

MAJESCO ENTERTAINMENT CO

Form 10-Q

September 14, 2011

Table of Contents

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

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

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

Indicate by check mark whether the registrant 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 No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

As of September 9, 2011, there were 41,295,721 shares of the Registrant's common stock outstanding.

**MAJESCO ENTERTAINMENT COMPANY AND SUBSIDIARY
INDEX**

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements:</u>	3
<u>Condensed Consolidated Balance Sheets as of July 31, 2011 (unaudited) and October 31, 2010</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended July 31, 2011 and 2010 (unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended July 31, 2011 and 2010 (unaudited)</u>	5
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	21
<u>Item 4. Controls and Procedures</u>	21
<u>PART II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 3. Defaults Upon Senior Securities</u>	23
<u>Item 4. (Removed and Reserved)</u>	24
<u>Item 5. Other Information</u>	24
<u>Item 6. Exhibits</u>	24
<u>SIGNATURES</u>	25
<u>EX-10.1</u>	
<u>EX-10.2</u>	
<u>EX-10.3</u>	
<u>EX-10.4</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	July 31, 2011 (unaudited)	October 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,674	\$ 8,004
Due from factor	1,409	1,015
Accounts and other receivables, net	2,788	725
Inventory, net	4,607	8,418
Advance payments for inventory	566	5,454
Capitalized software development costs and license fees	9,417	4,903
Prepaid expenses and other current assets	896	921
Total current assets	39,357	29,440
Property and equipment, net	1,289	520
Other assets	232	69
Total assets	\$ 40,878	\$ 30,029
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 12,351	\$ 11,375
Inventory financing payables		5,557
Advances from customers and deferred revenue	622	945
Total current liabilities	12,973	17,877
Warrant liability	1,187	144
Commitments and contingencies		
Stockholders' equity:		
Common stock \$.001 par value; 250,000,000 shares authorized; 40,952,586 and 39,326,376 shares issued and outstanding at July 31, 2011 and October 31, 2010, respectively	41	39
Additional paid-in capital	118,811	114,824
Accumulated deficit	(91,607)	(102,333)
Accumulated other comprehensive loss	(527)	(522)
Net stockholders' equity	26,718	12,008
Total liabilities and stockholders' equity	\$ 40,878	\$ 30,029

See accompanying notes

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	July 31		July 31	
	2011	2010	2011	2010
Net revenues	\$ 19,545	\$ 12,153	\$ 100,154	\$ 52,265
Cost of sales				
Product costs	8,577	7,398	42,681	24,573
Software development costs and license fees	3,015	1,975	16,237	12,074
Loss on impairment of software development costs and license fees-future releases				1,021
	11,592	9,373	58,918	37,668
Gross profit	7,953	2,780	41,236	14,597
Operating costs and expenses				
Product research and development	1,947	720	5,150	2,361
Selling and marketing	2,313	1,641	11,952	6,225
General and administrative	2,484	2,004	8,089	6,394
Loss on impairment of software development costs and license fees cancelled games	150	116	1,512	276
Depreciation and amortization	121	43	223	140
	7,015	4,524	26,926	15,396
Operating income (loss)	938	(1,744)	14,310	(799)
Other expenses (income)				
Interest and financing costs, net	123	82	1,077	703
Change in fair value of warrant liability	(1,258)	(183)	2,085	(412)
Income (loss) before income taxes	2,073	(1,643)	11,148	(1,090)
Income taxes	184		421	(1,647)
Net income (loss)	\$ 1,889	\$ (1,643)	\$ 10,727	\$ 557
Net income (loss) per share:				
Basic	\$ 0.05	\$ (0.04)	\$ 0.28	\$ 0.02
Diluted	\$ 0.05	\$ (0.04)	\$ 0.27	\$ 0.01
Weighted average shares outstanding:				
Basic	38,803,090	36,934,987	38,165,521	36,838,981
Diluted	41,318,806	36,934,987	39,827,022	37,142,649

See accompanying notes

4

Table of Contents

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

	Nine Months Ended	
	July 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 10,727	\$ 557
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	223	140
Change in fair value of warrant liability	2,085	(412)
Non-cash compensation expense	1,064	1,324
Loss on disposal of assets		19
Provision for price protection and customer allowances	2,380	3,073
Amortization of software development costs and license fees	3,467	3,629
Loss on impairment of software development costs and license fees	1,512	1,297
Inventory write-downs	1,612	
Changes in operating assets and liabilities, net of acquisition:		
Due from factor	(2,786)	(940)
Accounts and other receivables	(1,987)	475
Inventory	2,199	2,672
Capitalized software development costs and license fees	(9,420)	(6,705)
Advance payments for inventory	4,888	
Prepaid expenses and other assets	261	2,270
Accounts payable and accrued expenses	753	(2,115)
Advances from customers and other liabilities	(376)	(676)
Net cash provided by operating activities	16,602	4,608
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(396)	(192)
Purchase of assets of Quick Hit, Inc., net of acquired cash	(800)	
Net cash used in investing activities	(1,196)	(192)
CASH FLOWS FROM FINANCING ACTIVITIES		
Inventory financing	(5,557)	(5,684)
Proceeds from exercise of options and warrants	1,824	
Net cash used in financing activities	(3,733)	(5,684)
Effect of exchange rates on cash and cash equivalents	(3)	(22)
Net increase (decrease) in cash and cash equivalents	11,670	(1,290)
Cash and cash equivalents beginning of period	8,004	11,839
Cash and cash equivalents end of period	\$ 19,674	\$ 10,549

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

Landlord-provided leasehold improvements	\$ 163	\$
Warrant liability reclassified to additional paid-in capital upon exercise	1,042	

SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest	\$ 1,078	\$ 710
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See accompanying notes

5

Table of Contents

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, 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 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 July 31,				Nine Months Ended July 31,			
	2011	%	2010	%	2011	%	2010	%
United States	\$ 14,214	72.7%	\$ 12,122	99.7%	\$ 91,425	91.3%	\$ 50,488	96.6%
Europe	5,331	27.3%	31	0.3%	8,729	8.7%	1,777	3.4%
Total	\$ 19,545	100.0%	\$ 12,153	100.0%	\$ 100,154	100.0%	\$ 52,265	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

Table of Contents

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).

We operate hosted online games in which players can play for free and purchase virtual goods for use in the games. We recognize revenues from the sale of virtual goods as service revenues over the estimated period in which players use the goods in the game. We currently estimate these periods of use to be three to four months. We will periodically assess our estimates for this period of use and future increases or decreases in these estimates will affect our recognized revenues prospectively. We also recognize advertising revenue related to advertising placed on our game sites as ads are served.

