognized at its fair value on the acquisition date and, for certain arrangements, changes in fair value to be recognized in earnings until settled. SFAS 141(R) also requires acquisition-related transaction and restructuring costs to be expensed rather than treated as part of the cost of the acquisition. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 and will impact the Company's financial statements only in the event of such a business combination.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements an Amendment of ARB No. 51* (SFAS 160), which establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent's owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities*, which amends and expands the disclosure requirements of FASB Statement No. 133 with the intent to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments, how the derivative instruments and the related hedged items are accounted for and how the related hedged items affect an entity's financial position, performance and cash flows. This Statement is effective for financial statements for fiscal years and interim periods beginning after November 15, 2008. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). FAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. FAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU

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Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We do not expect the adoption of this statement to have a material impact on our results of operations, financial position or cash flows.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (FAS 142). This change is intended to improve the consistency between the useful life of a recognized intangible asset under FAS 142 and the period of expected cash flows used to measure the fair value of the asset under FAS 141R and other GAAP. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will be our fiscal year 2010. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. We do not expect the adoption of this statement to have a material impact on our results of operations, financial position or cash flows.

In June 2008, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* (EITF 07-5). EITF 07-5 mandates a two-step process for evaluating whether an equity-linked financial instrument or embedded feature is indexed to the entity's own stock. It is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which is our first quarter of 2009. We do not expect the adoption of EITF 07-5 will have a material impact on results of operations, financial position, or cash flows.

3. INCOME TAXES

On November 1, 2007 the Company adopted FIN 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 contains a two step approach to recognizing and measuring uncertain income tax positions. The first step is to evaluate the uncertain tax position for recognition. Each position is evaluated based on its technical merits and a determination is made whether it is "more likely than not" that the position would be sustained upon examination by a tax authority with full knowledge of the facts and circumstances. No benefit is recognized for a tax position that does not meet the "more likely than not" recognition threshold. The second step is to measure the tax benefit of each position. The tax benefit is the largest amount that is more than 50% likely to be realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 on November 1, 2007 had no impact on Majesco's accumulated deficit balance.

Realization of deferred tax assets, including those related to net operating loss carryforwards, are dependent upon future earnings, if any, of which the timing and amount are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. Based upon the Company's current operating results, management has concluded that it is not more likely than not that such assets will be realized.

Utilization of the net operating loss carryforwards may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code. The annual limitation may result in the expiration of net operating loss carryforwards before utilization. The net operating loss carryforwards for income tax purposes at October 31, 2008 amounts to approximately \$73.5 million and expires between 2023 and 2027. The Company files income tax returns in the U.S. and various foreign jurisdictions. Income taxes payable approximated \$0.1 million at January 31, 2009.

In November 2008, the Company received proceeds of approximately \$1.1 million from the sale of the rights to approximately \$14.2 million of New Jersey state income tax operating loss carryforwards, under the Technology Business Tax Certificate Program administered by the New Jersey Economic Development

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Authority. The amount represents utilization of approximately 34% of the \$41.0 million of net operating loss carryforwards available to the Company in the state of New Jersey, prior to the transfer. The amount has been recorded as an income tax benefit during the quarter ended January 31, 2009.

The Company has recorded a provision for federal alternative minimum taxes of \$0.1 million for the three months ended January 31, 2009.

4. DUE (TO) FROM FACTOR

Due from (to) factor consists of the following:

	January 31, 2009	October 31, 2008
Outstanding accounts receivable sold to factor	\$ 20,234	\$ 12,004
Less: allowance	(3,707)	(3,359)
Less: advances from factor	(11,633)	(9,628)
	\$ 4,894	\$ (983)

Approximately \$20.0 million of accounts receivable was assigned to the factor at January 31, 2009, of which the Company assumed credit risk of approximately \$6.6 million.

