

FULL HOUSE RESORTS INC
Form 10QSB
May 22, 2006
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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006.

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File No. 1-32583

FULL HOUSE RESORTS, INC.

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

Delaware
(State or other jurisdiction of
incorporation or organization)

13-3391527
(I.R.S. Employer
Identification No.)

4670 S. Fort Apache Road
Suite 190

Las Vegas, Nevada
(Address of principal executive offices)

89147
(zip code)

(702) 221-7800

(Registrant's telephone number)

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

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

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APPLICABLE ONLY TO CORPORATE ISSUERS

As of March 31, 2006, Registrant had 10,340,380 shares of its \$.0001 par value common stock outstanding.

Transitional Small Business Disclosure Format (check one) Yes No

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Table of Contents**FULL HOUSE RESORTS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	MARCH 31, 2006 (unaudited)	DECEMBER 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,544,368	\$ 3,275,270
Other	340,670	118,810
	2,885,038	3,394,080
Notes receivable, tribal governments	4,745,099	4,268,529
Land held for development	3,988,832	3,858,832
Contract rights, net of accumulated amortization	5,124,274	5,087,752
Deposits and other assets	201,186	199,074
	\$ 16,944,429	\$ 16,938,267
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 125,726	\$ 130,580
Accrued expenses	192,798	369,268
Income tax payable	238,269	321,112
	556,793	820,960
Note payable to co-venturer, including accrued interest	2,664,527	2,619,773
Deferred income tax liability	104,336	124,807
Other long-term liabilities	272,137	272,137
	3,041,000	3,016,717
Non-controlling interest in consolidated joint venture	2,057,283	2,098,628
Stockholders equity:		
Cumulative preferred stock, par value \$.0001, 5,000,000 shares authorized; 700,000 shares issued and outstanding; aggregate liquidation preference of \$4,987,500 and \$4,935,000 including undeclared dividends in arrears of \$2,887,500 and \$2,835,000	70	70
Common stock, par value \$.0001, 25,000,000 shares authorized; 10,340,380 shares issued and outstanding	1,034	1,034
Additional paid-in capital	17,429,889	17,429,889
Deficit	(6,141,640)	(6,429,031)
	11,289,354	11,001,962
	\$ 16,944,429	\$ 16,938,267

See notes to condensed consolidated financial statements.

Table of Contents**FULL HOUSE RESORTS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	THREE MONTHS ENDED MARCH 31,	
	2006	2005
Equity in net income of unconsolidated joint venture	\$ 977,564	\$ 857,337
Operating costs and expenses		
Project development costs	110,422	277,789
General and administrative	595,721	427,716
Depreciation and amortization	18,219	25,770
	724,362	731,275
Unrealized gains on valuation of notes receivable	227,192	5,168
Arbitration award, net		848,393
Income from operations	480,394	979,623
Other income (expense)		
Interest and other income	28,255	10,499
Interest expense	(44,754)	(31,952)
Income before non-controlling interest and income taxes	463,895	958,170
Non-controlling interest in net loss of consolidated joint venture	41,345	
Income before income taxes	505,240	958,289
Income taxes	(217,848)	(344,241)
Net income	287,392	613,929
Less undeclared dividends on cumulative preferred stock	(52,500)	(52,500)
Net income applicable to common shares	\$ 234,892	\$ 561,429
Net income per common share		
Basic and diluted	\$ 0.02	\$ 0.05
Weighted average number of common shares outstanding		
Basic	10,340,380	10,340,380
Diluted	11,040,928	10,915,380

See notes to condensed consolidated financial statements.

Table of Contents**FULL HOUSE RESORTS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	THREE MONTHS ENDED MARCH 31,	
	2006	2005
Net cash used in operating activities	\$ (27,408)	\$ (203,738)
Cash flows from investing activities:		
Advances to tribal governments	(409,139)	(408,697)
Repayments by co-venturer	37,215	
Deposits	(276,304)	
Acquisition of contract rights and other assets	(52,266)	(200,000)
Net cash used in investing activities	(703,494)	(608,697)
Net decrease in cash and cash equivalents	(730,902)	(812,435)
Cash and cash equivalents, beginning of period	3,275,270	2,466,365
Cash and cash equivalents, end of period	\$ 2,544,368	\$ 1,653,930

See notes to condensed consolidated financial statements.

