

Galaxy Gaming, Inc.
Form 10-Q
August 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from to

Commission file number: 000-30653

Galaxy Gaming, Inc.

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

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

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

(702) 939-3254

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(Issuer's telephone number)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

Yes No

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

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

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
39,843,591 common shares as of August 10, 2018.

GALAXY GAMING, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE THREE MONTHS ENDED JUNE 30, 2018

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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GALAXY GAMING, INC.

CONDENSED BALANCE SHEETS

| | June 30, 2018 | December 31, 2017 |
|--|------------------|----------------------|
| ASSETS | | |
| Current assets: | (Unaudited) | |
| Cash, cash equivalents and restricted cash | \$3,708,353 | \$3,581,209 |
| Accounts receivable, net of allowance of \$78,706 and \$32,993, respectively | 2,633,027 | 2,301,752 |
| Inventory, net | 559,086 | 524,126 |
| Income tax receivable | 186,406 | — |
| Prepaid expense and other | 368,577 | 363,102 |
| Total current assets | 7,455,449 | 6,770,189 |
| Property and equipment, net | 251,670 | 263,867 |
| Assets deployed at client locations, net | 393,665 | 373,650 |
| Goodwill and other intangible assets, net | 10,708,345 | 11,452,809 |
| Deferred tax assets, net | 230,648 | 230,648 |
| Other assets, net | 23,000 | 23,000 |
| Total assets | \$19,062,777 | \$19,114,163 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$270,250 | \$1,035,383 |
| Accrued expenses | 819,061 | 887,796 |
| Income taxes payable | — | 519,610 |
| Revenue contract liability | 1,187,307 | 1,083,639 |
| Deferred rent, current portion | 28,050 | 23,679 |
| Current portion of long-term debt and capital lease obligations | 1,486,981 | 1,195,787 |
| Other current liabilities | 95,558 | 123,441 |
| Total current liabilities | 3,887,207 | 4,869,335 |
| Deferred rent, net | — | 14,025 |
| Capital lease obligations, net | — | 14,217 |
| Long-term debt, net | 9,337,472 | 7,420,385 |
| Common stock warrant liability | — | 1,333,333 |
| Interest rate swap liability | 77,235 | — |
| Total liabilities | 13,301,914 | 13,651,295 |
| Commitments and Contingencies (See Note 11) | | |
| Stockholders' equity | | |
| Preferred stock, 10,000,000 shares authorized, \$0.001 par value; | | |
| 0 shares issued and outstanding, respectively | — | — |
| Common stock, 65,000,000 shares authorized; \$0.001 par value; | | |
| 39,843,591 and 39,565,591 shares issued and outstanding, respectively | 39,844 | 39,566 |
| Additional paid-in capital | 4,315,015 | 3,957,703 |
| Accumulated earnings | 1,406,004 | 1,465,599 |
| Total stockholders' equity | 5,760,863 | 5,462,868 |
| Total liabilities and stockholders' equity | \$19,062,777 | \$19,114,163 |

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

GALAXY GAMING, INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| Revenue: | | | | |
| Product leases and royalties | \$4,536,350 | \$3,650,813 | \$8,896,705 | \$7,124,654 |
| Product sales and service | (177) | 7,995 | 162 | 9,450 |
| Total revenue | 4,536,173 | 3,658,808 | 8,896,867 | 7,134,104 |
| Costs and expenses: | | | | |
| Cost of ancillary products and assembled components | 36,629 | 62,266 | 59,387 | 83,148 |
| Selling, general and administrative | 2,597,089 | 2,359,889 | 5,182,159 | 4,446,058 |
| Research and development | 249,799 | 126,386 | 443,201 | 264,433 |
| Depreciation and amortization | 458,790 | 447,557 | 910,350 | 883,642 |
| Share-based compensation | 191,112 | 118,551 | 357,590 | 168,388 |
| Total costs and expenses | 3,533,419 | 3,114,649 | 6,952,687 | 5,845,669 |
| Income from operations | 1,002,754 | 544,159 | 1,944,180 | 1,288,435 |
| Other income (expense): | | | | |
| Interest expense | (247,319) | (438,247) | (613,412) | (883,579) |
| Foreign currency exchange (loss) gain | (83,917) | 58,155 | 21,884 | 65,952 |
| Change in estimated fair value of warrant liability | — | (256,909) | — | (323,409) |
| Change in estimated fair value of interest rate swap liability | (77,235) | — | (77,235) | — |
| Loss on extinguishment of debt | (1,347,506) | — | (1,347,506) | — |
| Interest income | 188 | — | 631 | — |
| Total other expense | (1,755,789) | (637,001) | (2,015,638) | (1,141,036) |
| (Loss) income before benefit (provision) for income taxes | (753,035) | (92,842) | (71,458) | 147,399 |
| Benefit (provision) for income taxes | 156,642 | 13,083 | 11,863 | (64,891) |
| Net (loss) income | \$(596,393) | \$(79,759) | \$(59,595) | \$82,508 |
| Net (loss) income per share, basic and diluted | \$(0.01) | \$(0.00) | \$(0.00) | \$0.00 |
| Weighted-average shares outstanding: | | | | |
| Basic | 39,805,020 | 39,365,591 | 39,784,525 | 39,335,757 |
| Diluted | 39,805,020 | 39,365,591 | 39,784,525 | 40,773,647 |