The Company records revenue for distribution agreements where it is acting as an agent as defined by ASC Topic 605, *Revenue Recognition, Subtopic 45, Principal Agent Considerations*, on a net basis. 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. Royalty revenue from sales by our distribution partner in Europe amounted to \$2,521 in the three months ended July 31, 2011, or approximately 13% of total revenue. Royalty revenue amounted to less than 10% of total revenue in other periods presented.

Inventory. Inventory, which consists primarily of finished goods, is stated at the lower of cost as determined by the first-in, first-out method, or market. The Company estimates the net realizable value of slow-moving inventory on a title-by-title basis and charges the excess of cost over net realizable value to cost of sales. In the three and nine months ended July 31, 2011, such charges to cost of sales amounted to \$743 and \$1,612, respectively, based on current estimates of net realizable value. Such estimates may change and additional charges may be incurred until the related inventory items are sold.

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

Table of Contents

the period such a determination is made. These expenses may be incurred prior to a game's release for games that have been developed. If a game is cancelled prior to completion of development 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.

Costs of developing online free-to-play social games, including payments to third-party developers are expensed as research and development expenses. Revenue from these games is largely dependent on players' future purchasing behavior in the game and currently the Company cannot reliably project that future net cash flows from developed games will exceed related development costs.

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 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 (Loss) Per Share. Basic income (loss) per share of common stock is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Basic income (loss) 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 under the treasury stock method.

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.

Concentrations. The Company develops and distributes video game software for proprietary platforms under licenses from Nintendo, Sony and Microsoft, which must be periodically renewed. The Company's agreements with these manufacturers also grant them certain control over the supply and manufacturing of the Company's products. In addition, in the three and nine months ended July 31, 2011, sales of the Company's Zumba Fitness game accounted for approximately 80% and 70% of revenues, respectively. We license the rights to publish these games from a third party and have rights to publish other Zumba Fitness games. If the new versions are not successful, this may have a significant impact on our future revenues. In addition, if these arrangements are disrupted, the Company's operations could be adversely affected. In the nine months ended July 31, 2010, the Company's Cooking Mama games accounted for 50% of revenues.

Recent Accounting Pronouncements

Fair Value In May 2011, the FASB issued an update to ASC 820-10, *Measuring Liabilities at Fair Values*. The update to ASC 820-10 clarifies the application of fair value standards in certain circumstances and requires additional disclosures about fair value measurements within Level 3, including sensitivity to changes in unobservable inputs. The update will become effective for the Company on November 1, 2012. The Company is currently evaluating the potential impact of the update on its financial position, results of operations, and cash flows.

Comprehensive Income In June 2011, the FASB issued an update to ASC 220, *Comprehensive Incomes*. The update to ASC 220 establishes standards for the reporting and presentation of comprehensive income. The update will become effective for the Company on November 1, 2012. The Company is currently evaluating the potential impact of the update on its financial position, results of operations, and cash flows.

Table of Contents**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.

	July 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	\$ 19,046	\$ 19,046	\$	\$
Bank deposits	\$ 628	\$ 628	\$	\$
Total financial assets	\$ 19,674	\$ 19,674	\$	\$
Liabilities:				
Warrant liability	\$ 1,187	\$	\$	\$ 1,187
Total financial liabilities	\$ 1,187	\$	\$	\$ 1,187

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 July 31, 2011	Three Months ended July 31, 2010	Nine Months ended July 31, 2011	Nine Months ended July 31, 2010
Estimated fair value of stock	\$ 2.45-\$3.75	\$ 0.68-\$0.86	\$ 0.62-\$3.75	\$ 0.68-\$1.02
Expected warrant term	1.6-1.9 years	2.6-2.9 years	1.6-2.4 years	2.6-3.4 years
Risk-free rate	0.3-0.6%	0.7-1.4%	0.3-0.8%	0.7%-1.6%
Expected volatility	77.9-77.9%	74.3-75.9%	73.5-77.9%	74.3-76.1%
Dividend yield	0%	0%	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 and nine months ended July 31, 2011 and 2010 is presented below:

	Three Months Ended July 31, 2011	Three Months Ended July 31, 2010	Nine Months Ended July 31, 2011	Nine Months Ended July 31, 2010
Beginning balance	\$ 2,551	\$ 397	\$ 144	\$ 626
Warrants exercised	(106)		(1,042)	

Total loss (gain) included in net income	(1,258)	(183)	2,085	(412)
Ending balance	\$ 1,187	\$ 214	\$ 1,187	\$ 214

In the three and nine months ended July 31, 2011, upon exercise of 60,706 and 598,440, respectively, of the warrants outstanding, the warrant liability associated with those warrants, amounting to \$106 and \$1,042 respectively, was reclassified to additional paid-in capital.

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

4. INCOME TAXES

The federal and state income tax provisions recorded by the Company for the three and nine months ended July 31, 2011 reflect the use of available net operating loss carryforwards to offset taxable income. NOL carryforwards available for income tax purposes at July 31, 2011 amount to approximately \$71 million for federal income taxes and approximately \$24 million for certain state income taxes. Due to the Company's history of losses, a valuation allowance sufficient to fully offset NOLs and other deferred tax assets has been established under current accounting pronouncements and this valuation allowance will be maintained until sufficient positive evidence exists to support its reversal.

For the nine months ended July 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.

Table of Contents**5. DUE FROM FACTOR**

Due from factor consists of the following:

	July 31, 2011	October 31, 2010
Outstanding accounts receivable sold to factor	\$ 8,704	\$ 13,754
Less: allowances	(4,455)	(3,298)
Less: advances from factor	(2,840)	(9,441)
	\$ 1,409	\$ 1,015

Outstanding accounts receivable sold to the factor as of July 31, 2011 and October 31, 2010 for which the Company retained credit risk amounted to \$0.6 million and \$1.4 million, respectively. As of July 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:

	Nine Months Ended July 31,	
	2011	2010
Allowances beginning of period	\$ (3,298)	\$ (4,380)
Provision for price protection	(2,392)	(3,073)
Amounts charged against allowance and other changes	1,235	4,506
Allowances end of period	\$ (4,455)	\$ (2,947)

6. ACCOUNTS AND OTHER RECEIVABLES

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

	July 31, 2011	October 31, 2010
Royalties receivable	\$ 2,391	\$
Trade accounts receivable	359	726
Allowances		(25)
Other	38	24
	\$ 2,788	\$ 725

