

MAJESCO ENTERTAINMENT CO
Form 10-K
January 17, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the fiscal year ended October 31, 2011**

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period from to**

Commission File No. 000-51128

MAJESCO ENTERTAINMENT COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

06-1529524
(I.R.S. Employer
Identification No.)

160 Raritan Center Parkway

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Edison, New Jersey 08837

(Address of principal executive office)

Registrant's telephone number, including area code (732) 225-8910

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

(Title of class)	(Name of exchange on which registered)
Common Stock, Par Value \$0.001	NASDAQ Capital Market

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein and, will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

The aggregate market value of the common stock held by non-affiliates as of April 30, 2011 was \$143 million.

The outstanding number of shares of common stock as of January 10, 2012 was 41,333,481.

The Registrant's proxy or information statement is incorporated by reference into Part III of this Annual Report on Form 10-K.

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Explanatory Note

The Company was previously a smaller reporting company that determined that it no longer qualified as such as of its October 31, 2011 determination date, at which time the Company met the definition of an accelerated filer. In accordance with SEC Release 33-8876, the Company has elected to comply with the disclosure requirements for a smaller reporting company in connection with the preparation of this annual report on Form 10-K.

Item 1. Business. Forward-looking Statements

Statements in this annual report on Form 10-K 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 this annual report. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of these terms or other common terminology. These statements are only predictions. Actual events or results may differ materially. Moreover, neither we nor any other person assumes 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 annual report to conform these statements to actual results. References herein to we, us, and the Company are to Majesco Entertainment Company.

Introduction

We are a provider of interactive entertainment software primarily for the casual game playing, mass-market consumer. Our products allow us to capitalize on the large and growing installed base of interactive entertainment enthusiasts on a variety of different consoles, handheld, and digital platforms. We sell our products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors, or make them available for digital download over internet or mobile networks. We have developed our network of retail and distribution relationships over our 25-year history.

We publish video games for almost all major current generation interactive entertainment hardware platforms, including Nintendo's 3DS, DS, and Wii, Sony's PlayStation 3, or PS3, Microsoft's Xbox 360 and the personal computer, or PC. We also publish games for digital platforms such as Xbox Live Arcade (XBLA) and PlayStation Network (PSN), as well as mobile platforms like iPhone, iPad and iPod Touch, and online platforms such as Facebook.

Our video game titles are targeted at various demographics at a range of price points. In some instances, these titles are based on licenses of well-known properties and, in other cases are 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.

Due to the larger budget requirements for developing and marketing premium console titles for core gamers, we focus on publishing casual games targeting mass-market consumers. Recently, hardware manufacturers have introduced a number of innovative user interfaces attracting the casual game consumer to their platforms, such as the touch stylus for the Nintendo DS, motion based controllers for the Nintendo Wii and Sony PlayStation, and full-body motion sensing for the Microsoft Xbox 360. This has created new gaming genres such as dance and fitness, for which we have published innovative products in these categories. Additionally, touch screen interfaces and improved visual displays for smartphones and tablets, and on social networking platforms for the personal computer have proven to be attractive platforms for the casual game consumer.

Corporate Background

Our principal executive offices are located at 160 Raritan Center Parkway, Edison, NJ 08837, and our telephone number is (732) 225-8910. Our web site address is www.majescoentertainment.com. Majesco Sales Inc. was incorporated in 1986 under the laws of the State of New Jersey. On December 5, 2003, Majesco Sales Inc. completed a reverse merger with Majesco Holdings Inc. (formerly ConnectivCorp), then a publicly traded company with no active operations. Majesco Holdings Inc. was incorporated in 2004 under the laws of the State of Delaware. As a result of the merger, Majesco Sales Inc. became a wholly-owned subsidiary and the sole operating business of the public company. On April 4, 2005,

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Majesco Sales Inc. was merged into Majesco Holdings Inc., and, in connection with the merger, Majesco Holdings Inc. changed its name to Majesco Entertainment Company.