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

GALAXY GAMING, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2018 | June 30, 2017 |
| Cash flows from operating activities: | | |
| Net (loss) income | \$(59,595) | \$82,508 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 910,350 | 883,642 |
| Amortization of debt issuance costs and debt discount | 109,563 | 146,319 |
| Bad debt expense | 45,713 | 6,000 |
| Loss on extinguishment of debt | 1,347,506 | — |
| Change in estimated fair value of warrant liability | — | 323,409 |
| Change in estimated fair value of interest rate swap liability | 77,235 | — |
| Share-based compensation | 357,590 | 168,388 |
| Unrealized foreign exchange gains on cash, cash equivalents and restricted cash | (32,374) | (40,789) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (376,988) | (263,815) |
| Inventory | (148,077) | (174,485) |
| Prepaid expenses and other current assets | 5,202 | (38,346) |
| Accounts payable | (765,133) | 43,130 |
| Income tax receivable/payable | (706,016) | (68,589) |
| Accrued expenses | (68,735) | 234,954 |
| Revenue contract liability | 103,668 | (6,139) |
| Other current liabilities | (27,883) | (12,835) |
| Deferred rent | (9,654) | (5,283) |
| Net cash provided by operating activities | 762,372 | 1,278,069 |
| Cash flows from investing activities: | | |
| Investment in intangible assets | (7,000) | (43,917) |
| Acquisition of property and equipment | (53,586) | (31,023) |
| Net cash used in investing activities | (60,586) | (74,940) |
| Cash flows from financing activities: | | |
| Proceeds from debt issued | 11,098,986 | — |
| Proceeds from stock option exercises | — | 35,000 |
| Payments of debt issuance costs | (136,162) | (17,091) |
| Payment of warrant liability | (1,333,333) | — |
| Principal payments on capital lease obligations | (16,168) | (15,307) |
| Principal payments on long-term debt | (9,845,839) | (607,708) |
| Payments of long-term debt redemption premium | (374,500) | — |
| Net cash used in financing activities | (607,016) | (605,106) |
| Effect of exchange rate changes on cash | 32,374 | 40,789 |
| Net increase in cash, cash equivalents and restricted cash | 127,144 | 638,812 |
| Cash, cash equivalents and restricted cash – beginning of period | 3,581,209 | 2,389,338 |
| Cash, cash equivalents and restricted cash – end of period | \$3,708,353 | \$3,028,150 |
| Supplemental cash flow information: | | |

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| | | |
|--|-----------|-----------|
| Cash paid for interest | \$503,849 | \$739,862 |
| Inventory transferred to assets deployed at client locations | \$113,117 | \$135,144 |
| Cash paid for income taxes | \$709,423 | \$75,000 |

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

GALAXY GAMING, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. NATURE OF OPERATIONS

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

Nature of operations. We are an established global gaming company specializing in the design, development, manufacturing, marketing and acquisition of proprietary casino table games and associated technology, platforms and systems for the casino gaming industry. Casinos use our proprietary products and services to enhance their gaming floor operations and improve their profitability, productivity and security, as well as to offer popular cutting-edge gaming entertainment content and technology to their players. We market our products and services to land-based, riverboat, cruise ship and internet gaming companies located in North America, the Caribbean, Central America, the British Isles, Europe and Africa and to cruise ships and internet gaming sites worldwide.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation. The accompanying condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) and the rules of the Securities and Exchange Commission (“SEC”). In the opinion of management, all adjustments necessary in order for the financial statements to be not misleading have been reflected herein. As permitted by the rules and regulations of the SEC, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to those rules and regulations. The operating results for interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year.

In the opinion of management, the accompanying unaudited interim condensed financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly our financial position and the results of our operations and cash flows for the periods presented. These unaudited interim condensed financial statements should be read in conjunction with the financial statements and the related notes thereto included in our Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on April 2, 2018 (the “2017 10-K”).

Basis of accounting. The financial statements have been prepared on the accrual basis of accounting in conformity with U.S. GAAP. Revenues are recognized when earned and expenses (such as wages, consulting expenses, legal, regulatory and professional fees and rent) are recognized when they are incurred. We do not have significant categories of cost of revenue, as most of our revenue is derived from the licensing of intellectual property.

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

Reclassifications. Certain accounts and financial statement captions in the prior periods have been reclassified to conform to the current period financial statement presentations, including the addition of restricted cash to cash and cash equivalents on the consolidated statements of cash flows as a result of the adoption of ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. See below for further detail.

Other Significant Accounting Policies. See Note 3 in Item 8. “Financial Statements and Supplementary Data” included in our 2017 10-K.

Recently adopted accounting standards

Revenue Recognition. Effective January 1, 2018, we adopted Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASC 606”), which is a comprehensive new revenue recognition standard that supersedes virtually all existing revenue guidance, including industry-specific guidance. Under the new standard, revenue is recognized when control of the promised goods or services is transferred to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods and services. The standard creates a five-step model that generally requires companies to use more judgment and make more estimates than under the previous guidance when considering the terms of contracts along with all relevant facts and circumstances. These include the identification of customer contracts and separating performance obligations, the determination of transaction price that potentially includes an estimate of variable consideration, allocating the transaction price to each separate performance obligation, and recognizing revenue in line with the pattern of transfer. We adopted ASC 606 using the modified retrospective approach (reporting the cumulative effect as of the date of adoption). See Note 3 for further detail.

Restricted Cash. Effective January 1, 2018, we adopted ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This ASU requires amounts generally described as restricted cash and cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. We adopted this guidance on a retrospective basis, which resulted in the inclusion of restricted cash within cash and cash equivalents on our balance sheets and statements of cash flows. Such restricted cash represents reserves set aside in a restricted bank account in accordance with the requirements of gaming regulations to be used for the purpose of funding payments to winners of our jackpots and was \$60,996 and \$95,062 at June 30, 2018 and December 31, 2017, respectively. Cash flows from operating activities for the six months ended June 30, 2017 increased by \$8,693 as a result of the adoption of this guidance.

Compensation - Stock Compensation. Effective January 1, 2018, we adopted ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. The adoption did not have a material impact on our financial statements.

New accounting standards not yet adopted

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

Goodwill Impairment. In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the current two-step goodwill impairment test by eliminating Step 2 of the test. This guidance requires a one-step impairment test in which an entity compares the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, if any. This guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the impact of adopting this guidance and will adopt this guidance for the annual test to be performed for the year ended December 31, 2018.

NOTE 3. REVENUE RECOGNITION

Adoption of ASC 606, Revenue from Contracts with Customers

On January 1, 2018, we adopted ASC 606 and applied it to all contracts using the modified retrospective method. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts have not and will not be adjusted and continue to be reported in accordance with our historical accounting

treatment under Topic 605, Revenue Recognition.