7. INVENTORIES

Inventories consist of the following:

	July 31, 2011	October 31, 2010
Finished goods	\$ 3,798	\$ 6,711
Packaging and components	809	1,707
	\$ 4,607	\$ 8,418

8. PREPAID EXPENSES

Prepaid expenses consist of the following:

	July 31, 2011	October 31, 2010
Prepaid advertising	\$ 595	\$ 746
Other	301	175
	\$ 896	\$ 921

Table of Contents**9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued expenses consist of the following:

	July 31, 2011	October 31, 2010
Accounts payable – trade	\$ 3,394	\$ 4,856
Royalties and software development	5,149	5,517
Salaries, accrued bonuses and other compensation	2,477	592
Other accruals	1,331	410
	\$ 12,351	\$ 11,375

10. STOCK BASED COMPENSATION ARRANGEMENTS

The Company issued 284,766 and 614,250 shares of restricted stock during the three and nine months ended July 31, 2011, respectively, and cancelled no shares in either period. The Company issued 163,949 and 279,131 shares of restricted stock during the three and nine months ended July 31, 2010, respectively, and cancelled 199,736 and 221,720 shares during the same respective periods. The Company values shares of restricted stock at fair value as of the grant date.

The Company issued options to purchase 0 and 100,000 shares of common stock during the three and nine months ended July 31, 2011, respectively, and cancelled no options in the periods. The issued options have an exercise price of \$1.64 per share, equal to the market value of a share of the Company's stock on the grant date, and expire in 2018. The options have a total grant-date fair value of \$95, based on the Black-Scholes model and estimated share-price volatility of 75.2%, estimated life of 4.3 years and a risk-free rate of 1.8%. The Company did not issue or cancel any options to purchase shares of common stock during the three and nine months ended July 31, 2010. The Company values options at fair value as of the grant date.

11. INCOME (LOSS) PER SHARE

The table below provides a reconciliation of basic and diluted average shares outstanding used in computing income (loss) per share, after applying the treasury stock method.

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
Basic weighted average shares outstanding	38,803,090	36,934,987	38,165,521	36,838,981
Common stock options	557,178		368,012	303,668
Non-vested portion of restricted stock grants	1,432,762		958,477	
Warrants	525,776		335,012	
Diluted weighted average shares outstanding	41,318,806	36,934,987	39,827,022	37,142,649

Options and warrants to acquire 386,970 and 545,732 shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended July 31, 2011, respectively, as the effect of their inclusion would be anti-dilutive. Options and warrants to acquire 3,725,399 and 3,725,399 shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended July 31, 2010, respectively, as the effect of their inclusion would be anti-dilutive.

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

July 31, 2011	July 31, 2010
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Shares issuable under common stock warrants	1,296,501	2,241,470
Shares issuable under stock options	1,306,081	1,483,929
Non-vested portion of restricted stock grants	2,097,469	1,673,327
	4,700,051	5,398,726

Table of Contents**12. COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive income (loss) for the three- and nine-month periods ended July 31, 2011 and 2010, are summarized as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
Net income (loss)	\$ 1,889	\$ (1,643)	\$ 10,727	\$ 557
Other comprehensive income (loss) foreign currency translation adjustments	(3)	(4)	(5)	(83)
Total comprehensive income (loss)	\$ 1,886	\$ (1,647)	\$ 10,722	\$ 474

13. COMMITMENTS AND CONTINGENCIES*Infringement claim*

In July 2011, a claim was made against Microsoft and certain game publishers, including the Company, that have released games for Microsoft's Kinect for Xbox 360, alleging patent infringement and seeking monetary damages and injunctive relief. The Company intends to defend itself against the claim and believes it has third-party indemnity rights that may cover certain costs to the Company. The Company cannot currently estimate a potential range of loss if the claim against the Company is successful.

Workforce reduction

During January 2010, Company management initiated a plan of restructuring to better align its workforce to its revised operating plans. As part of the plan, the Company reduced its personnel count by 16 employees, then representing 17% of its workforce. The Company recorded charges of approximately \$403 in the nine months ended July 31, 2010 in connection with the terminations, which consisted primarily of severance and unused vacation payments. The expenses were included in operating costs and expenses as shown in the table below:

	Nine Months Ended July 31, 2010
Product research and development	\$ 90
Selling and Marketing	243
General and Administrative	70
Total	\$ 403

These payments were made during the Company's fiscal year ended October 31, 2010. At July 31, 2011 and October 31, 2010, the Company had no remaining liability related to the workforce reduction.

14. RELATED PARTIES

The Company currently has an agreement with Morris Sutton, the Company's former Chief Executive Officer and father of the Company's Chief Executive Officer, under which he provides services as a consultant. The agreement provides for a monthly retainer of \$13. Mr. Sutton was also eligible to receive a commission in an amount equal to 2% of net sales to certain accounts before January 1, 2010. Commissions were recorded when the sales occurred, but not paid until collection of the related accounts receivable from customers. Therefore, some of these payments were made to Mr. Sutton in 2010.

The following table summarizes expenses related these agreements with Mr. Sutton:

	Three Months Ended July 31,	Nine Months Ended July 31,
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	2011	2010	2011	2010
Consulting	\$ 38	\$ 38	\$ 113	\$ 113
Commissions and fees				131
Total	\$ 38	\$ 38	\$ 113	\$ 244

MSI Entertainment, a company controlled by Morris Sutton, acted as an agent for the Company in sales to a distributor. The titles, for which the Company had no other planned distribution, were paid for in advance by the distributor. In the nine months ended July 31, 2011, the Company paid MSI a fee of \$78 in connection with the sales.

The Company also has an agreement with a member of its board of directors to provide specified strategic consulting services, in addition to his services as a board member, on a month-to-month basis at a monthly rate of \$10. Under this arrangement, fees earned in the three and nine months ended July 31, 2011 totaled \$30 and \$90, respectively. Fees earned in the three and nine months ended July 31, 2010 totaled \$30 and \$43, respectively.

Table of Contents**15. PURCHASE OF ASSETS**

On June 3, 2011, the Company acquired certain assets and assumed certain liabilities of Quick Hit, Inc. (Quick Hit), a developer and operator of online games. The aggregate purchase price paid was approximately \$837 in cash. The Company also entered into an exclusive license agreement with a senior lender to Quick Hit for the source code to an online interactive football game, with options to extend the license and purchase the game at the end of the license period. If exercised by the Company, extension and option payments of \$125, \$125 and \$60 are due in September 2011, December 2011 and September 2012, respectively.