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Industry Overview

The interactive entertainment software market is comprised of two primary sectors. The first sector is software for dedicated console and handheld gaming systems such as the Xbox 360, PlayStation 3, Wii and the DS and 3DS handheld systems. The majority of software for these platforms has historically been purchased in packaged form through retail outlets. However, in recent years an increasing amount of software has been made available digitally through online networks such as Microsoft's Xbox Live Arcade (XBLA) and Sony's PlayStation network (PSN). The second sector consists of software for multipurpose devices such as personal computers and mobile devices such as smartphones and tablets. Significant growth is projected in this area, particularly in the form of downloadable and online games for use with mobile devices or over online social networks such as Facebook. These games as a service platforms often utilize different customer monetization models such as freemium gaming where a customer accesses certain game functionality for free, while paying for certain content in the form of in-game microtransactions such as virtual goods, or premium game features. North American retail sales of video game software were approximately \$10 billion in 2011 according to the NPD Group, a global provider of consumer market research information. On a global basis, International Development Group (IDG) estimates that worldwide retail sales of console, handheld and PC software were roughly \$24 billion in 2011. IDG estimates that non-traditional (digital) revenue surpassed \$20 billion in 2011 and will grow to over \$40 billion by 2015.

Strategy

Our objective is to be an innovative provider of video games for the mass market with a focus on developing and publishing a wide range of casual and family oriented video games. Specifically, we strive to:

Develop franchise titles with the capability to sell multiple sequels.

Video game franchises are those game brands that successfully sell multiple sequels. These provide valuable long-term benefits both in customer base growth and revenue predictability. A core strategy for growth is to pursue the development and cultivation of long-term franchises both through internally generated intellectual property and long-term licensing arrangements.

Focus product development efforts on quality games that are easy to pick-up-and-play, priced affordably and targeted for the mass market.

Video game development of casual games is generally less expensive and simpler than development of games for the core gamer demographic, where expectations for graphic quality and depth of play are very high. In general, from a game play/content perspective, we are focused on publishing games that are relatively easy to play and whose subject matter will appeal to as wide an audience as possible. Historically, we focused our game development efforts on products for the Nintendo DS and Wii systems, which have appealing price points and unique play mechanics that continue to resonate with the mainstream gamer and have experienced significant installed base growth over the past four years. With the introduction of motion-based gaming to both the Xbox 360 and PlayStation 3, we have begun developing games for these platforms.

Leverage success of our existing franchises.

We plan to continue to extend our existing products through platform and brand extensions. We have successfully extended the *Cooking Mama* brand onto multiple games, including *Gardening Mama*, *Crafting Mama*, *Babysitting Mama* and *Camping Mama* and across multiple platforms including Nintendo DS, Wii, and 3DS systems. We will look to continue to grow this series with additional sequels, brand extensions and innovations.

Zumba Fitness launched on November 18, 2010 for the Nintendo Wii, Kinect for Xbox 360, and PlayStation 3 Move, and sold over 4 million units worldwide in its first twelve months. We aim to continue to capitalize on the rapid growth of this fitness program with additional releases in fiscal 2012. *Zumba Fitness 2*, for the Nintendo Wii, was released on November 15, 2011, and we plan to release *Zumba Fitness Rush* on Kinect for Xbox 360 in February 2012.

Build our digital business and product offering.

In 2011, we began building a business in digitally-delivered games alongside our traditional console and handheld business. This business encompasses new platforms such as free-to-play social games on Facebook, mobile games on Apple's iOS as well as Android devices, and downloadable games on XBLA, PSN and WiiWare. To date, we have launched several digital games, including *Cooking Mama: Friends Café*, and *Parking Wars 2*, on Facebook, and *Bloodrayne Betrayal*, on XBLA and PSN, among others. In addition, we acquired the assets and development team of Quick Hit, Inc. in June of 2011 to increase our capability to develop and publish games for online and mobile platforms.

Leverage our industry relationships and entrepreneurial environment to enter new categories and bring innovative products to market.

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In the past, we have leveraged our experience, entrepreneurial environment and industry relationships with developers, manufacturers, content providers, retailers and resellers to create and distribute new and innovative products. We will continue to capitalize on current market trends and pursue new product opportunities in categories related to our core business.