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FULL HOUSE RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The interim condensed consolidated financial statements of Full House Resorts, Inc. (the Company) included herein reflect all adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operations for the interim periods presented. Certain information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America has been omitted pursuant to the interim financial information rules and regulations of the Securities and Exchange Commission.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005, from which the balance sheet information as of December 31, 2005, was derived. Certain minor reclassifications to previously reported balances have been made to conform to the current period presentation. The results of operations for the period ended March 31, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

2. CHANGE IN ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company was required to adopt the Financial Accounting Standards Board's Statement of Financial Accounting Standard (SFAS) No. 123R, *Share-Based Payment* (SFAS 123R), to account for its stock-based compensation beginning January 1, 2006, and elected the modified prospective method of transition. However, the adoption of SFAS 123R did not have any effect on the Company's results of operations for the current quarter.

3. INVESTMENT IN UNCONSOLIDATED JOINT VENTURE

The investment in unconsolidated joint venture on the balance sheet is comprised of the Company's 50% ownership interest in Gaming Entertainment (Delaware), LLC (GED), a joint venture between the Company and Harrington Raceway Inc., carried on the equity method of accounting.

Summary information for GED's operations for the three months ended March 31, is as follows:

	2006	2005
Management fee revenues	\$ 2,079,940	\$ 1,903,917
Net income	1,955,128	1,781,938

Table of Contents**4. NOTES RECEIVABLE, TRIBAL GOVERNMENTS**

Full House has advanced funds directly to tribes to fund tribal operations and for development expenses related to potential projects. The repayment of these notes is contingent upon the development of the projects, and ultimately, the successful operation of the facilities. The Company's agreements with the tribes provide for the reimbursement of these advances plus applicable interest either from the proceeds of any outside financing of the development, the actual operation itself or in the event that the Company does not complete the development, from the revenues of the tribal gaming operation following completion of development activities undertaken by others.

As of March 31, 2006 and December 31, 2005, Full House has notes receivable from various tribal governments valued respectively, as follows:

	March 31, 2006	December 31, 2005
Estimated fair value of notes receivable:		
Michigan tribe	\$ 4,386,605	\$ 4,038,427
Other	358,494	230,102
	\$ 4,745,099	\$ 4,268,529
Contractual (face) value of notes		
Michigan tribe	\$ 8,484,477	\$ 8,243,344
Other	502,642	334,635
	\$ 8,987,119	\$ 8,577,979

Certain portions of the advances to or on behalf of the tribal governments are in dispute, which has been considered in management's fair value estimates.

5. CONTINGENCY

Litigation involving environmental issues in Michigan has been filed to prevent the Secretary of the Interior from taking the site for the Michigan project into trust, which in the event of an unfavorable outcome, might prevent or delay the completion of the Michigan project and realization of a portion of the Company's investment therein. The legal challenge is pending in federal district court in Washington, D.C. As a result, a draft environmental impact statement (EIS) has been prepared. The Company anticipates the issuance of a formal acceptance of the EIS in the second quarter of 2006. Prior to the land being taken into trust by the Bureau of Indian Affairs for this project, the court must approve the EIS as well.

6. SUBSEQUENT EVENT

On April 6, 2006, the Company signed an agreement under which it will acquire for \$25.5 million (subject to upward adjustment if the operation exceeds certain financial targets during the 12 months prior to closing) all of the outstanding shares of Stockman's Casino, Inc., which owns and operates Stockman's Casino and Holiday Inn Express in Fallon, Nevada. The closing of the transaction is expected to occur later this year and is also subject to the receipt of all regulatory approvals and availability of adequate acquisition financing, which may include debt, equity or a combination thereof.

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Item 2. Management's Discussion and Analysis or Plan of Operation.

Overview

Full House Resorts, Inc., a Delaware corporation, develops, manages and/or invests in gaming related opportunities. We continue to actively investigate, on our own and with partners, new business opportunities including commercial and tribal gaming operations. We seek to expand through acquiring, managing, or developing casinos in profitable markets. Currently, we are a 50% investor in Gaming Entertainment (Delaware), LLC, a joint venture with Harrington Raceway, Inc., which manages Midway Slots and Simulcast at the Delaware State Fairgrounds in Harrington, Delaware. Midway Slots has 1,581 gaming devices, a 450-seat buffet, a 50-seat diner, a gourmet steak house and an entertainment lounge area.

We also have a management agreement with the Nottawaseppi Huron Band of Potawatomi Indians, referred to herein as the Michigan tribe, for the development and management of a casino resort in the Battle Creek, Michigan area, which is currently in the pre-development stage. The planned casino resort is expected to have more than 2,000 gaming devices.