The acquisition has been accounted for as a purchase business combination pursuant to ASC 805, Business Combinations, and as such the Quick Hit assets acquired and liabilities assumed were recorded at their estimated respective fair values and the excess of the purchase price over the fair value of the identifiable assets acquired and the liabilities assumed was recorded as Goodwill. The Company acquired certain key operating assets as well as the Quick Hit development team to execute on its social games strategy. The Company believes the team can enhance its ability to build, deploy and monetize online games. These factors contributed to a purchase price in excess of the fair value of net tangible and intangible assets acquired. The acquisition was financed with available cash on hand. The Company made significant assumptions and estimates in determining the preliminary allocation of the purchase price, which are subject to change during the measurement period (up to one year from the acquisition date) as the Company finalizes the valuation of certain tangible and intangible assets acquired and liabilities assumed in connection with the acquisition.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the acquisition date:

	Valuation
Intangible assets	\$ 105
Property and equipment	434
Working Capital and other assets	225
Net identifiable assets	764
Goodwill	73
Net assets acquired	\$ 837

In accordance with ASC 805, the following supplemental pro forma consolidated financial information is provided using historical data of Quick Hit, Inc. and of the Company, adjusted for the application of the acquisition method of accounting as if the acquisition had occurred on November 1, 2009 for the three and nine-month periods ended July 31, 2010 and on November 1, 2010 for the three and nine-month periods ended July 31, 2011.

Quick Hit was originally formed in 2008 to develop and operate a series of online, head-to-head sports games (e.g. football, baseball, basketball, hockey and soccer) with aspects of massively multiplayer online role-playing games (MMORPG) and 3D technology. Between 2009 and 2011, Quick Hit revised its business plan to focus resources on adding features to its football game launched in 2009, delayed its schedule of future releases and reduced its workforce from over 30 in 2009 to 12 by June 2011. The Company intends to utilize this workforce to operate its social games strategy and reduce its subcontracted development costs. Accordingly, the supplemental pro forma financial information is not intended to represent or be indicative of the Company's consolidated results of operations that would have been reported had the Quick Hit acquisition been completed as of the dates presented, and should not be taken as a representation of the Company's future consolidated results of operations or financial position. The unaudited pro forma information also does not reflect any operating efficiencies and associated cost savings that the Company may achieve with respect to the combined companies.

Three Months	Three Months Ended	Nine Months Ended	Nine Months Ended
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	Ended July 31, 2011	July 31, 2010	July 31, 2011	July 31, 2010
Net revenues	\$ 19,624	\$ 12,234	\$ 100,883	\$ 52,487
Net income (loss)	\$ 1,634	\$ (3,403)	\$ 7,731	\$ (4,462)
Basic net income (loss) per share	\$ 0.04	\$ (0.09)	\$ 0.20	\$ (0.12)
Diluted net income (loss) per share	\$ 0.04	\$ (0.09)	\$ 0.19	\$ (0.12)

In both the three and nine-month periods ended July 31, 2011, net revenues and net losses related to the former Quick Hit operations amounted to approximately \$77 and \$540, respectively. In connection with the transaction, the Company hired 12 employees of Quick Hit, representing substantially all of its personnel. In addition, the Company issued 170,652 shares of restricted common stock as part of the inducement and retention of employees. The shares of restricted common stock have a transaction-date fair value of \$524, which will be recognized as stock-based compensation expense as the shares vest at the rate of one-third of the shares granted every six months over the 18 month period following June 3, 2011.

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

Statements in this quarterly report on Form 10-Q that are not historical facts constitute forward-looking statements that are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Those factors include, among other things, those listed under "Risk Factors" and elsewhere in our annual report on Form 10-K for the fiscal year ended October 31, 2010 and other filings with the SEC. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continuing, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Moreover, neither we nor any other person assume responsibility for the accuracy or completeness of these statements. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results. References herein to we, us, our, and the Company are to Majesco Entertainment Company.

Overview

We are a provider of video game products primarily for the family-oriented, mass-market consumer. We sell our products primarily to large retail chains, specialty retail stores, and distributors. We publish video games for almost all 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. We also publish games for numerous digital platforms, including mobile platforms such as iPhone, iPad and iPod Touch, as well as online platforms such as Facebook.

Our 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, we focus on publishing more casual games targeting mass-market consumers. In some instances, our titles are based on licenses of well-known properties and, in other cases based on original properties. We collaborate and enter into agreements with content providers and video game development studios for the creation of our video games.

Our operations involve similar products and customers worldwide. These products are developed and sold domestically and internationally. The Company is centrally managed and our 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, we operate in a single segment.

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

Cost of Sales. Cost of sales consists of product costs and amortization and impairment of software development costs and license fees. A significant component of our cost of sales is product costs. Product costs are comprised primarily of manufacturing and packaging costs of the disc or cartridge media, royalties to the platform manufacturer and manufacturing and packaging costs of peripherals and accessories. In cases where we act as a distributor for other publishers' products, cost of sales may increase as we acquire products at a higher fixed wholesale price. While product costs as a percentage of revenue are higher on these products, we do not incur upfront development and licensing fees or resulting amortization of software development costs. Commencing upon the related product's release, capitalized software development and intellectual property license costs are amortized to cost of sales. When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales less on impairment of software development costs and license fees in future releases. These expenses may be incurred prior to a game's release.

Gross Profit. Gross profit is the excess of net revenues over product costs and amortization and impairment of software development and license fees. Development and license fees incurred to produce video games are generally incurred up front and amortized to cost of sales. The recovery of these costs and total gross profit is dependent upon

achieving a certain sales volume, which varies by title.

Product Research and Development Expenses. Product research and development expenses relate principally to costs of third-party video game developers and related supervision, testing new products and conducting quality assurance evaluations during the development cycle not allocated to games for which technological feasibility has been established. Costs incurred are employee-related, may include equipment, and are not allocated to cost of sales. These costs also include the cost to develop and maintain free to play online games which are still considered to be in the planning stage, or for which costs cannot be reasonably expected to be recovered through future revenues.

Table of Contents

Selling and Marketing Expenses. Selling and marketing expenses consist of marketing and promotion expenses, including television advertising, the cost of shipping products to customers and related employee costs. Credits to retailers for trade advertising are a component of these expenses.

