MAJESCO ENTERTAINMENT CO
Form 10-Q
March 14, 2011

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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, 2011
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 Incorporation or Organization)	(I.R.S. Employer 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 þ No o

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

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

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

As of March 4, 2011, there were 39,655,860 shares of the Registrant s common stock outstanding.

MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY
January 31, 2011 QUARTERLY REPORT ON FORM 10-Q
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	January 31, 2011 (unaudited)	October 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,889	$ 8,004
Due from factor	13,769	1,015
Accounts and other receivables, net	844	725
Inventory, net	7,240	8,418
Advance payments for inventory	643	5,454
Capitalized software development costs and license fees	3,521	4,903
Prepaid expenses	486	921
Total current assets	34,392	29,440
Property and equipment, net	551	520
Other assets	69	69
Total assets	$ 35,012	$ 30,029
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 14,768	$ 11,375
Inventory financing payables	84	5,557
Advances from customers	555	945
Total current liabilities	15,407	17,877
Warrant liability	560	144
Commitments and contingencies		
Stockholders equity:		
Common stock $.001 par value; 250,000,000 shares authorized; 39,519,707 and 39,326,376 shares issued and outstanding at January 31, 2011 and October 31, 2010, respectively	40	39
Additional paid-in capital	115,100	114,824
Accumulated deficit	(95,571)	(102,333)
Accumulated other comprehensive loss	(524)	(522)
Net stockholders equity	19,045	12,008
Total liabilities and stockholders equity	$ 35,012	$ 30,029

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	
	2011	**2010**
Net revenues	$ 48,466	$ 29,206
Cost of sales		
Product costs	20,823	11,728
Software development costs and license fees	8,012	7,867
Loss on impairment of software development costs and license fees-future releases		905
	28,835	20,500
Gross profit	19,631	8,706
Operating costs and expenses		
Product research and development	1,230	934
Selling and marketing	7,009	3,056
General and administrative	3,308	2,124
Depreciation and amortization	45	53
	11,592	6,167
Operating income	8,039	2,539
Other expenses (income)		
Interest and financing costs, net	710	497
Change in fair value of warrants	416	(202)
Income before income taxes	6,913	2,244
Income taxes	151	(1,563)
Net income	$ 6,762	$ 3,807
Net income per share:		
Basic	$ 0.18	$ 0.10
Diluted	$ 0.18	$ 0.10
Weighted average shares outstanding:		
Basic	37,638,705	36,808,062
Diluted	37,732,220	36,829,239

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, 2011	Three Months Ended January 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 6,762	$ 3,807
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	45	53
Change in fair value of warrants	416	(202)
Non-cash compensation expense	276	522
Loss on disposal of assets		19
Provision for price protection and customer allowances	1,887	1,169
Amortization of software development costs and license fees	2,784	2,186
Loss on impairment of software development costs and license fees	25	905
Changes in operating assets and liabilities:		
Due from factor	(14,238)	(6,671)
Accounts and other receivables	(521)	(645)
Inventory	1,178	2,599
Capitalized software development costs and license fees	(1,427)	(1,957)
Advance payments for inventory	4,811	2,472
Prepaid expenses and other assets	435	304
Accounts payable and accrued expenses	3,394	2,741
Advances from customers and other liabilities	(391)	(374)
Net cash provided by operating activities	5,436	6,928
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(77)	(4)
Net cash used in investing activities	(77)	(4)
CASH FLOWS FROM FINANCING ACTIVITIES		
Inventory financing	(5,472)	(6,053)
Net cash used in financing activities	(5,472)	(6,053)
Effect of exchange rates on cash and cash equivalents	(2)	(7)
Net (decrease) increase in cash and cash equivalents	(115)	864
Cash and cash equivalents beginning of period	8,004	11,839
Cash and cash equivalents end of period	$ 7,889	$ 12,703
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Cash paid for interest	$ 710	$ 497

See accompanying notes

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

1. PRINCIPAL BUSINESS ACTIVITY AND BASIS OF PRESENTATION

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

The Company is a provider of video game products primarily for the family-oriented, mass-market consumer. It sells its products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors. It publishes video games for major current generation interactive entertainment hardware platforms, including Nintendo s DS, DSi and Wii, Sony s PlayStation 3, or PS3, and PlayStation Portable, or PSP, Microsoft s Xbox 360 and the personal computer, or PC. It also publishes games for numerous digital platforms, including mobile platforms such as iPhone, iPad and iPod Touch, as well as online platforms such as Facebook.

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

The Company s operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company may also enter into agreements with licensees, particularly for sales of its products internationally. The Company is centrally managed and its chief operating decision makers, the chief executive and other officers, use consolidated and other financial information supplemented by sales information by product category, major product title and platform for making operational decisions and assessing financial performance. Accordingly, the Company operates in a single segment.