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Products

We offer our customers a wide selection of interactive entertainment products for a variety of platforms. Our goal is to grow individual titles into successful franchises, which can provide predictable and profitable growth for years. When a franchise is successful, it may account for a large percentage of our overall net revenue. This has occurred in the past in the cases of both *Cooking Mama* and *Zumba Fitness*, as these brands have grown through numerous iterations across multiple platforms. In addition, we own the intellectual property related to certain games and also license the rights to content from developers or media entertainment companies, such as in the titles *Alvin and the Chipmunks: The Squeakquel*, *Hulk Hogan's Main Event*, and *Twister Mania*.

In fiscal year 2011, revenue from sales of *Zumba Fitness* represented approximately 70 percent of our total net revenue. In fiscal year 2009 and 2010, *Cooking Mama* accounted for 49 and 44 percent of net revenue, respectively.

Zumba Fitness introduced in November 2010 sold over 4 million copies worldwide in its first year. According to NPD, *Zumba Fitness* was the number one fitness title of 2011. We have licensed the right to release sequels to this product in 2012 and 2013.

The original *Cooking Mama* game was first introduced in 2006 for the Nintendo DS and has sold more than three million units to date. The *Cooking Mama* franchise has sold over 9 million units across ten titles in North America. Most recently, *Cooking Mama* made its debut on the Nintendo 3DS with the launch of *Cooking Mama 4: Kitchen Magic*, which was released in November 2011.

In addition to our traditional retail games, we also create titles for the leading online and mobile platforms, including Facebook, Apple's iOS, Android, Microsoft's XBLA, and Sony's PSN.

Selected titles, their compatible platforms and launch dates include:

Selected Titles	Platform	Launch Date
Cooking Mama	DS	September 2006
Cooking Mama: Cook Off	Wii	March 2007
Cooking Mama 2: Dinner with Friends	DS	November 2007
Jillian Michaels Fitness Ultimatum 2009	Wii	October 2008
Cooking Mama: World Kitchen	Wii	November 2008
Gardening Mama	DS	March 2009
Jillian Michaels Fitness Ultimatum 2010	Wii, DS	October 2009
Cooking Mama 3: Shop and Chop	DS	October 2009
Hello Kitty Party	DS	November 2009
Alvin and the Chipmunks: The Squeakquel	Wii, DS	December 2009
Tetris Party Deluxe	Wii, DS	June 2010
Greg Hastings Paintball 2	Xbox 360, Wii	September 2010
Gardening Mama	iPhone, iPad	October 2010
My Baby 3 & Friends	DS	October 2010
Crafting Mama	DS	October 2010
Babysitting Mama	Wii	November 2010
Zumba Fitness	Wii, Xbox 360, PS3	November 2010
Cooking Mama Friends Café	Facebook	January 2011
Camping Mama: Outdoor Adventures	DS	October 2011
Hulk Hogan's Main Event	Xbox 360	October 2011
Pet Zombies	3DS	October 2011

Product Development

Prior to initiating the development of a video game title, we perform market research, studio due diligence and financial analysis. A title must then be approved by our "green light" committee comprised of members from our executive, product development, finance, sales and marketing and legal/business affairs teams before being accepted for publication. Once accepted, the title is evaluated at regular milestones to ensure it is progressing on time, according to specifications and on budget.

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We primarily use third party development studios to develop our video game products. However, we employ game producers and quality assurance personnel to manage the creation of the game and its ultimate approval by the first party hardware manufacturer. We carefully select third parties to develop video games based on their capabilities, suitability, availability and cost. We usually have broad rights to commercially utilize products created by the third party developers we work with. Development contracts are structured to provide developers with incentives to provide timely and satisfactory performance by associating payments with the achievement of substantive development milestones, and by providing for the payment of royalties to them based on sales of the developed product, only after we recoup development costs. We have worked, and continue to work, with independent third party developers, such as:

Zoe Mode

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Panic Button

1st Playable Productions

Behaviour Interactive and

Wayforward Technologies.