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

Loss on Impairment of Software Development Costs and License Fees – Cancelled Games. Loss on impairment of software development costs and license fees – cancelled games consists of contract termination costs, and the write-off of previously capitalized costs, for games that were cancelled prior to their release to market. We periodically review our games in development and compare the remaining cost to complete each game to projected future net cash flows expected to be generated from sales. In cases where we don't expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete the game, we cancel the game, and record a charge to operating expenses. While we incur a current period charge on these cancellations, we believe we are limiting the overall loss on a game project that is no longer expected to perform as originally expected due to changing market conditions or other factors. Significant management estimates are required in making these assessments, including estimates regarding retailer and customer interest, pricing, competitive game performance, and changing market conditions.

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

Income Taxes. Income taxes consists of our provision for income taxes and proceeds from the sale of rights to certain net operating loss carryforwards in the state of New Jersey. Utilization of our net operating loss, or NOL, carryforwards may be subject to a substantial annual limitation due to the change in ownership provisions of the Internal Revenue Code. The annual limitation may result in the expiration of net operating loss carryforwards before utilization. Due to our history of losses, a valuation allowance sufficient to fully offset our NOL and other deferred tax assets has been established under current accounting pronouncements, and this valuation allowance will be maintained until sufficient positive evidence exists to support its reversal.

Seasonality and Variations in Interim Quarterly Results

Our quarterly net revenues, gross profit, and operating income are impacted significantly by the seasonality of the retail selling season, and the timing of the release of new titles. Sales of our catalog and other products are generally higher in the first and fourth quarters of our fiscal year (ending January 31 and October 31, respectively) due to increased retail sales during the holiday season. Sales and gross profit as a percentage of sales also generally increase in quarters in which we release significant new titles because of increased sales volume as retailers make purchases to stock their shelves and meet initial demand for the new release. These quarters also benefit from the higher selling prices that we are able to achieve early in the product's life cycle. Therefore, sales results in any one quarter are not necessarily indicative of expected results for subsequent quarters during the fiscal year.

Critical Accounting Estimates

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

The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from these estimates under different assumptions or conditions.

We have identified the policies below as critical to our business operations and to the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed

throughout management's discussion and analysis of financial condition and results of operations when such policies affect our reported and expected financial results.

Revenue Recognition. We recognize revenue upon the shipment of our product when: (1) title and the risks and rewards of ownership are transferred; (2) persuasive evidence of an arrangement exists; (3) we have no continuing obligations to the customer; and (4) the collection of related accounts receivable is probable. 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 our software products provide limited online features at no additional cost to the consumer. Generally, we have considered such features to be incidental to our overall product offerings and an inconsequential deliverable. Accordingly, we do not defer any revenue

Table of Contents

related to products containing these limited online features. However, in instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, such characteristics will be taken into account when applying our revenue recognition policy. In addition, some of our 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 we enter 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.

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

Our provisions for price protection and other allowances fluctuate over periods as a result of a number of factors including analysis of historical experience, current sell-through of retailer inventory of our products, current trends in the interactive entertainment market, the overall economy, changes in customer demand and acceptance of our products and other related factors. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. However, actual allowances granted could materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions, technological obsolescence due to new platforms, product updates or competing products. For example, the risk of requests for allowances may increase as consoles pass the midpoint of their lifecycle and an increasing number of competitive products heighten pricing and competitive pressures. While management believes it can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, this will result in a change in our reserves, which would impact the net revenues and/or selling and marketing expenses we report. For the nine-month periods ended July 31, 2011 and 2010, we provided allowances for future price protection and other allowances of \$2.4 million and \$3.1 million, respectively. The fluctuations in the provisions reflect fluctuations in gross sales and our estimates of future price protection based on the factors discussed above.

We attempt to limit our exposure to credit risk by factoring a significant portion of our receivables to a third party that primarily buys them without recourse. For receivables that are not sold without recourse, we analyze our aged accounts receivables, payment history and other factors to make a determination if collection of receivables is likely, or a provision for uncollectible accounts is necessary.

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

Prepaid license fees represent license fees to holders for the use of their intellectual property rights in the development of our products. Minimum guaranteed royalty payments for intellectual property licenses are initially recorded as an asset (capitalized 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 commitment 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 we estimate the release date to be more than one year from the balance sheet date.

The amortization period for capitalized software development costs and 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 license fees is evaluated quarterly based on the expected performance of the specific products to which the costs relate.

Table of Contents

When, in management's estimate, future cash flows will not be sufficient to recover previously capitalized costs, we expense these capitalized costs to cost of sales—loss on impairment of software development costs and license fees—future releases, in the period such a determination is made. These expenses may be incurred prior to a game's release for games that have been developed. If a game is cancelled prior to completion of development and never released to market, the amount is expensed to operating costs and expenses—loss on impairment of capitalized software development costs and license fees—cancelled games. As of July 31, 2011, the net carrying value of our licenses and software development costs was \$9.4 million. If we were required to write off licenses or software development costs, due to changes in market conditions or product acceptance, our results of operations could be materially adversely affected.

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

We have expensed as research and development all costs associated with the development of social games. We have acquired an online game in connection with the June 2011 acquisition of selected assets of Quick Hit, Inc. and have developed and launched two additional games available on Facebook, which have not earned significant revenues to date, and are continuing to evaluate alternatives for future development and monetization. We have also added the former development team of Quick Hit, Inc., to enhance our abilities in the development and operation of our social games.

Inventory. Inventory, which consists principally of finished goods, is stated at the lower of cost or market. Cost is determined by the first-in, first-out method. We estimate the net realizable value of slow-moving inventory on a title-by-title basis and charge the excess of cost over net realizable value to cost of sales. Some of our inventory items are packaged with accessories, such as belts for our *Zumba* games and dolls for our *Babysitting Mama* game. The purchase of these accessories involves longer lead times and minimum purchase amounts, which require us to maintain higher levels of inventory than for other games. Therefore, these items have a higher risk of obsolescence, which we review periodically based on inventory and sales levels. As of July 31, 2011, our net inventory balance includes an aggregate of approximately \$1.6 million of accessories and games bundled with accessories.

Accounting for Stock-Based Compensation. Stock-based compensation expense is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including, in the case of stock option awards, estimating expected stock volatility. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

Commitments and Contingencies. We are subject to claims and litigation in the ordinary course of our business. We record a liability for commitments and contingencies when the amount is both probable and reasonably estimable. See Note 13 to our Consolidated Financial Statements.