The adoption of ASC 606 had the following impact on our balance sheet and statement of operations: (i) we reported higher product leases and royalty revenue and selling, general and administrative expense for the three and six months ended June 30, 2018 as a result of the assessment of our distributor relationships. We have entered into agreements with certain distributors in Europe, which sublicense our intellectual property to gaming establishments in Europe. We have historically recorded net revenues (gross revenue generated minus distributor fees paid) as product leases and royalty revenue. However, after applying principal vs. agent considerations to these distributor relationships in accordance with ASC 606, we have determined that revenues earned from gaming establishments in Europe should now be recorded as gross revenue and fees earned by such distributors should be recorded as selling, general and administrative expenses as we had control of the sub-licensed intellectual property prior to the licensing of such intellectual property to the gaming establishments; and (ii) prepayments from customers in advance of the period that the revenue is recognized were historically recorded under the caption “deferred revenue” in the accompanying balance sheet. This caption has now been renamed “revenue contract liability” in accordance with the requirements of ASC 606.

For the three months ended June 30, 2018, the adoption of ASC 606 had the following impact on our statement of operations:

| | Three Months Ended June 30, 2018 | | |
|---|----------------------------------|-------------|-----------|
| | As | Balance | Impact of |
| | reported | without the | the |
| | | adoption of | adoption |
| | | ASC 606 | |
| Product leases and royalties | \$4,536,350 | \$4,270,278 | \$266,072 |
| Selling, general and administrative expense | \$2,597,089 | \$2,331,017 | \$266,072 |

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For the six months ended June 30, 2018, the adoption of ASC 606 had the following impact on our statement of operations:

| | Six Months Ended June 30, 2018 | | |
|---|--------------------------------|---|------------------------|
| | As reported | Balance without the adoption of ASC 606 | Impact of the adoption |
| Product leases and royalties | \$8,896,705 | \$8,423,936 | \$472,769 |
| Selling, general and administrative expense | \$5,182,159 | \$4,709,390 | \$472,769 |

Revenue Recognition

We generate revenue primarily from the licensing of our intellectual property. We also, occasionally, receive a one-time sale of certain products and/or reimbursement of our manufactured equipment.

License Fees. We derive product lease and royalty revenue from negotiated recurring fee license agreements and the performance of our products. We account for these agreements as month-to-month contracts for the purposes of ASC 606 and recognize revenue each month as we satisfy our performance obligations by granting access to intellectual property to our clients. In addition, revenue associated with performance-based agreements is recognized during the month that the usage of the product or intellectual property occurs. We believe it is inappropriate to use the input method as the inputs do not correlate to the satisfaction of our performance obligations. Intellectual property requires significant upfront investment in the form of human resources required for their development and/or capital resources for acquisition from third parties. However, limited maintenance is required once the games have been placed on casino floors. The output method, on the other hand, recognizes revenue based on direct measurements of the value to our customers of the licensed intellectual property, which we believe is more appropriate. We have further applied the “as invoiced” practical expedient under the output method by recognizing product lease and royalty revenue in proportion to the amount for which we have the right to invoice.

Some of our intellectual property requires the installation of certain equipment and both the intellectual property and the related equipment are licensed in one bundled package. We have determined that the equipment is not distinct from the intellectual property and, therefore, we have only one performance obligation and, as a result, the allocation of the transaction price to different performance obligations is not necessary.

Product Sales. Occasionally, we sell certain incidental products or receive reimbursement of our manufactured equipment after the commencement of the new license agreement. Revenue from such sales is recognized as a separate performance obligation when we ship the items.

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Disaggregation of Revenue. The following table disaggregates our revenue by major source for the three and six months ended June 30, 2018 and 2017:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------|--------------------------------|-------------|------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Table games | \$4,413,878 | \$3,522,221 | \$8,607,035 | \$6,875,153 |
| E-tables | 113,837 | 121,452 | 272,665 | 234,981 |
| Other | 8,458 | 15,135 | 17,167 | 23,970 |
| Total revenue | \$4,536,173 | \$3,658,808 | \$8,896,867 | \$7,134,104 |

The following table disaggregates our revenue by geographic location for the three and six months ended June 30, 2018 and 2017:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------|--------------------------------|-------------|------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| North America and Caribbean | \$3,494,692 | \$3,034,662 | \$6,945,401 | \$5,871,552 |
| Europe | 1,041,481 | 624,146 | 1,951,466 | 1,262,552 |
| Total revenue | \$4,536,173 | \$3,658,808 | \$8,896,867 | \$7,134,104 |

Revenue Contract Asset and Liability. Upon the adoption of ASC 606, we have applied the practical expedient of expensing incremental commissions paid to sales representatives directly related to the acquisition and fulfillment of new contracts, when the amortization period of the contract asset that we otherwise would have recognized is one year or less.

We invoice our clients monthly in advance for unlimited use of our intellectual property licenses. Upon the adoption of ASC 606, we

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recognized a revenue contract liability that represents such advanced billing to our clients for unsatisfied performance. We reduce the revenue contract liability and recognize revenue when we transfer those goods or services and, therefore, satisfy our performance obligation.

The table below summarizes changes in the revenue contract liability during the six months ended June 30, 2018:

| | Revenue Contract liability |
|-------------------------------------|----------------------------------|
| Beginning balance – January 1, 2018 | \$1,083,639 |
| Increase (advanced billings) | 6,730,824 |
| Decrease (revenue recognition) | (6,627,156) |
| Ending balance – June 30, 2018 | \$1,187,307 |

Revenue recognized during the six months ended June 30, 2018 that was included in the beginning balance of revenue contract liability above was \$1,083,639.

NOTE 4. INVENTORY

Inventory, net consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|-----------------------------------|-----------|-----------|
| Raw materials and component parts | \$287,777 | \$235,673 |
| Finished goods | 301,309 | 318,453 |
| Inventory, gross | 589,086 | 554,126 |
| Less: inventory reserve | (30,000) | (30,000) |
| Inventory, net | \$559,086 | \$524,126 |

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|-------------------------------|-----------|-----------|
| Furniture and fixtures | \$308,776 | \$280,694 |
| Automotive vehicles | 215,127 | 215,127 |
| Leasehold improvements | 156,843 | 156,843 |
| Computer equipment | 147,496 | 121,992 |
| Office equipment | 53,484 | 53,483 |
| Property and equipment, gross | 881,726 | 828,139 |

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| | | |
|--------------------------------|-----------|-----------|
| Less: accumulated depreciation | (630,056) | (564,272) |
| Property and equipment, net | \$251,670 | \$263,867 |

Property and equipment, net included \$156,843 of leasehold improvements acquired under capital leases as of June 30, 2018 and December 31, 2017. Accumulated depreciation of leasehold improvements totaled \$128,271 and \$113,035 as of June 30, 2018 and December 31, 2017, respectively (Note 9).