The following table sets forth the adjustments to the price protection and other customer sales incentive allowances included as a reduction of the amounts due from factor:

	Three Months Ended January 31,	
	2009	2008
Balance beginning of period	\$ (3,359)	\$ (3,105)
Add: provision	(600)	(1,015)
Less: amounts charged against allowance	252	1,109
Balance end of period	\$ (3,707)	\$ (3,011)

5. ACCOUNTS AND OTHER RECEIVABLES

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

	January 31, 2009	October 31, 2008
Accounts receivable	\$ 525	\$ 2,927
Legal fee reimbursements due from insurance carriers	203	105
	\$ 728	\$ 3,032

6. PREPAID EXPENSES

The following table presents the major components of prepaid expenses:

	January 31, 2009	October 31, 2008
Advance payments for inventory	\$ 787	\$ 242

Prepaid media advertising	1,195	1,598
Other	184	116

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	January 31, 2009	October 31, 2008
	\$ 2,166	\$ 1,956

7. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following:

	January 31, 2009	October 31, 2008
Accounts payable – trade	\$ 3,924	\$ 5,264
Accrued expenses:		
Royalties – including accrued minimum guarantees	7,282	2,268
Salaries and other compensation	1,067	1,987
Sales commissions	244	203
Other accruals	917	975
	\$ 13,434	\$ 10,697

8. COMPREHENSIVE INCOME

The components of comprehensive income for the three month periods ended January 31, 2009 and 2008, are summarized as follows:

	Three Months Ended January 31,	
	2009	2008
Net income	\$ 4,162	\$ 2,702
Other comprehensive loss – Foreign currency translation adjustments	(158)	(38)
Total comprehensive income	\$ 4,004	\$ 2,664

9. CONTINGENCIES AND COMMITMENTS*Commitments*

At January 31, 2009, the Company was committed under agreements with certain developers for future milestone and license fee payments aggregating \$4.9 million which are payable within one year from the balance sheet date. Milestone payments represent scheduled installments due to the Company's developers based upon the developers providing the Company certain deliverables, as predetermined in the Company's contracts. The milestone payments generally represent advances against royalties to the developers. These payments will be used to reduce future royalties due to the developers from sales of the Company's video games.

The Company has entered into at will employment agreements with certain key executives. These employment agreements include provisions for, among other things, annual compensation, bonus arrangements and equity compensation. These agreements also contain provisions related to severance terms and change of control provisions.

On September 27, 2007, the Company entered into settlement agreements to settle certain litigations pending in the United States District Court, District of New Jersey: (i) a securities class action brought on behalf of a purported class of purchasers of the Company's securities; (ii) a private securities action filed by

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Trinad Capital Master Fund, Ltd.; and (iii) a second action filed by Trinad purportedly on behalf of the Company.

In January 2009, the Company entered into an amendment to the securities class action settlement agreement. Under the terms of the settlement agreement in the securities class action, as amended, the Company will make cash payments totaling \$700,000 in three installments, the first two payments of which were made in January and February 2009, and the last of which is due to be paid in May 2009. The Company will also contribute one million shares of its common stock. The Company's insurance carrier will also make a cash payment.

On February 23, 2009, the settlement was approved by the Court, and the class action was dismissed. The dismissal is subject to appeal through March 26, 2009. If there is no appeal, the settlement will become effective, and the Company will contribute the shares to the settlement fund by March 30, 2009. The settlement administrator will thereafter distribute the shares to eligible settlement claimants.

During the twelve months ended October 31, 2007, the Company recorded a \$2.8 million charge in connection with the expected settlement of the class action litigation, based on the terms of the original settlement. The charge is comprised of \$2.5 million, representing the fair value, on the date the agreement was executed, of the common stock expected to be distributed when the settlement becomes effective and \$0.3 million representing the increase in the value of the shares from that date to October 31, 2007. During the year ended October 31, 2008, the Company recorded a gain on litigation settlement of \$0.3 million representing the decline in the value of the shares to be issued under the settlement, as if it occurred on October 31, 2008.

The estimated settlement liability was further adjusted as of October 31, 2008, to reflect the terms of the amended settlement agreement entered into on January 16, 2009. Accordingly, an additional gain on settlement of litigation of \$1.3 million was recorded during the year ended October 31, 2008. The total estimated liability at October 31, 2008 is \$1.3 million, comprised of the \$0.7 million in cash payments, and \$0.6 million representing 1.0 million shares of common stock at the closing market price of \$0.55 at that date. The stock portion of the settlement was adjusted to a fair value of \$0.7 million at January 31, 2009, reflecting the closing market price of \$0.69 at that date. The value of the common stock on the date the shares are issued may be different than \$0.69, resulting in further adjustment to the settlement liability.