In addition, we have entered into development and gaming management agreements with the Nambé Pueblo tribe of New Mexico for the development of a coordinated entertainment venue centered on a 50,000 square foot casino to be built approximately 15 miles north of Santa Fe, New Mexico. We also have development and management agreements with the Northern Cheyenne Tribe of Montana for the development and management of a 25,000 square foot gaming facility to be built approximately 28 miles north of Sheridan, Wyoming. The management agreements are subject to approval by the National Indian Gaming Commission.

In April 2006, we entered into a stock purchase agreement to acquire all of the outstanding shares of Stockman's Casino, Inc. We expect the closing of the transaction to occur later this year, subject to the receipt of all regulatory approvals and conditioned upon financing. Stockman's Casino, Inc. owns and operates Stockman's Casino and Holiday Inn Express in Fallon, Nevada, located about one hour east of Reno. Stockman's Casino is completing a renovation, which will result in almost 8,400 square feet of gaming space with approximately 280 gaming machines, 4 table games and a keno game. The casino has a bar, a fine dining restaurant and a coffee shop. The Holiday Inn Express has 98 guest rooms, indoor and outdoor swimming pools, a sauna, fitness club, meeting room and business center.

Critical Accounting Estimates and Policies

Although our financial statements necessarily make use of certain accounting estimates by management, we believe that, except as discussed below, no matters that are the subject of such estimates are so highly uncertain or susceptible to change as to present a significant risk of a material impact on our financial condition or operating performance.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the fair value and recoverability of our investments in development projects, including unconsolidated and consolidated joint ventures, advances to tribal governments and intangible contract rights. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic

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conditions and the legal and regulatory environment. We regularly evaluate these estimates and assumptions, particularly in areas, if any, that we consider critical accounting estimates, where changes in such estimates and assumptions could have a material impact on our results of operations, financial position and, generally to a lesser extent, cash flows. Where recoverability of these assets is contingent upon the successful development and management of the projects, we evaluate the likelihood that the projects will be completed and then evaluate the prospective market dynamics and how the proposed facilities should compete in order to forecast future cash flows necessary to recover the recorded value of the assets. In most cases, we engage independent experts to prepare market and/or feasibility studies to assist in the preparation of forecasted cash flows. Our conclusions are reviewed as warranted by changing conditions.

Long-term assets related to Indian casino projects

We account for the estimated fair value of advances made to tribes as in-substance structured notes in accordance with the guidance contained in Emerging Issues Task Force (EITF) Issue No. 96-12, *Recognition of Interest Income and Balance Sheet Classification of Structured Notes*.

We evaluate the financial opportunity of each potential service arrangement before entering into an agreement to provide financial support for the development of an Indian casino project. This process includes determining the financial feasibility of the project assuming the project is built, assessing the likelihood that the project will receive the necessary regulatory approvals and funding for construction and operations to commence, and estimating the expected timing of the various elements of the project including commencement of operations. When we enter into a service or lending arrangement, management has concluded that the probable future economic benefit is sufficient to compensate us for our efforts in relation to the perceived financial risks. No asset, including notes receivable or contract rights, related to an Indian casino project is recorded on our books unless it is considered probable that the project will be built and result in an economic benefit sufficient for us to recover the asset.

In initially determining the financial feasibility of the project, we analyze the proposed facilities and their location in relation to market conditions, including customer demographics and existing and proposed competition for the project. Typically, independent consultants are also hired to prepare market and financial feasibility reports. These reports are reviewed by management and updated periodically as conditions change.

We also consider the status of the regulatory approval process including whether:

the Bureau of Indian Affairs recognizes the tribe,

the tribe has the right to acquire land to be used as a casino site,

the Department of the Interior has put the land into trust as a casino site,

the tribe has a gaming compact with the state government,

the National Indian Gaming Commission has approved a proposed management agreement, and

other legal or political obstacles exist or are likely to occur.

The development phase of each relationship commences with the signing of the respective agreements and continues until the casinos open for business. Thereafter, the management phase of the relationship, governed by the management contract, continues for a period of up to seven years. We make advances to the tribes, recorded as notes receivable, primarily to fund certain portions of the projects, which may bear no interest or are at below market interest until operations commence. Repayment of the

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notes receivable and accrued interest is only required if the casino is successfully opened and distributable profits are available from the casino operations. Under the management contract, we typically earn a management fee calculated as a percentage of the net operating income of the gaming facility. In addition, repayment of the loans and the manager's fees are subordinated to certain other financial obligations of the respective operations. Generally, the order of priority of payments from the casinos' cash flows is as follows:

a certain minimum monthly priority payment to the tribe,

repayment of various senior debt associated with construction and equipping of the casino with interest accrued thereon,

repayment of various debt with interest accrued thereon due to us,

management fee to us,

other obligations, and

the remaining funds distributed to the tribe.