For the six months ended June 30, 2018 and 2017, depreciation expense related to property and equipment was \$65,783 and \$80,231, respectively.

NOTE 6. ASSETS DEPLOYED AT CLIENT LOCATIONS

Assets deployed at client locations, net consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|--|-----------|-----------|
| Enhanced table systems | \$743,127 | \$638,981 |
| Less: accumulated depreciation | (349,462) | (265,331) |
| Assets deployed at client locations, net | \$393,665 | \$373,650 |

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For the six months ended June 30, 2018 and 2017, depreciation expense related to assets deployed at client locations was \$93,101 and \$52,779, respectively.

NOTE 7. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and finite-lived intangible assets, net consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|---|--------------|--------------|
| Goodwill | \$1,091,000 | \$1,091,000 |
| Finite-lived intangible assets: | | |
| Patents | 13,475,000 | 13,475,000 |
| Customer relationships | 3,400,000 | 3,400,000 |
| Trademarks | 2,880,967 | 2,880,967 |
| Non-compete agreements | 660,000 | 660,000 |
| Internally-developed software | 109,968 | 102,968 |
| Other intangible assets, gross | 20,525,935 | 20,518,935 |
| Less: accumulated amortization | (10,908,590) | (10,157,126) |
| Other intangible assets, net | 9,617,345 | 10,361,809 |
| Goodwill and other intangible assets, net | \$10,708,345 | \$11,452,809 |

For the six months ended June 30, 2018 and 2017 amortization expense related to the finite-lived intangible assets was \$751,464 and \$750,632, respectively.

Estimated future amortization expense is as follows:

| Twelve months Ending June 30, | Total |
|-------------------------------|-------------|
| 2019 | \$1,501,207 |
| 2020 | 1,492,626 |
| 2021 | 1,411,884 |
| 2022 | 1,390,947 |
| 2023 | 537,231 |
| Thereafter | 3,283,450 |
| Total amortization | \$9,617,345 |

NOTE 8. ACCRUED EXPENSES

Accrued expenses consisted of the following at June 30, 2018 and December 31, 2017:

| 2018 | 2017 |
|------|------|
|------|------|

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| | | |
|---------------------------|-----------|-----------|
| Payroll and related | \$639,071 | \$712,584 |
| Commissions and royalties | 70,410 | 65,380 |
| Professional fees | 62,911 | 63,488 |
| Other | 46,669 | 46,344 |
| Total accrued expenses | \$819,061 | \$887,796 |

NOTE 9. CAPITAL LEASE OBLIGATIONS

Capital lease obligations consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|---|-----------|----------|
| Capital lease obligation | \$ 30,811 | \$47,002 |
| Less: Current portion | (30,811) | (32,785) |
| Total capital lease obligations – long-term | \$ — | \$14,217 |

The capital leases consist of improvements located at our corporate headquarters in Las Vegas, Nevada.

NOTE 10. LONG-TERM DEBT

Long-term debt consisted of the following at June 30, 2018 and December 31, 2017:

| | 2018 | 2017 |
|--|--------------|--------------|
| Nevada State Bank Term Loan and revolver | \$10,779,786 | \$ — |
| Breakaway Term Loan | — | 9,450,000 |
| Equipment notes payable | 104,834 | 124,311 |
| Insurance notes payable | 18,583 | 73,734 |
| Notes payable, gross | 10,903,203 | 9,648,045 |
| Less: | | |
| Unamortized debt issuance costs | (109,560) | (480,397) |
| Warrants issued | — | (584,261) |
| Notes payable, net | 10,793,643 | 8,583,387 |
| Less: Current portion | (1,456,171) | (1,163,002) |
| Long-term debt, net | \$9,337,472 | \$ 7,420,385 |

Nevada State Bank Credit Agreement. On April 24, 2018, we entered into a credit agreement with ZB, N.A. dba Nevada State Bank (“NSB” and the “NSB Credit Agreement”), which provides for a \$11.0 million five-year term loan (the “NSB Term Loan”) and a \$1.0 million one-year revolving credit facility (the “NSB Revolver”).

Outstanding balances under the NSB Term Loan and the NSB Revolver accrue interest based on one-month US dollar London interbank offered rate (“LIBOR”) plus an Applicable Margin of 3.50%, or 4.00%, depending on our Leverage Ratio (as defined in the NSB Credit Agreement).

We are required to make monthly principal and interest payments, both of which are calculated over a seven-year term, with a balloon payment due on April 24, 2023. Borrowings under the NSB Credit Agreement are secured by a lien on substantially all of our assets.

Effective May 1, 2018, we entered into an interest rate swap agreement with an affiliate of NSB (the “Swap Agreement”) to fix the interest rate on the NSB Term Loan at 6.43% (assuming a Leverage Ratio less than 2.0) for three years. The notional amount of the Swap Agreement is initially \$10.9 million but will decrease over time as a result of the anticipated principal paydowns.

The NSB Credit Agreement contains affirmative and negative financial covenants and other restrictions customary for borrowings of this nature. In particular, we are required to maintain a minimum trailing-four-quarters Fixed Charge Coverage Ratio (as defined in the NSB Credit Agreement) of 1.25 and a maximum Leverage Ratio of 3.00. The NSB Credit Agreement allows us to make share repurchases and to incur up to an additional \$1.0 million of unsecured indebtedness provided that we are in compliance with the covenants in the NSB Credit Agreement on a pro forma basis. We were in compliance with the financial covenants of the NSB Credit Agreement as of June 30, 2018.

Upon execution of the NSB Credit Agreement, we borrowed \$11.0 million under the NSB Term Loan and \$0.1 million under the NSB Revolver.

Breakaway Term loan. In August 2016, we entered into a term loan agreement (the “Breakaway Term Loan Agreement”) for an aggregate principal amount of \$10,500,000 (the "Breakaway Term Loan"). In conjunction with the Breakaway Term Loan, we also entered into a warrant agreement (the “Warrant Agreement”), pursuant to which we issued the lenders a six-year warrant to purchase 1,965,780 shares of our common stock (the “Warrants”).