The settlement of the private securities claim in the action brought by Trinad, on its own behalf, provides that the Company's insurance carrier will make a cash payment to Trinad, subject to the class action settlement becoming effective. The Court dismissed this action without prejudice on February 23, 2009, but it may be reopened within sixty days if the settlement is not consummated.

The settlement agreement in the action filed by Trinad, purportedly on behalf of the Company, will not result in a payment to the Company. Plaintiff's attorneys will not receive any fees in connection with the settlement. This settlement is subject to notice to the Company's shareholders and to court approval.

Since the settlement in the class action is subject to appeal, and the settlement in the derivative action is subject to notice to shareholders and to court approval as well as appeal, there is no assurance that these settlements will be consummated. Further, if these settlements are not achieved, there can be no assurance that the Company's insurance will be adequate to cover the Company's costs relating to these litigations.

The Company at times may be a party to other routine claims and suits in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the outcome of such routine

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claims will not have a material adverse effect on the Company's business, financial condition, and results of operations or liquidity.

10. RELATED PARTIES

The Company previously received printing and packaging services from a business of which the brother of Morris Sutton, the Company's former Chairman Emeritus, and uncle of Jesse Sutton, the Company's Chief Executive Officer, is a principal. During the three months ended January 31, 2008, the Company was charged \$0.1 million for these services. No charges were incurred for these services for the three months ended January 31, 2009. These charges are included in product costs in the accompanying consolidated statement of operations. Such charges were, to the Company's knowledge, on terms no less favorable to those that would be incurred in arm's length transactions with other providers of similar services.

The Company currently has an agreement with Morris Sutton, the Company's former Chief Executive Officer and Chairman Emeritus, under which he provides services as a consultant. The agreement provides for a monthly retainer of \$12.5, effective January 1, 2009, and a commission equal to 2% of sales to certain specified accounts. Consulting expenses for the three months ended January 31, 2009 include \$28 of fees earned in each of November and December of 2008 under Mr. Sutton's prior agreement which expired December 31, 2008.

The following table summarizes expense to Morris Sutton, in thousands:

	Three Months Ended	
	January 31,	
	2009	2008
Consulting	\$ 70	\$ 88
Commissions	87	28
Business expenses	2	11
Total	\$ 159	\$ 127

The Company had accounts payable and accrued expenses of approximately \$40 and \$30 as of January 31, 2009 and October 31, 2008, respectively, due Morris Sutton.

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

Overview

We are a provider of interactive entertainment products. We sell our products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors. We also sell our products internationally through distribution agreements with other publishers. We have developed our retail and distribution network over our 22-year history.

We publish video game software for most major interactive entertainment hardware platforms, including Nintendo's Wii, Game Boy Advance, or GBA, DS, Sony's PlayStation 3, or PS3, PlayStation 2, or PS2, and PlayStation Portable, or PSP, Microsoft's Xbox, Xbox 360, the personal computer, or PC, and other mobile devices.

Our video game titles are targeted at various demographics at a range of price points, from lower-priced value titles to more expensive premium titles. In some instances, these titles are based on licenses of well known properties, and in other cases based on original properties. We collaborate and enter into agreements with content providers and video game development studios for the creation of the majority of our video games.

Our business model and product strategy is primarily focused on games with relatively lower development costs for both console and handheld systems targeting mass-market consumers. We believe this strategy allows us to capitalize on our strengths and expertise while reducing some of the cost and risk associated with publishing a large number of premium console titles. We continue to publish titles for popular handheld systems such as the DS and PSP. We also publish software for Nintendo's Wii console, as we believe this platform allows us to develop games within our cost parameters, while enabling us to reach mass-market consumers. In addition, we continue to look opportunistically for titles to publish on the PC and other home console systems.

We license rights to intellectual property used in our video games from third parties and work with third-party development studios to develop our own proprietary video game titles. In 2007, we opened a development studio to develop video games. However, we expect to continue to use third-party studios for the significant majority of our video game development.

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

Cost of Sales. Cost of sales consists of product costs and amortization of software development costs and license fees. A significant component of our cost of sales is product costs. These are comprised primarily of manufacturing and packaging costs of the disc or cartridge media, royalties to the platform manufacturer and manufacturing and packaging costs of peripherals. Commencing upon the related product's release, capitalized software development and intellectual property license costs are amortized to cost of sales.