Net revenues by geographic region were as follows:

	Three Months Ended January 31,			
	2011	**%**	**2010**	**%**
United States	$ 48,300	100%	$ 27,959	95.7%
Europe	166	0%	1,247	4.3%
Total	$ 48,466	100%	$ 29,206	100.0%

The accompanying interim condensed consolidated financial statements of the Company are unaudited, but in the opinion of management, reflect all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim period. Accordingly, they do not include all information and notes required by generally accepted accounting principles for complete financial statements. The Company s financial results are impacted by the seasonality of the retail selling season and the timing of the release of new titles. The results of operations for interim periods are not necessarily indicative of results to be expected for the entire fiscal year. The balance sheet at October 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes for the year ended October 31, 2010 filed with the Securities and Exchange Commission on Form 10-K on January 31, 2011.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

When the Company enters into license or distribution agreements that provide for multiple copies of games in exchange for guaranteed amounts, revenue is recognized in accordance with the terms of the agreements, generally upon delivery of a master copy, assuming our performance obligations are complete and all other recognition criteria are met, or as per-copy royalties are earned on sales of games.

Capitalized Software Development Costs and License Fees. Software development costs include fees, in the form of milestone payments made to independent software developers and licensors. 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 and prepaid license fees 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 owners for the use of their intellectual property rights in the development of the Company s 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. Licenses are expensed to cost of sales at the higher of (i) the contractual royalty rate based on actual sales or (ii) an effective rate based upon total projected revenue related to such license. Capitalized software development costs are classified as non-current if they relate to titles for which the Company estimates the release date to be more than one year from the balance sheet date.

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, the Company expenses these capitalized costs to cost of sales-software development costs and license fees future release, in the period such a determination is made. These expenses may be incurred prior to a game s release. If a game is cancelled and never released to market, the amount is expensed to general and administrative expenses. If the Company was required to write off licenses, due to changes in market conditions or product acceptance, its results of operations could be materially adversely affected.

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Prepaid license fees and milestone payments made to the Company s 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.

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 price protection and 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.

Income Per Share. Basic income per share of common stock is computed by dividing net income applicable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Basic income per share excludes the impact of unvested shares of restricted stock issued as long term incentive awards to directors, officers and employees. Diluted income per share reflects the potential impact of common stock options and unvested shares of restricted stock and outstanding common stock purchase warrants that have a dilutive effect.

The table below provides a reconciliation of basic and diluted average shares outstanding, after applying the treasury stock method.

	Three Months Ended January 31,	
	2011	**2010**
Basic weighted average shares outstanding	37,638,705	36,808,062
Common stock options	47,785	21,177
Non-vested portion of restricted stock grants	45,730	
Diluted weighted average shares outstanding	37,732,220	36,829,239

The table below provides total potential shares outstanding, including those that are anti-dilutive, at the end of each reporting period:

	January 31, 2011	**January 31, 2010**
Shares issuable under common stock warrants	2,226,470	2,201,469
Shares issuable under stock options	1,699,216	1,462,752
Non-vested portion of restricted stock grants	1,878,917	1,748,022
	5,804,603	5,412,243

The Company issued 193,331 and 57,289 shares of restricted stock during the three months ended January 31, 2011 and 2010, respectively, and cancelled 0 and 21,984 shares during the same respective periods. The Company values shares of restricted stock at fair value as of the grant date.

Reclassifications. For comparability, certain 2010 amounts have been reclassified, where appropriate, to conform to the financial statement presentation used in 2011.

Commitments and Contingencies. The Company records a liability for commitments and contingencies when the amount is both probable and reasonably estimable.

Recent Accounting Pronouncements

Amendments to Variable Interest Entity Guidance In June 2009, the Financial Accounting Standards Board, or FASB, issued ASC Topic 860-10-65, *Accounting for Transfers of Financial Assets*. The standard removes the concept of a qualifying special purpose entity from ASC Topic 860, *Transfers and Servicing*, and eliminates the exception for qualifying special purpose entities from consolidation guidance. In addition, the standard establishes specific conditions for reporting a transfer of a portion of a financial asset as a sale. If a transfer does not meet established sale conditions, the transferor and transferee must account for the transaction as a secured borrowing. An enterprise that continues to transfer portions of a financial asset that do not meet the established sale conditions would be eligible to record a sale only after it has transferred all of its interest in that asset. The effective date is fiscal years beginning after November 15, 2009. Accordingly, the Company adopted the provisions in the first quarter of fiscal 2011. The adoption did not have a material impact on the Company s results of operations, financial position or cash flows.

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Multiple-Deliverable Revenue Arrangements In October 2009, the FASB issued new guidance related to the accounting for multiple-deliverable revenue arrangements. These new rules amend the existing guidance for separating consideration in multiple-deliverable arrangements and establish a selling price hierarchy for determining the selling price of a deliverable. These new rules became effective, on a prospective basis, for the Company on November 1, 2010. The adoption did not have a material impact on the Company s results of operations, financial position or cash flows.

Certain Revenue Arrangements That Include Software Elements In October 2009, the FASB issued new guidance that changes the accounting model for revenue arrangements by excluding tangible products containing both software and non-software components that function together to deliver the product s essential functionality and instead have these types of transactions be accounted for under other accounting literature in order to determine whether the software and non-software components function together to deliver the product s essential functionality. These new rules became effective, on a prospective basis, for the Company on November 1, 2010. The adoption did not have a material impact on the Company s results of operations, financial position or cash flows.