Results of operations***Three months ended July 31, 2011 versus three months ended July 31, 2010***

Net Revenues. Net revenues for the three months ended July 31, 2011 increased to \$19.5 million from \$12.2 million in the comparable quarter last year. The increase was due to sales of *Zumba Fitness* released in the first quarter of fiscal 2011 on three platforms, the Nintendo Wii, Kinect for the Xbox 360, and Sony's Move for the Playstation. In addition, we recognized revenue from royalties and sales of accessories related to sales of *Zumba Fitness* in Europe by our distribution partner. In total, revenue from *Zumba Fitness* accounted for approximately 80% of total revenue in the period. New releases affecting revenues in the three months ended July 31, 2011 included *Cake Mania 4* and *Spy Kids*. The three months ended July 31, 2010 reflect the release of *Tetris* for the Nintendo Wii and Nintendo DS.

The following table sets forth our net revenues by platform:

Three Months Ended July 31,

Nine months Ended July 31,

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	2011	%	2010	%	2011	%	2010	%
	(thousands)		(thousands)		(thousands)		(thousands)	
Nintendo Wii	\$ 14,036	72%	\$ 4,624	38%	\$ 59,794	60%	\$ 15,275	29%
Microsoft Xbox 360	2,306	12%	218	2%	20,334	20%	395	1%
Nintendo DS	2,249	11%	7,139	59%	14,610	15%	35,396	68%
Sony Playstation 3	637	3%			4,438	4%		
Royalties, accessories and other	317	2%	172	1%	978	1%	1,199	2%
TOTAL	\$ 19,545	100%	\$ 12,153	100%	\$ 100,154	100%	\$ 52,265	100%

Table of Contents

Gross Profit. Gross profit for the three months ended July 31, 2011 was \$8.0 million compared to a gross profit of \$2.8 million in the same quarter last year. The increase in gross profit was primarily attributable to increased net revenues for the three months ended July 31, 2011, as discussed above. Gross profit as a percentage of net sales was 41% for the three months ended July 31, 2011, compared to 23% for the three months ended July 31, 2010. The increase in gross profit as a percentage of sales was primarily due to sales of *Zumba Fitness* in the United States and Europe. We license the rights to publish *Zumba Fitness* in Europe to another video game publisher and receive a royalty based on net revenues of the product. We record these revenues net in accordance with ASC 605-45, *Revenue Recognition* *Principal Agent Considerations*.

Product Research and Development Expenses. Research and development costs increased \$1.2 million to \$1.9 million for the three months ended July 31, 2011, from \$0.7 million for the comparable period in 2010. The increase was primarily due to development costs related to our online games business and increased production headcount. In June 2011, we acquired assets from Quick Hit, Inc., a developer and operator of online games, and added their former development team to enhance our abilities in the development and operation of our social games. In addition, during 2011, we opened a second production facility in San Francisco and increased the number of producers we have managing game development due to an increase in the number and quality of games we are developing.

Selling and Marketing Expenses. Total selling and marketing expenses were approximately \$2.3 million for the three months ended July 31, 2011, compared to \$1.6 million for the three months ended July 31, 2010. The increase was primarily due to increased media advertising, sales commissions and other variable costs associated with increased sales volumes, primarily due to *Zumba Fitness*.

General and Administrative Expenses. For the three-month period ended July 31, 2011, general and administrative expenses increased to approximately \$2.5 million, from \$2.0 million in the three-month period ended June 30, 2010 due primarily to increases in employee compensation and professional services.

Loss on Impairment of Software Development Costs and License Fees *Cancelled Games.* For the three-month period ended July 31, 2011, loss on impairment of software development costs and license fees cancelled games, amounted to \$0.2 million compared to \$0.1 million in the prior-year period. Our games in development are subject to periodic reviews to assess game design and changing market conditions. When we do not expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete a game, we cancel the game, and record a charge to operating expenses for the carrying amount of the game.

Operating Income. Operating income for the three months ended July 31, 2011 was approximately \$0.9 million, compared to a loss of \$1.7 million in the comparable period in 2010. As discussed above, increased revenues and gross profits during the three months ended July 31, 2011 were partially offset by increased development and other operating expenses and losses on impaired games during the period.

Change in Fair Value of Warrant Liability. We have outstanding warrants that contain a provision that may require settlement by transferring assets and are, therefore, recorded at fair value as liabilities. We recorded a gain of \$1.3 million for the three months ended July 31, 2011, which reflected a decrease in the fair value of the warrants primarily based upon the decreased market price of a share of our common stock during the period, compared to a gain of \$0.2 million for the three months ended July 31, 2010. In the nine months ended July 31, 2011, 598,440 of the 1,697,735 previously-outstanding warrants subject to remeasurement were exercised. The remaining outstanding warrants expire in September 2012.

Income Taxes. In the three months ended July 31, 2011, our income tax expense was \$0.2, which represents our current alternative minimum tax provision and certain state income taxes and reflects the use of available net operating loss carryforwards to offset taxable income. In the three months ended July 31, 2010, no provision for income taxes was recorded due to the operating losses in the period.

Net Income. Net income for the three months ended July 31, 2011 was \$1.9 million compared to a \$1.6 million loss for the three months ended July 31, 2010. As discussed above, increased revenues and gross profits and the change in the fair value of our warrant liability more than offset increased operating expenses.

Nine months ended July 31, 2011 versus nine months ended July 31, 2010

Net Revenues. Net revenues for the nine months ended July 31, 2011 increased to \$100.2 million from \$52.3 million in the comparable period last year. During the nine months ended July 31, 2011, we released *Babysitting Mama* for the Nintendo Wii and *Zumba Fitness* on three platforms, the Nintendo Wii, Kinect for the Xbox 360, and Sony's Move for the Playstation3. The strong performance of the *Zumba* titles was primarily responsible for the increased revenues over the prior-year period. Sales of *Zumba Fitness* accounted for approximately 70% of total revenue in the period. Sales from our series of products based on Cooking Mama accounted for approximately 50% of revenue in the nine months ended July 31, 2010.

Table of Contents

Gross Profit. Gross profit for the nine months ended July 31, 2011 was \$41.2 million compared to a gross profit of \$14.6 million in the same period last year. The increase in gross profit was primarily attributable to increased net revenues for the nine months ended July 31, 2011, as discussed above. Gross profit as a percentage of net sales was 41% for the nine months ended July 31, 2011, compared to 28% for the nine months ended July 31, 2010. The increase in gross profit as a percentage of sales was primarily due to sales of *Zumba Fitness* in the United States and Europe. These factors were partially offset by inventory charges in the period related primarily to *Babysitting Mama*. In addition, we recognized \$1.0 million of losses on impairment of software development costs and license fees in the nine months ended July 31, 2010.