Gross Profit. Gross Profit is the excess of net revenues over product costs and amortization of software development and license fees. Development and license fees incurred to produce video games are generally incurred up front and amortized to cost of sales. The recovery of these costs and total gross profit is dependent upon achieving a certain sales volume, which varies by title. Our value titles are generally characterized as having lower gross profit margin potential than premium titles as a result of their lower sales price and, carry lower financial risk associated with the recovery of upfront development and license fees as compared with premium game titles.

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Product Research and Development Expenses. Product research and development expenses relate principally to our cost of supervision of third party video game developers, testing new products and conducting quality assurance evaluations during the development cycle as well as costs incurred at our development studio that are not allocated to games for which technological feasibility has been established. Costs incurred are employee-related, may include equipment, and are not allocated to cost of sales.

Selling and Marketing Expenses. Selling and marketing expenses consist of marketing and promotion expenses, the cost of shipping products to customers and related employee costs. A component of these expenses is credits to retailers for trade advertising.

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

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

Provision (Benefit) for Income Taxes. Utilization of our net operating loss (NOL) carryforwards may be subject to a substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code. The annual limitation may result in the expiration of net operating loss carryforwards before utilization. Due to our history of losses, a valuation allowance sufficient to offset our NOL fully and other deferred tax assets has been established under the provisions of SFAS No. 109, and this valuation allowance will be maintained until sufficient positive evidence exists to support its reversal.

Seasonality and Variations in Interim Quarterly Results

Our quarterly net revenues, gross profit, and operating income are impacted significantly by the seasonality of the retail selling season, and the timing of the release of new titles. Sales of our catalog and other products are generally higher in the first and fourth quarters of our fiscal year (ending January 31 and October 31, respectively) due to increased retail sales during the holiday season. Sales and gross profit as a percentage of sales also generally increase in quarters that we release significant new titles because of increased sales volume as retailers make purchases to stock their shelves and meet initial demand for the new release. These quarters also benefit from the higher selling prices that we are able to achieve early in the product's life cycle. For example, sales and gross profit during the three months ended January 31, 2009 benefited from strong holiday sales of our existing products, and the release of *Cooking Mama; World Kitchen* for the Nintendo Wii in November 2008 and *Jillian Michaels; Fitness Ultimatum* for the Nintendo Wii in October 2008. Therefore, sales results in any one quarter are not necessarily indicative of expected results for subsequent quarters during the fiscal year.

Critical Accounting Policies

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

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

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

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

Revenue Recognition. We recognize revenue upon the shipment of our product when: (1) title and risk of loss are transferred; (2) persuasive evidence of an arrangement exists; (3) we have no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. Some of our software products provide limited online features at no additional cost to the consumer. Generally, we have considered such features to be incidental to our overall product offerings and an inconsequential deliverable. Accordingly, we do not defer any revenue related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying our revenue recognition policy.

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

Our reserves for price protection and other allowances fluctuate over periods as a result of a number of factors including analysis of historical experience, current sell-through of retailer inventory of our products, current trends in the interactive entertainment market, the overall economy, changes in customer demand and acceptance of our products and other related factors. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. However, actual allowances granted could materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions, technological obsolescence due to new platforms, product updates or competing products. For example, the risk of requests for allowances may increase as consoles pass the midpoint of their lifecycle and an increasing number of competitive products heighten pricing and competitive pressures. While management believes it can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, this will result in a change in our reserves, which would impact the net revenues and/or selling and marketing expenses we report. For the three month periods ended January 31, 2009 and 2008, we provided allowances for future price protection and other allowances of \$0.6 million and \$1.0 million, respectively. The fluctuations in the provisions reflected our estimates of future price protection based on the factors discussed above. We limit our exposure to credit risk by factoring the majority of our receivables to a third party that generally buys our receivables without recourse.