The outstanding principal initially accrued interest at the rate of 14.0% per annum, which decreased to 12.5% per annum for any quarterly period in which we achieved a specified leverage ratio. Beginning October 1, 2017, the interest rate per annum decreased to 12.5% due to the achievement of such ratio.

On April 24, 2018, we used the proceeds from the NSB Term Loan and NSB Revolver to repay in full the remaining principal amount under the Breakaway Term Loan, together with accrued but unpaid interest, an early redemption premium and associated legal fees. In addition, we redeemed the Warrants at \$1,333,333. The early redemption of the Breakaway Term Loan resulted in approximately \$1.3 million of loss on extinguishment of debt.

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As of June 30, 2018, future maturities of our long-term debt obligations are as follows:

| Twelve months Ending June 30 , | Total |
|---------------------------------|--------------|
| 2019 | \$1,456,171 |
| 2020 | 1,419,207 |
| 2021 | 1,505,143 |
| 2022 | 1,595,582 |
| Thereafter | 4,927,100 |
| Total notes payable | 10,903,203 |
| Less: | |
| Unamortized debt issuance costs | (109,560) |
| Notes payable, net | \$10,793,643 |

NOTE 11. COMMITMENTS AND CONTINGENCIES

Concentration of risk. We are exposed to risks associated with a client who represent a significant portion of total revenues. For the six months ended June 30, 2018 and 2017, respectively, we had the following client revenue concentration:

| | 2018 | 2017 |
|----------|-------|-------|
| Client A | 11.2% | 14.1% |

We are also exposed to risks associated with the expiration of our patents. In 2015, domestic and international patents for two of our products expired, which accounted for approximately \$4,200,631 or 47.2% of our revenue for the six months ended June 30, 2018, as compared to \$3,141,418 or 44.0% of our revenue for the six months ended June 30, 2017. We continue to generate higher revenue from these products despite the expiration of the underlying patents and, accordingly, we do not expect the expiration of these patents to have a significant adverse impact on our future financial statements.

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

The initial term of the Spencer Lease commenced on April 1, 2014 and expires on June 30, 2019. We were obligated to pay approximately \$153,000 in annual base rent in the first year, and the annual base rent is scheduled to increase by approximately 4% each year. We are also obligated to pay real estate taxes and other building operating costs. Subject to certain conditions, we have certain rights under the Spencer Lease, including rights of first offer to purchase the premises if the landlord elects to sell. We also have an option to extend the term of the Spencer Lease for two consecutive terms of three years each, at the then current fair market value rental rate determined in accordance with the terms of the Spencer Lease.

In connection with the Spencer Lease, the landlord agreed to finance tenant improvements of \$150,000 (“TI Allowance”). The base rent is increased by an amount sufficient to fully amortize the TI Allowance through the initial Spencer Lease term upon equal monthly payments of principal and interest, with interest imputed on the outstanding principal balance at the rate of 5.5% per annum. The TI Allowance has been classified as a capital lease on the condensed balance sheet (Note 9).

Total rent expense was \$146,693 and \$144,059 for the six months ended June 30, 2018 and 2017, respectively.

Estimated future minimum operating lease payment obligations total \$238,920, which are all due within the twelve months ending June 30, 2019.

Legal proceedings. In the ordinary course of conducting our business, we are, from time to time, involved in various legal and administrative proceedings, regulatory government investigations and other matters, including those in which we are a plaintiff or defendant, that are complex in nature and have outcomes that are difficult to predict. We record accruals for such contingencies to the extent we conclude that it is probable that a liability will be incurred and the amount of the related loss can be reasonably estimated. Our assessment of each matter may change based on future unexpected events. An unexpected adverse judgment in any pending litigation could cause a material impact on our business operations, intellectual property, results of operations or financial position. Unless otherwise expressly stated, we believe costs associated with litigation will not have a material impact on our financial position or liquidity, but may be material to the results of operations in any given period. We assume no obligation to update the status of pending litigation, except as may be required by U.S. GAAP, applicable law, statute or regulation. For a complete description of the facts and circumstances surrounding material litigation to which we are a party, see Note 11 in Item 8. “Financial Statements and Supplementary Data” included in our 2017 10-K.

NOTE 12. STOCKHOLDERS' EQUITY

On March 31, 2018, we issued 13,000 restricted shares of our common stock valued at \$13,520, to each of Messrs. Norm DesRosiers, Bryan Waters and William Zender, who are members of our Board of Directors (the "Board"), in consideration of their service on the Board during the three months ended March 31, 2018. These shares vested immediately on grant date.

On June 30, 2018, we issued 13,000 restricted shares of our common stock valued at \$15,600, to each of Messrs. DesRosiers, Waters and Zender, in consideration of their service on the Board during the three months ended June 30, 2018. These shares vested immediately on grant date.

On April 24, 2018, our Board authorized the repurchase of shares of our common stock in an amount not to exceed \$1.0 million. Such repurchases may be made from time to time based on market conditions and may be completed in the open market or in privately-negotiated transactions. Repurchase transactions will be executed only when we believe that we will remain in compliance with the covenants of the NSB Credit Agreement. Finally, execution of share repurchases may require regulatory approval in one or more jurisdictions. We have not repurchased any of our common stock as of June 30, 2018.

NOTE 13. INCOME TAXES

Our forecasted annual effective tax rate at June 30, 2018 was 16.6%, as compared to 45.1% at June 30, 2017. For the six months ended June 30, 2018 and 2017, our effective tax rate was 16.6% and 44.0%, respectively. The decrease in both rates was primarily due to a reduction in the federal statutory rate as a result of the Tax Cuts and Jobs Act signed in December 2017 (the "Tax Act"). As of June 30, 2018, we had completed our preliminary assessment for the tax effects resulting from the enactment of the Tax Act and made a reasonable estimate of the effect on our annual effective tax rate and existing deferred tax balances. We will continue to make and refine our calculations as additional analysis is completed. In addition, our estimates may also be affected as we gain a more thorough understanding of the Tax Act.

NOTE 14. STOCK WARRANTS, OPTIONS AND GRANTS

Stock options. During the six months ended June 30, 2018 and 2017, we issued 270,000 and 785,000 options to purchase our common stock, respectively, to members of our Board, independent contractors, executive officers and employees.