Product Research and Development Expenses. Research and development costs increased \$2.8 million to \$5.2 million for the nine months ended July 31, 2011, from \$2.4 million for the comparable period in 2010. The increase was primarily due to costs related to our online games business, increased production headcount, and charges incurred for development of console game prototypes prior to reaching technological feasibility. We incurred approximately \$1.0 million in the current period for third-party development of online games for Facebook. In addition, in June 2011, we acquired assets from Quick Hit, Inc., a developer and operator of online games, and added their former development team to enhance our abilities in the development and operation of our social games. In addition, during 2011, we opened a second production facility in San Francisco and increased the number of producers we have managing game development due to an increase in the number and quality of games we are developing. The effects of these costs were partially offset by the effects of \$0.1 million severance charges recorded in the prior year.

Selling and Marketing Expenses. Total selling and marketing expenses were approximately \$12.0 million for the nine months ended July 31, 2011, compared to \$6.2 million for the nine months ended July 31, 2010. The increase was primarily due to increased media advertising and other marketing costs associated with the launch of *Zumba Fitness* and *Babysitting Mama*, including several television and internet advertising campaigns. Variable costs including commissions, warehousing and freight also increased due to higher volume and, were partially offset by lower costs incurred in Europe following our shift from a publishing and distribution model to a licensing approach, including the effects of severance charges recorded in the prior year.

General and Administrative Expenses. For the nine-month period ended July 31, 2011, general and administrative expenses were \$8.1 million, an increase of \$1.7 million from \$6.4 million in the comparable period in 2010. The increase was primarily due to an increase in profit-based bonus compensation recognized in the current period.

Loss on Impairment of Software Development Costs and License Fees - Cancelled Games. For the nine-month period ended July 31, 2011, loss on impairment of software development costs and license fees - cancelled games, amounted to \$1.5 million compared to \$0.3 million in the prior-year period, reflecting a greater number of projects cancelled. Our games in development are subject to periodic reviews to assess game design and changing market conditions. When we do not expect the projected future net cash flows generated from sales to be sufficient to cover the remaining incremental cash obligation to complete a game, we cancel the game, and record a charge to operating expenses for the carrying amount of the game. Charges for the nine months ended July 31, 2011 included several games in development for the Sony Move platform, which totaled \$0.6 million, and other game projects totaling \$0.9 million.

Operating Income. Operating income for the nine months ended July 31, 2011 was approximately \$14.3 million, an increase of \$15.1 million from a \$0.8 million loss in the comparable period in 2010. As discussed above, increased revenues and gross profits during the nine months ended July 31, 2011 more than offset increased sales, marketing and other operating expenses and impairments during the period.

Change in Fair Value of Warrant Liability. We have outstanding warrants that contain a provision that may require settlement by transferring assets and are, therefore, recorded at fair value as liabilities. We recorded a loss of \$2.1 million for the nine months ended July 31, 2011, which reflected an increase in the fair value of the warrants during the period primarily as a result of the increased market price for a share of our common stock, compared to a gain of \$0.4 million for the nine months ended July 31, 2010, which reflected a decrease in the fair value of warrants during the period.

Income Taxes. For the nine months ended July 31, 2010, we received proceeds of approximately \$1.7 million from the sale of approximately \$21.2 million of New Jersey state income tax net operating loss carryforwards under the

state's Technology Business Tax Certificate Program and recorded the proceeds as an income tax benefit in the period. In the nine months ended July 31, 2011, our income tax expense represents our current alternative minimum tax provision and certain state income taxes and reflects the use of available net operating loss carryforwards to offset taxable income. We did not sell New Jersey loss carryforwards in the period. Any potential future sales of New Jersey loss carryforwards that the Company may pursue will be subject to the provisions of the tax certificate program, including an application and qualification process, and the availability of approved funding.

Net Income. Net income for the nine months ended July 31, 2011 was \$10.7 million compared to \$0.6 million for the nine months ended July 31, 2010. As discussed above, increased revenues and gross profits more than offset increased operating expenses, impairments and the change in the fair market value of our warrant liability.

Table of Contents**Liquidity and Capital Resources**

Our current plan is to fund our operations through product sales. However, our operating results may vary significantly from period to period and we have previously incurred operating losses. We may be required to modify our plan, or seek outside sources of financing, and/or equity sales, if our operating plan and sales targets are not met. There can be no assurance that such funds will be available on acceptable terms, if at all. In the event that we are unable to negotiate alternative financing, or negotiate terms that are acceptable to us, we may be forced to modify our business plan materially, including making reductions in game development and other expenditures. Additionally, we are dependent on our purchase order financing and account receivable factoring agreement to finance our working capital needs, including the purchase of inventory. If the current level of financing was reduced or we fail to meet our operational objectives, it could create a material adverse change in the business.

As of July 31, 2011, our cash and cash equivalents balance was \$19.7 million and funds available to us under our factoring and purchase order financing agreements were \$3.7 million and \$10.0 million, respectively. We expect continued fluctuations in the use and availability of cash due to the seasonality of our business, timing of receivables collections and working capital needs necessary to finance our business.

Factoring and Purchase Order Financing.

To satisfy our liquidity needs, we factor our receivables. Under our factoring agreement, we have the ability to take cash advances against accounts receivable and inventory of up to \$20.0 million, and the availability of up to \$2.0 million in letters of credit. The factor, in its sole discretion, can reduce the availability of financing at any time. We had outstanding advances against accounts receivable of approximately \$2.8 million under our factoring agreement at July 31, 2011. We also utilize financing to provide funding for the manufacture of our products. Under an agreement with a finance company, we have up to \$10.0 million of availability for letters of credit and purchase order financing. In connection with these arrangements, the finance company and the factor have a security interest in substantially all of our assets.

Under the terms of our factoring agreement, we sell our accounts receivable to the factor. The factor, in its sole discretion, determines whether or not it will accept the credit risk associated with a receivable. If the factor does not accept the credit risk on a receivable, we may sell the accounts receivable to the factor while retaining the credit risk. In both cases we surrender all rights and control over the receivable to the factor. However, in cases where we retain the credit risk, the amount can be charged back to us in the case of non-payment by the customer. The factor is required to remit payments to us for the accounts receivable purchased from us, provided the customer does not have a valid dispute related to the invoice. The amount remitted to us by the factor equals the invoiced amount, adjusted for allowances and discounts we have provided to the customer, less factor charges of 0.45 to 0.5% of the invoiced amount.