Software Development Costs and Prepaid License Fees. We account for software development costs in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* (FAS 86). Software development costs include development fees, in the form of

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

Prepaid license fees represent license fees to holders for the use of their intellectual property rights in the development of our products. Minimum guaranteed royalty payments for intellectual property licenses are initially recorded as an asset (prepaid license fees) and a current liability (accrued royalties payable) at the contractual amount upon execution of the contract or when specified milestones or events occur and when no significant performance remains with the licensor. Capitalized software development costs classified as non-current relate to titles for which we estimate the release date to be more than one year from the balance sheet date. Licenses are expensed to cost of sales at the higher of (1) the contractual royalty rate based on actual sales or (2) an effective rate based upon total projected revenue related to such license.

When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales—software development costs and license fees. As of January 31, 2009, the net carrying value of our licenses and software development costs was \$6.5 million. If we were required to write off licenses, due to changes in market conditions or product acceptance, our results of operations could be materially adversely affected.

The amortization period for capitalized software development costs and prepaid license fees is usually no longer than one year from the initial release of the product. If actual revenues or revised forecasted revenues fall below the initial forecasted revenue for a particular license, the charge to cost of sales may be larger than anticipated in any given quarter. The recoverability of capitalized software development costs and prepaid license fees is evaluated quarterly based on the expected performance of the specific products to which the costs relate. When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales. Significant management judgments and estimates are utilized in the assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred to complete and publish the product.

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

Inventory. Inventory, which consists principally of finished goods, is stated at the lower of cost or market. Cost is determined by the first-in, first-out method. We estimate the net realizable value of slow-moving inventory on a title-by-title basis and charge the excess of cost over net realizable value to cost of sales.

Accounting for Stock-Based Compensation. In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), *Share Based Payment* (SFAS 123(R)). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. We adopted SFAS 123(R) on November 1, 2005 using the modified prospective transition method, which requires that compensation cost be

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recognized for all awards granted, modified or settled after the effective date as well as for all awards granted to employees prior to the effective date that remain unvested as of the effective date.

Commitments and Contingencies. We account for commitments and contingencies in accordance with financial accounting standards board Statement No. 5, Accounting for Contingencies. We record a liability for commitments and contingencies when the amount is both probable and reasonably estimable.

Results of operations***Three months ended January 31, 2009 versus three months ended January 31, 2008***

Net Revenues. Net revenues for the three months ended January 31, 2009 increased to \$32.8 million from \$18.7 million in the comparable quarter last year. The \$14.1 million increase is primarily due to increased revenue from new releases. Our quarterly net revenues are impacted significantly by the timing of new releases. Net revenues for the three months ended January 31, 2009 include the revenues from the release of two titles for the Nintendo Wii; *Cooking Mama World Kitchen*; and *Jillian Michaels Fitness Ultimatum 2009*, which was released late in the fourth quarter of fiscal 2008. Comparatively, the same quarter during the prior year included launch revenues from one title release, *Cooking Mama: Dinner with Friends* for the Nintendo DS.

Gross Profit. Gross profit for the three months ended January 31, 2009 was \$11.9 million compared to a gross profit of \$7.5 million in the same quarter last year. The increase in gross profit is primarily attributable to the higher net revenues for 2009 discussed above. Gross profit as a percentage of net sales was 36% for the three months ended January 31, 2009 compared to 40% for the three months ended January 31, 2008. The decrease in gross profit as a percentage of sales is primarily attributable to higher royalties and amortization of development costs as a percentage of net sales in 2009, as compared to 2008.

Product Research and Development Expenses. Research and development costs increased \$0.4 million to \$1.3 million for the three months ended January 31, 2009, from \$0.9 million for the comparable period in 2008. The increase is primarily the result of expenses related to our development studio. During the three months ended January 31, 2009 substantially all of the work performed in the studio was allocated to non-capitalizable projects. Additionally, approximately \$0.1 million was expensed for a video game project that was terminated.

Selling and Marketing Expenses. Total selling and marketing expenses were approximately \$4.1 million for the three months ended January 31, 2009 compared to \$2.4 million for the three months ended January 31, 2008. The increase was due to television advertising programs during the holiday selling period, internet and advertising media related to increased new releases in 2009, and increased order fulfillment and shipping expenses related to increased sales volume. Selling and marketing expense as a percentage of net sales was approximately 13% for the three months ended January 31, 2009 and 2008.