The fair value of all stock options granted for the six months ended June 30, 2018 and 2017 was determined to be \$169,807 and \$329,508, respectively, using the Black-Scholes option pricing model with the following assumptions:

| | Six Months Ended June 30, 2018 | Six Months Ended June 30, 2017 |
|-------------------------|--|--|
| Dividend yield | 0% | 0% |
| Expected volatility | 78% | 83 - 87% |
| | 2.46% - | 1.84 - |
| Risk free interest rate | 2.73% | 1.94% |
| Expected life (years) | 5.00 | 5.00 |

A summary of stock option activity is as follows:

| | Common stock options | Weighted- average exercise price | Aggregate intrinsic value | Weighted-average remaining contractual term (years) |
|---------------------------------|-------------------------|--|---------------------------------|---|
| Outstanding – December 31, 2017 | 2,811,250 | \$ 0.54 | \$1,849,517 | 3.65 |
| Issued | 270,000 | 0.98 | — | — |
| Exercised | — | — | — | — |
| Expired | — | — | — | — |
| Outstanding – June 30, 2018 | 3,081,250 | \$ 0.58 | \$1,847,242 | 3.30 |
| Exercisable – June 30, 2018 | 2,151,250 | \$ 0.51 | \$1,444,025 | 2.96 |

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A summary of unvested stock option activity is as follows:

| | Common stock options | Weighted-average exercise price | Aggregate intrinsic value | Weighted-average remaining contractual term (years) |
|------------------------------|----------------------|---------------------------------|---------------------------|---|
| Unvested – December 31, 2017 | 825,557 | \$ 0.63 | \$ 467,379 | 4.27 |
| Granted | 270,000 | 0.98 | — | — |
| Vested | (165,557) | 0.57 | — | — |
| Forfeited or expired | — | — | — | — |
| Unvested – June 30, 2018 | 930,000 | \$ 0.75 | \$ 403,217 | 4.01 |

As of June 30, 2018, our unrecognized stock-based compensation expense associated with the stock options issued was \$281,566, which will be amortized over a weighted-average of 2.5 years.

Warrants. On August 29, 2016, in connection with the Breakaway Term Loan Agreement, we issued the lenders the Warrants to purchase 1,965,780 shares of our common stock at an initial exercise price of \$0.30 per share. On April 24, 2018, we paid \$1,333,333 to redeem the Warrants in full upon extinguishment of the Breakaway Term Loan (Note 10).

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

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

The estimated fair value of cash equivalents, restricted cash, accounts receivable and accounts payable approximates their carrying amount due to their short-term nature. The estimated fair value of our long-term debt and capital lease obligations approximates their carrying value based upon our expected borrowing rate for debt with similar remaining maturities and comparable risk. As of June 30, 2018, the interest rate swap agreement was the only financial instrument measured at estimated fair value on a recurring basis based on level 2 inputs.

NOTE 16. SUBSEQUENT EVENTS

We evaluated subsequent events through the date of issuance of the financial statements. There have been no subsequent events that occurred during such period that would require adjustment to or disclosure in the financial statements as of and for the three and six months ended June 30, 2018.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the Securities Act, and is subject to the safe harbors created by those sections. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "may," variations of these words or similar expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. Such forward-looking statements speak only as of the date of this report; we undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by us in this report, as well as the disclosures made in the Galaxy Gaming, Inc. Annual Report on Form 10-K for the year ended December 31, 2017 filed on April 2, 2018 (the "2017 10-K"), and other filings we make with the Securities and Exchange Commission, which attempt to advise interested parties of the risks, uncertainties, and other factors that affect our business, operating results, financial condition and stock price.

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

OVERVIEW

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

Additional information regarding our products and product categories may be found in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2017 10-K and on our web site, www.galaxygaming.com. Information found on the web site should not be considered part of this report.

Results of operations for the three months ended June 30, 2018 and 2017. For the three months ended June 30, 2018, our continuing operations generated gross revenues of \$4,536,173 compared to gross revenues of \$3,658,808 for the comparable prior-year period, representing an increase of 877,365, or 24.0%. This increase was primarily attributable to higher revenue from: (i) Bonus Jackpot System due to additional game placements; (ii) Premium Games such as Heads Up Hold 'em and Player's Edge, which command a higher price point per unit; and (iii) internet-based gaming

activities. In addition, the adoption of ASC 606 resulted in \$266,072 of higher revenue reported for the three months ended June 30, 2018. Since we elected to adopt ASC 606 using the modified retrospective approach, no changes were made to our previously issued financial statements, including the statement of operations for the three months ended June 30, 2017. Excluding the impact of the adoption of ASC 606, gross revenue for the three months ended June 30, 2018 would have been \$4,270,101, an increase of 16.7% over the comparable prior period.

Selling, general and administrative expenses for the three months ended June 30, 2018 were \$2,597,089 compared to \$2,359,889 for the comparable prior period, representing an increase of \$237,200, or 10.1%. Excluding the impact of the adoption of ASC 606, selling, general and administrative expenses for the three months ended June 30, 2018 would have been \$2,331,017, a decrease of 0.8% over the comparable prior period.

Research and development expenses for the three months ended June 30, 2018 were \$249,799, compared to \$126,386 for the comparable prior-year period, representing an increase of \$123,413, or 97.6%. This increase was primarily due to increased costs associated with testing our products currently in development.

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Stock-based compensation expenses for the three months ended June 30, 2018 was \$191,112, as compared to \$118,551 for the comparable prior-year period, representing an increase of \$72,561, or 61.2%. The increase was primarily due to higher amortization of stock options and restricted shares of common stock issued since July 2017 to executive officers, board members and independent contractors.

Income from operations increased \$458,595 or 84.3% to \$1,002,754 for the three months ended June 30, 2018, compared to \$544,159 for the comparable prior-year period. This increase was primarily attributable to higher revenue, partially offset by higher selling, general and administrative, research and development and share-based compensation expenses.

Total interest expense decreased \$190,928, or 43.6%, to \$247,319 for the three months ended June 30, 2018, compared to \$438,247 for the comparable prior-year period. The decrease was mainly attributable to lower interest rate on the NSB Term Loan and the NSB Revolver as compared to the Breakaway Term Loan and a reduction in interest rate on the Breakaway Term Loan beginning October 1, 2017 due to achievement of a specified leverage ratio.