In addition, we may request that the factor provide us with cash advances based on our accounts receivable and inventory. The factor may either accept or reject our request for advances at its discretion. Generally, the factor allowed us to take advances in an amount equal to 70% of net accounts receivable, plus 60% of our inventory balance, up to a maximum of \$2.5 million of our inventory balance. Occasionally, the factor allows us to take advances in excess of these amounts for short-term working capital needs. These excess amounts are typically repaid within a 30-day period. At July 31, 2011, we had no excess advances outstanding.

Amounts to be paid to us by the factor for any accounts receivable are offset by any amounts previously advanced by the factor. The interest rate is prime plus 1.5%, annually, subject to a 5.5% floor. In certain circumstances, an additional 1.0% annually is charged for advances against inventory.

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

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

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

Commitments under development agreements amounted to \$9.3 million at July 31, 2011, compared to \$3.3 million at July 31, 2010. In addition, certain agreements provide for minimum commitments for marketing support.

Table of Contents

Off-Balance Sheet Arrangements

As of July 31, 2011, we had no off-balance sheet arrangements.

Cash Flows

Cash and cash equivalents were \$19.7 million as of July 31, 2011 compared to \$8.0 million at October 31, 2010 and \$10.5 million at July 31, 2010. Working capital as of July 31, 2011 was \$26.5 million compared to \$11.6 million at October 31, 2010. Changes in cash and working capital balances reflect operating results as well as significant seasonal factors.

Operating Cash Flows. Our principal operating source of cash is sales of our interactive entertainment products. Our principal operating uses of cash are for payments associated with third-party developers of our software, costs incurred to manufacture, sell and market our video games and general and administrative expenses.

For the nine months ended July 31, 2011, we generated approximately \$16.6 million in cash flow from operating activities, compared to \$4.6 million in the same period last year. The increase in cash provided by operating activities was primarily due to increased operating income in the period, which increased \$15.1 million from a \$0.8 million loss in the nine months ended July 31, 2010 to \$14.3 million of operating income in the nine months ended July 31, 2011. Operating income excludes the non-cash effects of the change in our warrant liability and interest and financing costs. Commitments under development agreements amount to \$9.3 million at July 31, 2011, compared to \$3.3 million at July 31, 2010. Accordingly, cash outflows for development may increase in future periods compared to comparable prior periods. In addition, certain agreements provide for minimum commitments for marketing support.

Investing Cash Flows. Cash used in investing activities for the nine months ended July 31, 2011 increased compared to the nine months ended 2010 due to the acquisition of computer hardware, software and other assets from Quick Hit, Inc. in June 2011. Other investing outflows in the periods reflect primarily of purchases of computer equipment.

Financing Cash Flows. Net cash used in financing activities for the nine months ended July 31, 2011 and 2010 primarily consisted of cash used to reduce outstanding borrowings under our purchase order financing agreement for seasonal inventory. In the nine months ended July 31, 2011, we received \$1.8 million of proceeds from the exercise of outstanding units and warrants.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Not Applicable.

Item 4. Controls and Procedures

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

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

While we believe our disclosure controls and procedures and our internal control over financial reporting are adequate, no system of controls can prevent errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur. Controls can also be circumvented by individual acts of some people, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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

Table of Contents

Based on the evaluation of the effectiveness of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective at a reasonable assurance level.

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

On July 1, 2011, a complaint for patent infringement was filed in the United States District Court for the District of Delaware by Impulse Technology Ltd. against Microsoft Corporation and certain other game publisher defendants that have released games for Microsoft's Kinect for Xbox 360, including the Company. The complaint alleges infringement relating to Microsoft's Xbox Kinect hardware, and correspondingly, the Company's Zumba Fitness game for Xbox 360, of Impulse's patents for certain motion tracking technology. Impulse is seeking injunctive relief and monetary damages in an unspecified amount for the alleged infringement. The Company intends, in conjunction with Microsoft and the other defendants, to defend itself against the claim and believes it has third-party indemnity rights that may cover certain costs to the Company. The Company cannot currently estimate a potential range of loss if the claim against the Company is successful.

Item 1A. Risk Factors

A description of the risks associated with our business, financial condition, and results of operations is set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended October 31, 2010. These factors continue to be meaningful for your evaluation of the Company and we urge you to review and consider the risk factors presented in the Form 10-K. There have been no material changes to these risks.

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

Pursuant to previously issued warrants and unit purchase options, we issued shares of our common stock and received gross proceeds on the dates shown below.

Common stock issued pursuant to exercise of warrants at an exercise price of \$2.04 per share:

Date	Common Shares Issued	Gross Proceeds Received
June 14, 2011	50,000	\$ 102,000
June 16, 2011	8,400	\$ 17,136

Common stock issued pursuant to exercise of unit purchase options at an exercise price of \$1.50 per share:

Date	Common Shares Issued	Gross Proceeds Received
May 17, 2011	21,000	\$ 31,500

The issuance of the shares of common stock and warrants issued upon exercise of such previously issued outstanding warrants and unit purchase options were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The resale by

Table of Contents

the holders of the shares issued is covered by a registration statement on Form S-3 declared effective by the Securities and Exchange Commission on December 10, 2007.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

Item 5. Other Information

None.

Item 6. Exhibits

- 10.1# XBOX 360 Publisher License Agreement, effective September 13, 2005, by and between Microsoft Licensing, GP and Majesco Entertainment Company.
- 10.2# Amendment to the XBOX 360 Publisher License Agreement (2008 renewal, etc.), effective September 1, 2009, by and between Microsoft Licensing, GP and Majesco Entertainment Company.
- 10.3# Amendment to the XBOX 360 Publisher License Agreement (Russian Incentive Program, Hits Program Revisions), effective February 4, 2010, by and between Microsoft Licensing, GP and Majesco Entertainment Company.
- 10.4 Second Amendment to the Confidential License Agreement for Nintendo DS (Western Hemisphere), effective May 1, 2005 by and between Nintendo of America, Inc. and Majesco Entertainment Company.
- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- # We have requested confidential treatment of certain provisions contained in this exhibit. The copy filed as an exhibit omits the information subject to the confidentiality request.

Table of Contents

SIGNATURE

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

**MAJESCO ENTERTAINMENT
COMPANY**

/s/ Jesse Sutton
Jesse Sutton
Chief Executive Officer
Date: September 14, 2011

25