General and Administrative Expenses. For the three month period ended January 31, 2009, general and administrative expenses were \$2.5 million, an increase of \$0.5 million from \$2.0 million in the comparable period in 2008. The increase is primarily due to higher compensation expenses relating to our incentive bonus program. This bonus program is primarily based on net income generated by the Company. General and administrative expenses include \$0.4 million of non-cash compensation expenses for the three months ended January 31, 2009 and 2008, respectively.

Settlement of Litigation Charges. Settlement of litigation charges represents the change in fair value since October 31, 2008 of one million shares of stock expected to be issued in settlement of our class action securities litigation (see discussion below).

Operating Income. Operating income for the three months ended January 31, 2009 was \$3.7 million, compared to operating income of \$2.4 million for the three month period ended January 31, 2008. The

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increase in operating income primarily resulted from the impact of the higher net revenue and gross profit, partially offset by the increased operating expenses discussed above.

Interest and Financing Costs, Net. Interest and financing costs increased to \$0.5 million for the three months ended January 31, 2009 from \$0.2 million for the three months ended January 31, 2008. The increase of \$0.3 million is the result of a higher percentage of our inventory purchases being financed through letters of credit and higher factoring fees related to sales volume.

Change in Fair Value of Warrants. On September 5, 2007, we issued warrants in connection with an equity financing. The warrants contain a provision that may require settlement by transferring assets. Therefore, they are recorded at fair value as liabilities in accordance with FASB statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and FASB Staff position 150-1 *Issuers Accounting for Freestanding Financial Instruments Composed of More Than One Option or Forward Contract Embodying Obligations under FASB Statement 150*.

We recorded an expense of \$0.1 million for the three months ended January 31, 2009, reflecting the increase in the fair value of the warrants during the period, compared to income of \$0.5 million for the three months ended January 31, 2008, reflecting a decrease in the fair value of warrants during the period.

Income Taxes. For the three months ended January 31, 2009, income taxes is comprised of a provision for alternative minimum taxes of \$0.1 million, and a tax benefit of \$1.1 million related to the sale of the rights to certain state net operating loss carryforwards. We recorded no provision for income taxes other than alternative minimum taxes because our net operating loss carryforwards exceeded our taxable income.

In November 2008, we received proceeds of approximately \$1.1 million from the sale of the rights to approximately \$14.2 million of New Jersey state income tax net operating loss carryforwards, under the Technology Business Tax Certificate Program administered by the New Jersey Economic Development Authority. The amount represents utilization of approximately 34% of the \$41.0 million of net operating loss carryforwards available to the Company in the State of New Jersey, prior to the transfer. The amount has been recorded as an income tax benefit during the quarter ending January 31, 2009.

For the three months ended January 31, 2008, we did not provide for any income taxes because our net operating loss carryforwards exceeded our taxable income.

Net Income. Net income for the three months ended January 31, 2009 was \$4.2 million, an increase of \$1.5 million from net income of \$2.7 million for the comparable period in 2008, primarily due to the increased operating income and change in fair value of warrants discussed above.

Liquidity and Capital Resources

We generated net income of \$3.4 million in our 2008 fiscal year. However, we incurred a net loss of \$4.8 million in our 2007 fiscal year. Historically, we have funded our operating losses through sales of our equity and use of our purchase order financing and factor arrangements. We raised approximately \$6.0 million in gross proceeds from the sale of our equity securities in September 2007.

We generated net income of \$4.2 million for the three months ended January 31, 2009. Our current plan is to fund our operations through product sales. However, we may be required to modify that plan, or seek outside sources of financing if our operating plan and sales targets are not met. There can be no assurance that such funds will be available on acceptable terms, if at all. In the event that we are unable to negotiate alternative financing, or negotiate terms that are acceptable to us, we may be forced to modify our business plan materially, including making reductions in game development and other expenditures. Management believes it can operate under the existing level of financing for at least one year. However, if the current level of financing was reduced and we were unable to obtain alternative financing, it could create a material adverse change in the business.

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While our cash and cash equivalents balance was \$10.5 million as of January 31, 2009, we expect continued fluctuations in the use and availability of cash due to the seasonality of our business, timing of receivables collections and working capital needs necessary to finance our business and growth objectives.

To provide liquidity, we factor our receivables. We also utilize purchase order financing through the factor and through a finance company to provide funding for the manufacture of our products. In connection with these arrangements, the finance company and the factor have a security interest in substantially all of our assets.