Fair Value In January 2010, the FASB issued an update to ASC 820-10, *Measuring Liabilities at Fair Values*. The update to ASC 820-10 requires disclosure of significant transfers in and out of Level 1 and Level 2 measurements and the reasons for the transfers, and a gross presentation of activity within the Level 3 rollforward, presenting separately information about purchases, sales issuances and settlements. The update to ASC 820-10 was adopted by the Company in 2010, except for the gross presentation of the Level 3 rollforward, which will be adopted by the Company in fiscal year 2011. The Company does not expect the adoption to have a material impact on its financial position, results of operations, and cash flows.

3. FAIR VALUE

The table below segregates all financial assets and liabilities that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

	January 31, 2011	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Assets:				
Money market funds	$ 7,045	$ 7,045	$	$
Bank- deposit	$ 844	$ 844	$	$
Total financial assets	$ 7,889	$ 7,889	$	$
Liabilities:				
Warrant liability	$ 560	$	$	$ 560
Total financial liabilities	$ 560	$	$	$ 560

The Company has outstanding warrants that may require settlement by transferring assets under certain change of control circumstances. These warrants are classified as liabilities in the accompanying balance sheet. The warrants have an exercise price of $2.04 per share and expire in September 2012. The Company measures the fair value of the warrants at each balance sheet date, using the Black-Scholes method, and a gain or loss is recorded in earnings each period as change in fair value of warrants.

Assumptions used to determine the fair value of the warrants were:

	Three months ended January 31, 2011	Three months ended January 31, 2010
Estimated fair value of stock	$ 0.62-$1.21	$ 0.85-$1.02
Expected warrant term	2.1-2.4 years	3.1-3.4 years
Risk-free rate	0.4%-0.6%	1.4%-1.6%
Expected volatility	73.5%-75.5%	76.1%
Dividend yield	0%	0%

A summary of the changes to the Company s warrant liability, as measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended January 31, 2011 and 2010 is presented below:

	Three months ended January 31, 2011	Three months ended January 31, 2010
Beginning balance	$ 144	$ 626
Total loss (gain) included in net income	416	(202)
Ending balance	$ 560	$ 424

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The carrying value of accounts receivable, accounts payable and accrued expenses, due from factor, and advances from customers are reasonable estimates of the fair values because of their short-term maturity.

4. INCOME TAXES

The only federal income tax provision recorded by the Company for the three months ended January 31, 2011 was for alternative minimum taxes. No other provision for income taxes has been recorded because the Company has available net operating loss carryforwards to offset taxable income. Net operating loss carryforwards available for income tax purposes at January 31, 2011 amount to approximately $75.7 million for federal income taxes and approximately $28.5 million for state income taxes.

For the three months ended January 31, 2010, the Company recorded an income tax benefit related to proceeds of $1,656 received in January 2010 from the sale of the rights to approximately $21,200 of New Jersey state income tax operating loss carryforwards, under the Technology Business Tax Certificate Program administered by the New Jersey Economic Development Authority.

5. DUE FROM FACTOR

Due from factor consists of the following:

	January 31, 2011	October 31, 2010
Outstanding accounts receivable sold to factor	$ 31,959	$ 13,754
Less: allowances	(6,842)	(3,298)
Less: advances from factor	(11,348)	(9,441)
	$ 13,769	$ 1,015

Outstanding accounts receivable sold to factor as of January 31, 2011 and October 31, 2010 for which the Company retained credit risk amounted to $0.8 million and $1.4 million, respectively. As of January 31, 2011 and October 31, 2010, there were no allowances for uncollectible accounts.

A summary of the changes in price protection and other customer sales incentive allowances included as a reduction of the amounts due from factor is presented below:

	Three Months Ended January 31,	
	2011	2010
Allowances beginning of period	$ (3,298)	$ (4,380)
Provision for price protection	(1,889)	(1,001)
Amounts charged against allowance and other changes	(1,655)	442
Allowances end of period	$ (6,842)	$ (4,939)

6. ACCOUNTS AND OTHER RECEIVABLES

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

	January 31, 2011	October 31, 2010
Accounts receivable	$ 514	$ 726
Allowances	(20)	(25)
Other	350	24

	$	844	$	725

7. PREPAID EXPENSES

Prepaid expenses consist of the following:

	January 31, 2011		October 31, 2010	
Prepaid media advertising	$	384	$	746
Other		102		175
	$	486	$	921

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8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following:

	January 31, 2011	October 31, 2010
Accounts payable trade	$ 4,846	$ 4,856
Royalties and software development	6,960	5,517
Sales commissions	327	120
Salaries, accrued bonuses and other compensation	2,255	592
Other accruals	380	290
	$ 14,768	$ 11,375

9. COMPREHENSIVE INCOME

The components of comprehensive income for the three-month periods ended January 31, 2011 and 2010, are summarized as follows:

Three Months Ended