There was no change in estimated fair value of warrants issued in connection with the Breakaway Term Loan for the three months ended June 30, 2018, compared to other expense of \$256,909 for the comparable prior-year period. The estimated fair value was determined using the Black-Scholes pricing model, subject to a ceiling on the maximum amount we would have to pay to repurchase the Warrants under certain circumstances. The Warrants were paid off on April 24, 2018 in connection with the payoff of the Breakaway Term Loan.

Loss on extinguishment of debt was \$1,347,506 as a result of an early redemption premium paid in connection with the payoff of the Breakaway Term Loan and the write-off of unamortized debt issuance costs and estimated grant-date fair value of the Warrants.

Income tax benefit was \$156,642 for the three months ended June 30, 2018, compared to \$13,083 for the comparable prior-year period. This increase was primarily attributable to the increase in loss before provision for income taxes, partially offset by a reduction in the federal statutory rate as a result of the Tax Cuts and Jobs Act signed in December 2017.

Results of operations for the six months ended June 30, 2018 and 2017. For the six months ended June 30, 2018, our continuing operations generated gross revenues of \$8,896,867 compared to gross revenues of \$7,134,104 for the comparable prior-year period, representing an increase of \$1,762,763, or 24.7%. This increase was primarily attributable to higher revenue from: (i) Bonus Jackpot System due to additional game placements; (ii) Premium Games such as Heads Up Hold 'em and Player's Edge, which command a higher price point per unit; and (iii) internet-based gaming activities. In addition, the adoption of ASC 606 resulted in \$472,769 of higher revenue reported for the six months ended June 30, 2018. Since we elected to adopt ASC 606 using the modified retrospective approach, no changes were made to our previously issued financial statements, including the statement of operations for the six months ended June 30, 2017. Excluding the impact of the adoption of ASC 606, gross revenue for the six months ended June 30, 2018 would have been \$8,424,098, an increase of 18.1% over the comparable prior period.

Selling, general and administrative expenses for the six months ended June 30, 2018 were \$5,182,159 compared to \$4,446,058 for the comparable prior period, representing an increase of \$736,101, or 16.6%. The increase was primarily due to higher compensation and related expense as we continue to invest in personnel and attract new talent. Excluding the impact of the adoption of ASC 606, selling, general and administrative expenses for the six months ended June 30, 2018 would have been \$4,709,390, an increase of 7.2% over the comparable prior period.

Research and development expenses for the six months ended June 30, 2018 were \$443,201, compared to \$264,433 for the comparable prior-year period, representing an increase of \$178,768, or 67.6%. This increase was primarily due to increased costs associated with testing our products currently in development.

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Stock-based compensation expenses for the six months ended June 30, 2018 was \$357,590, as compared to \$168,388 for the comparable prior-year period, representing an increase of \$189,202, or 112.4%. The increase was primarily due to higher amortization of stock options and restricted shares of common stock issued since January 2017 to executive officers, board members and independent contractors.

Income from operations increased \$655,747 or 50.9% to \$1,944,180 for the six months ended June 30, 2018, compared to \$1,288,435 for the comparable prior-year period. This increase was primarily attributable to higher revenue, partially offset by higher selling, general and administrative, research and development and share-based compensation expenses.

Total interest expense decreased \$270,167, or 30.6%, to \$613,412 for the six months ended June 30, 2018, compared to \$883,579 for the comparable prior-year period. The decrease was mainly attributable to lower interest rate on the NSB Term Loan and the NSB Revolver as compared to the Breakaway Term Loan and a reduction in interest rate on the Breakaway Term Loan beginning October 1, 2017 due to achievement of a specified leverage ratio.

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There was no change in estimated fair value of warrants issued in connection with the Breakaway Term Loan for the six months ended June 30, 2018, compared to other expense of \$323,409 for the comparable prior-year period. The estimated fair value was determined using the Black-Scholes pricing model, subject to a ceiling on the maximum amount we would have to pay to repurchase the Warrants under certain circumstances. The Warrants were paid off on April 24, 2018 in connection with the payoff of the Breakaway Term Loan.

Loss on extinguishment of debt was \$1,347,506 as a result of an early redemption premium paid in connection with the payoff of the Breakaway Term Loan and the write-off of unamortized debt issuance costs and estimated grant-date fair value of the Warrants.

Income tax benefit was \$11,863 for the six months ended June 30, 2018, compared to income tax provision of \$64,891 for the comparable prior-year period. This change was primarily attributable to the decrease in income before provision for income taxes, partially offset by a reduction in the federal statutory rate as a result of the Tax Cuts and Jobs Act signed in December 2017.

Adjusted EBITDA. Adjusted EBITDA includes adjustment to net income to exclude interest, taxes, depreciation, amortization, share based compensation, loss on extinguishment of debt, foreign currency exchange gains, change in estimated fair value of warrant liability, and settlement income. Adjusted EBITDA is not a measure of performance defined in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). However, Adjusted EBITDA is used by management to evaluate our operating performance. Management believes that disclosure of the Adjusted EBITDA metric offers investors, regulators and other stakeholders a view of our operations in the same manner management evaluates our performance. When combined with U.S. GAAP results, management believes Adjusted EBITDA provides a comprehensive understanding of our financial results. Adjusted EBITDA should not be considered as an alternative to net income or to net cash provided by operating activities as a measure of operating results or of liquidity. It may not be comparable to similarly titled measures used by other companies, and it excludes financial information that some may consider important in evaluating our performance. A reconciliation of U.S. GAAP net income from operations to Adjusted EBITDA is as follows:

| Adjusted EBITDA Reconciliation: | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------|------------------|-------------|
| | June 30, 2018 | 2017 | June 30, 2018 | 2017 |
| Net (loss) income | \$(596,393) | \$(79,759) | \$(59,595) | \$82,508 |
| Interest expense | 247,319 | 438,247 | 613,412 | 883,579 |
| Foreign currency exchange loss (gain) | 83,917 | (58,155) | (21,884) | (65,952) |
| Change in estimated fair value of warrant liability | — | 256,909 | — | 323,409 |
| Change in estimated fair value of interest rate swap liability | 77,235 | — | 77,235 | — |
| Loss on extinguishment of debt | 1,347,506 | — | 1,347,506 | — |
| Income tax (benefit) provision | (156,642) | (13,083) | (11,863) | 64,891 |
| Depreciation and amortization | 458,790 | 447,557 | 910,350 | 883,642 |
| Share based compensation expense | 191,112 | 118,551 | 357,590 | 168,388 |
| Interest income | (188) | — | (631) | — |
| Adjusted EBITDA | \$1,652,656 | \$1,110,267 | \$3,212,120 | \$2,340,465 |