Under our factoring agreement we have the ability to take cash advances against accounts receivable and inventory of up to \$20.0 million, and the availability of up to \$2.0 million in letters of credit. The factor, in its sole discretion, can reduce the availability of financing at anytime. In addition, we have \$10.0 million of availability for letters of credit and purchase order financing with another lender.

Factoring and Purchase Order Financing. As mentioned above, to provide liquidity, we take advances from our factor and utilize purchase order financing to fund the manufacturing of our products.

Under the terms of our factoring agreement, we assign our accounts receivable to the factor. The factor, in its sole discretion, determines whether or not it will accept a receivable based on its assessment of its credit risk. Once a receivable is accepted by the factor, the factor assumes substantially all of the credit risk associated with the receivable. The factor is required to remit payments to us for the assigned accounts receivable in accordance with the terms of the assigned invoice, regardless of whether the factor receives payment on the receivable, so long as the customer does not have a valid dispute related to the invoice. The amount remitted to us by the factor equals the invoiced amount adjusted for allowances and discounts we have provided to the customer less factor charges of 0.5% of invoiced amounts for these credit and collection services. In certain cases, we assign accounts receivable to the factor to provide collection services and to serve as collateral for advances, however, the Company retains the credit risk.

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

In addition, we may request that the factor provide us with cash advances based on our accounts receivable and inventory. The factor may either accept or reject our request for advances at its discretion. Amounts to be paid to us by the factor for any assigned receivable are offset by any amounts previously advanced by the factor. As our needs require, we may request that the factor advance 80% of the eligible receivables, and advance 60% of inventory up to a maximum of \$3.5 million. The interest rate is prime plus 1.5%. In certain circumstances, an additional 1% is charged for advances against inventory.

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

Commitments and Contingencies. We do not currently have any material commitments with respect to any capital expenditures.

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As of January 31, 2009, we had no open letters of credit for inventory purchases to be delivered during the subsequent quarter.

We are committed under agreements with certain developers and content providers for milestone and license fee payments aggregating \$4.9 million, which are payable within one year.

As of January 31, 2009, we were committed under operating leases for office space for approximately \$0.6 million through December 2010.

On September 27, 2007, we entered into settlement agreements to settle the following litigations pending in the United States District Court, District of New Jersey: (i) a securities class action brought on behalf of a purported class of purchasers of our securities; (ii) a private securities action filed by Trinad Capital Master Fund, Ltd.; and (iii) a second action filed by Trinad, purportedly on behalf of the Company.

In January 2009, we entered into an amendment to the securities class action settlement agreement. Under the terms of the settlement agreement in the securities class action, as amended, we will make cash payments totaling \$700,000 in three installments, the first two payments of which were made in January and February 2009, and the last of which is due to be paid in May 2009. We will also contribute one million shares of common stock. Our insurance carrier will also make a cash payment.

On February 23, 2009, the settlement was approved by the Court, and the class action was dismissed. The dismissal is subject to appeal through March 26, 2009. If there is no appeal, the settlement will become effective, and we will contribute the shares to the settlement fund by March 30, 2009. The settlement administrator will thereafter distribute the shares to eligible settlement claimants.

During the twelve months ended October 31, 2007, we recorded a \$2.8 million charge in connection with the expected settlement of the class action litigation, based on the terms of the original settlement. The charge is comprised of \$2.5 million, representing the fair value, on the date the agreement was executed, of the common stock expected to be distributed when the settlement becomes effective and \$0.3 million representing the increase in the value of the from that date to October 31, 2007. During the year ended October 31, 2008, we recorded a gain on litigation settlement of \$0.3 million representing the decline in the value of the shares to be issued under the settlement, as if it occurred on October 31, 2008.

The estimated settlement liability was further adjusted as of October 31, 2008, to reflect the terms of the amended settlement agreement entered into on January 16, 2009. Accordingly, an additional gain on settlement of litigation of \$1.3 million was recorded during the year ended October 31, 2008. The total estimated liability at October 31, 2008 is \$1.3 million, comprised of the \$0.7 million in cash payments, and \$0.6 million representing 1.0 million shares of common stock at the closing market price of \$0.55 at that date. The stock portion of the settlement was adjusted to a fair value of \$0.7 million at January 31, 2009, reflecting the closing market price of \$0.69 at that date. The value of the common stock on the date the shares are issued may be different than \$0.69, resulting in further adjustment to the settlement liability.