Notes receivable. We account for our notes receivable from and management contracts with the tribes as separate assets. Under the contractual terms, the notes do not become due and payable unless and until the projects are completed and operational. However, if our development activity is terminated prior to completion, we generally retain the right to collect in the event of completion by another developer. Because the stated rate of the notes receivable alone is not commensurate with the risk inherent in these projects (at least prior to commencement of operations), the estimated fair value of the notes receivable is generally less than the amount advanced. At the date of each advance, the difference between the estimated fair value of the note receivable and the actual amount advanced is recorded as either an intangible asset, contract rights, or expensed as period costs of retaining such rights if the rights were acquired in a separate unbundled transaction.

Subsequent to its effective initial recording at estimated fair value, the note receivable portion of the advance is adjusted to its current estimated fair value at each balance sheet date using typical market discount rates for prospective Indian casino operations, as affected by project-specific circumstances such as estimated probabilities affecting the expected opening date and changes in the status of regulatory approvals which include the six factors regarding the status of the regulatory approval process described above. The notes receivable are not adjusted to an estimated fair value that exceeds the face value of the note plus accrued interest, if any. Due to the uncertainties surrounding the projects, no interest income is recognized during the development period. However, changes in the estimated fair value of the notes receivable are recorded as unrealized gains or losses in our statement of operations.

Upon opening of the casino, the difference, if any, between the then recorded estimated fair value of the notes receivable, subject to any appropriate impairment adjustments pursuant to Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, and the amount contractually due under the notes would be amortized into income using the effective interest method over the remaining term of the note.

Contract rights. Intangible assets related to the acquisition of the management contracts are periodically evaluated for impairment based on the estimated cash flows from the management contract on an undiscounted basis and amortized using the straight-line method over the lesser of seven years or contractual lives of the agreements, typically beginning upon commencement of casino operations. In the event the carrying value of the intangible assets were to exceed the undiscounted cash flow, the difference between the estimated fair value and carrying value of the assets would be charged to operations.

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Summary of long-term assets related to Indian casino projects. Long-term assets associated with Indian casino projects at March 31, 2006 and December 31, 2005 totaled \$13,858,205 and \$13,345,113, respectively, consisting of notes receivable, contract rights, net of accumulated amortization, and land held for future development. Of such amounts \$12,983,383 and \$12,915,011 relate to the Michigan project, for which we have a management agreement with the Michigan tribe for the development and operation of a casino resort near Battle Creek, Michigan. To recap the current status of the Michigan project:

the Michigan tribe is federally recognized,

adequate land for the proposed casino resort has not been placed in trust pending the outcome of the environmental impact statement,

the Michigan tribe has a valid gaming compact with the State of Michigan,

the National Indian Gaming Commission has not yet approved the management contract, and

the Bureau of Indian Affairs is expected to issue a final environmental impact statement during the first half of 2006. At March 31, 2006, the sensitivity of changes in the key assumptions (discussed in greater detail below) related to the Michigan project are illustrated by the following increases (decreases) in the estimated fair value of the note receivable:

Discount rate increases to 25%	\$ (237,062)
Discount rate decreases to 20%	255,921
Forecasted opening date delayed one year	(805,703)
Forecasted opening date accelerated one year	986,986

Selected key assumptions and information used to estimate the fair value of the notes receivable for all projects at March 31, 2006 and December 31, 2005 is as follows:

	March 31, 2006	December 31, 2005
Aggregate face amount of the notes receivable	8,987,119	\$ 8,577,979
Estimated years until opening of casino:		
Michigan	2.75	3.00
New Mexico	1.75	2.00
Montana	1.75	2.00
Discount rate	22.5%	22.5%

It is estimated that the stated interest rates during the loan repayment term will be commensurate with the inherent risk at that time.

Factors that the Company considers in arriving at a discount rate include discount rates typically used by gaming industry investors and appraisers to value individual casino properties outside of Nevada

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and discount rates produced by the widely accepted Capital Asset Pricing Model (CAPM) using the following key assumptions:

S&P 500, 10 and 15-year average benchmark investment returns (medium-term horizon risk premiums);