Liquidity and capital resources. We expect that we will be able meet our operating, investing and financing needs for liquidity through cash on hand and anticipated positive cash flows from operations. In addition, as part of the refinancing transactions completed in April 2018, we have access to a revolving line of credit (borrowings on which may be restricted under certain circumstances). See Note 10 to our condensed financial statements included in Item 1

of this report. However, our expectations may not be realized, and the issuance of additional debt or equity financing may be required. There can be no assurance that we will be successful in raising additional funding, if necessary; and even if we are successful, it may not be on advantageous terms to us. If we are not able to secure additional funding, the implementation of our business plan could be impaired. Several unforeseen circumstances may affect our belief that our cash on hand and cash flows from operations will be adequate for our needs. For example, we may incur higher capital expenditures than anticipated to expand our operations. We may from time to time acquire products and businesses complementary to our business. We may also incur higher-than-expected expenses when applying for new licenses or in complying with current jurisdictional requirements.

As of June 30, 2018, we had total current assets of \$7,455,449 and total assets of \$19,062,777. This compares to \$6,770,189 and \$19,114,163, respectively, as of December 31, 2017. The decrease in current assets as of June 30, 2018 was primarily due to a decrease in goodwill and other intangible assets, net as a result of amortization recorded during the normal course of business. Our total current liabilities as of June 30, 2018 were \$3,887,207 and \$4,869,335 as of December 31, 2017. This decrease was primarily driven by a decrease in accounts payable (mainly due to a January 2018 payment of \$774,645 for license fees previously accrued at December 31, 2017) and income taxes payable (principally due to tax payments made during the six months ended June 30, 2018).

Our business model continues to be profitable and we have several options to ensure we are able to meet our short-term and long-term obligations.

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

At June 30, 2018, we do not have any available third-party lines or letters of credit or any written or oral commitments from officers or shareholders to provide us with loans or advances to support our operations or fund potential acquisitions. In April 2018, we completed a refinancing transaction which provided us with a \$1.0 million line of credit (borrowings on which may be restricted under certain circumstances). See Note 10 to our condensed financial statements included in Item 1 of this report.

Our operating activities provided \$762,372 in cash for the three months ended June 30, 2018, compared to \$1,278,069 for the three months ended June 30, 2017. The decrease in operating cash flow was primarily due to a January 2018 payment of \$774,645 for license fees previously accrued at December 31, 2017.

Additionally, investing activities used cash of \$60,586 for the three months ended June 30, 2018, which was due to the acquisition of property and equipment. Cash used in financing activities during the three months ended June 30, 2018 was \$607,016, which was primarily due to refinancing activities occurred on April 24, 2018 and principal payments towards long-term debt and capital leases.

Critical accounting policies. The discussion of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with U.S. GAAP. Critical accounting policies are those policies that, in management's view, are most important in the portrayal of our financial condition and results of operations. See Note 3 of our financial statements included in Item 8. "Financial Statements and Supplementary Data" of our 2017 10-K for further detail on these critical accounting policies.

Off balance sheet arrangements. As of June 30, 2018, there were no off balance sheet arrangements.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018 our disclosure controls and procedures were effective.

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

Limitations on the effectiveness of internal controls

Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material error. Our disclosure controls and procedures are designed to provide reasonable assurance

of achieving our objectives and our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at that reasonable assurance level. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting our business, we are, from time to time, involved in various legal proceedings, administrative proceedings, regulatory government investigations and other matters, including those in which we are a plaintiff, that are complex in nature and have outcomes that are difficult to predict. In accordance with topic ASC Topic 450, Contingencies, we record accruals for such contingencies to the extent that we conclude that it is probable that a liability will be incurred and the amount of the related loss can be reasonably estimated. Our assessment of each matter may change based on future unexpected events. An unexpected adverse judgment in any pending litigation could cause a material impact on our business operations, intellectual property, results of operations or financial position. Unless otherwise expressly stated, we believe costs associated with litigation will not have a material impact on our financial position or liquidity, but may be material to the results of operations in any given period. We assume no obligation to update the status of pending litigation, except as may be required by GAAP, applicable law, statute or regulation. For a complete description of the facts and circumstances surrounding material litigation to which we are a party, See Note 11 in Item 8. “Financial Statements and Supplementary Data” included in our 2017 10-K. There are no material updates to matters previously reported on our 2017 10-K.

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

On June 30, 2018, we issued 13,000 shares of our restricted common stock valued at \$15,600 to each of Messrs. Norm DesRosiers, Bryan Waters and William Zender, who are members of our Board, in consideration of their service on the Board during the three months ended June 30, 2018. In each of the transactions listed above, the securities were issued pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, (the “Securities Act”) and rules and regulations promulgated thereunder.

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

ITEM 6. EXHIBITS

| Exhibit Number | Description | FormFile No. | Exhibit Filing Date | Filed Herewith |
|----------------|--|---------------|---------------------|----------------|
| 10.1 | <u>Credit Agreement with ZB, N.A. dba Nevada State Bank, dated April 24, 2018</u> | 8-K 000-30653 | 10.1 April 27, 2018 | |
| 31.1 | <u>Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | X |
| 31.2 | <u>Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | X |
| 32.1 | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as</u> | | | X |

adopted pursuant to Section 906 of the Sarbanes-Oxley
Act of 2002

101 Financials in XBRL format X

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SIGNATURES

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

Galaxy Gaming, Inc.

Date: August 14, 2018

By: /s/ TODD P. CRAVENS

Todd P. Cravens

President and Chief Executive Officer (Principal Executive Officer)

Galaxy Gaming, Inc.

Date: August 14, 2018

By: /s/ HARRY C. HAGERTY

Harry C. Hagerty

Chief Financial Officer (Principal Accounting Officer)