The settlement of the private securities claim in the action brought by Trinad, on its own behalf, provides that our insurance carrier will make a cash payment to Trinad, subject to the class action settlement becoming effective. The Court dismissed this action without prejudice on February 23, 2009, but it may be reopened within sixty days if the settlement is not consummated.

The settlement agreement in the action filed by Trinad, purportedly on behalf of the Company, will not result in a payment to the Company. Plaintiff's attorneys will not receive any fees in connection with the settlement. This settlement is subject to notice to the Company's shareholders and to court approval.

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Since the settlement in the class action is subject to appeal, and the settlement in the derivative action is subject to notice to shareholders and to court approval as well as appeal, there is no assurance that these settlements will be consummated. Further, if these settlements are not achieved, there can be no assurance that the our insurance will be adequate to cover the Company's costs relating to these litigations.

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

Cash Flows

Cash and cash equivalents were \$10.5 million at January 31, 2009 compared to \$5.5 million at October 31, 2008.

Operating Cash Flows. Cash provided by operating activities during the three months ended January 31, 2009 was approximately \$6.6 million compared to \$1.1 million for the three months ended January 31, 2008. The increase in cash provided by operating activities is primarily due to increased net income and working capital resulting from decreased accounts receivable and inventory, and increased accounts payable, partially offset by increased capitalized software development and royalties due to an increase in the number of games in development. We expect continued volatility in the use and availability of cash due to the seasonality of our business, timing of receivables collections and working capital needs necessary to finance our business and growth objectives.

Investing Cash Flows. Cash used in investing activities for the three months ended January 31, 2009 was approximately \$0.1 million, compared to \$0.1 million for the three months ended January 31, 2008. Cash used in investing activities consists primarily of purchases of computer equipment and leasehold improvements necessary to accommodate our infrastructure growth.

Financing Cash Flows. Cash used in financing activities for the three months ended January 31, 2009 was due to a reduction in inventory financing.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to various market risks, including the changes in foreign currency exchange rates and interest rates. Market risk is the potential loss arising from changes in market rates and prices. The principal foreign currencies involved in the conduct of our international operations are the Euro and the British pound. Foreign exchange contracts used to hedge foreign currency exposure are subject to market risk. We do not enter into derivatives or other financial instruments for trading or speculative purposes. At January 31, 2009, we did not have any foreign exchange contracts.

Item 4. Controls and Procedures

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

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

While we believe our disclosure controls and procedures and our internal control over financial reporting have improved, no system of controls can prevent errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the

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inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur. Controls can also be circumvented by individual acts of some people, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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

Based on the evaluation of the effectiveness of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective at a reasonable assurance level. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As previously disclosed, in January 2009, the Company entered into an amendment to a securities class action settlement agreement relating to litigation pending in the United States District Court, District of New Jersey. Under the terms of the amended settlement agreement, we will make a cash payment totaling \$700,000 in three installments, two of which were made in January and February 2009, and the last of which is due to be paid in May 2009. We will also contribute one million shares of our common stock. Our insurance carrier will also make a cash payment.

On February 23, 2009, the settlement was approved by the Court, and the class action was dismissed. The dismissal is subject to appeal through March 26, 2009. If there is no appeal, the settlement will become effective, and we will contribute the shares to the settlement fund by March 30, 2009. The settlement administrator will thereafter distribute the shares to eligible settlement claimants.

In addition, on February 23, 2009, the Court dismissed without prejudice the private securities claim in the action brought by Trinad Capital, on its own behalf, however, it may be reopened within sixty days if the settlement is not consummated. The settlement of this action provides that our insurance carrier will make a cash payment to Trinad, subject to the class action settlement becoming effective.

Item 1A. Risk Factors

A description of the risks associated with our business, financial condition, and results of operations is set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended October 31, 2008. These factors continue to be meaningful for your evaluation of the Company and we urge you to review and consider the risk factors presented in the Form 10-K. There have been no material changes to these risks.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

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SIGNATURE

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

**MAJESCO
ENTERTAINMENT
COMPANY**

/s/ Jesse Sutton
Jesse Sutton
Chief Executive Officer

Date: March 16, 2009