The development process for video games also involves working with platform manufacturers from the initial game concept phase through approval of the final product. During this process, we work closely with the developers and manufacturers to ensure that the title undergoes careful quality assurance testing. Each platform manufacturer requires that the software and a prototype of each title, together with all related artwork and documentation, be submitted for its pre-publication approval. This approval is generally discretionary.

We develop online and mobile games internally, at our Foxboro, Massachusetts facility, or using external developers. On June 3, 2011, we acquired certain assets and the twelve person workforce of Quick Hit, Inc., a developer of free to play online games. This team will serve as the basis for our entry into the business of freemium games for play online and on mobile devices.

Intellectual Property

Platform Licenses

Hardware platform manufacturers require that publishers obtain a license from them to publish titles for their platforms. We currently have non-exclusive licenses from Nintendo, Microsoft and Sony for each of the popular console and handheld platforms. Each license generally extends for a term of between two to four years and is terminable under a variety of circumstances. Each license allows us to create one or more products for the applicable system, and requires us to pay a per-unit license fee and/or royalty payment from the title produced and may include other compensation or payment terms. Publishers are not required to obtain licenses for publishing video game software for PCs. All of the hardware manufacturers approve each of the titles we submit for approval on a title-by-title basis, at their discretion.

Licenses from Third Parties

While we develop original titles, most of our titles are based on rights, licenses and properties, including copyrights and trademarks, owned by third parties. Even our original titles usually include some rights or properties from third parties. License agreements with third parties generally extend for a term of between two to four years, are limited to specific territories or platforms and are terminable under a variety of events. Several of our licenses are exclusive within particular territories or platforms. The licensors often have strict approval and quality control rights. Typically, we are obligated to make minimum guaranteed royalty payments over the term of these licenses and advance payments against these guarantees, but other compensation or payment terms, such as milestone payments, are also common. From time to time, we may also license other technologies from third party developers for use in our products, which also are subject to royalties and other types of payment.

Licenses to Third Parties

As we create original titles we may decide to license rights to third parties, sometimes on an exclusive basis, in order to generate publicity or market demand for our titles, to generate additional revenue related to complementary products, or a combination of these factors. For example, for certain titles we have sold the movie rights, entered into strategy guide deals, licensed a comic book series as well as an apparel line.

Manufacturing

Sony, Nintendo and Microsoft control the manufacturing of our products that are compatible with their respective video game consoles, as well as the manuals and packaging for these products, and ship the finished products to us for distribution. Video games for Microsoft, Nintendo and Sony game consoles consist of proprietary format optical discs and are typically delivered to us within the relatively short lead time of approximately two to three weeks.

With respect to DS and 3DS products, which use a cartridge format, Nintendo typically delivers these products to us within 30 to 45 days after receipt of a purchase order.

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Initial production quantities of individual titles are based upon estimated retail orders and consumer demand. At the time a product is approved for manufacturing, we must generally provide the platform manufacturer with a purchase order for that product, and pay for the entire purchase price prior to production. To date, we have not experienced any material difficulties or delays in the manufacture and assembly of our products. However, manufacturers' difficulties, which are beyond our control, could impair our ability to bring products to the marketplace in a timely manner.

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We operate in a capital intensive industry. Significant working capital is required to finance the manufacturing of inventory of products, especially during peak holiday selling season.

We typically ship orders immediately upon receipt of the order. To the extent that any backlog exists at the end of any period, it is not a material indicator of future results.

Sales and Marketing

North America

Historically, our marketing programs have principally supported our premium game titles. While we support most of our titles in some manner, those with the most potential will have long lead times, multi-faceted marketing programs designed to generate enthusiasm and demand. Specific consumer marketing strategies we may employ include: TV; radio and print advertising; website and online marketing; demo distribution; promotions and cross-promotions with third parties; and point-of-purchase advertising.

Additionally, we customize public relations programs that are designed to create awareness with all relevant audiences, including core gamers and mass-entertainment consumers. To date, our public relations efforts have resulted in significant coverage for our company and individual titles in computer and video game publications, such as Game Informer, IGN and Nintendo Power, as well as major newspapers, magazines and broadcast outlets, such as CNN, USA Today, Wired, Maxim, Newsweek, and the New York Times, among others. We also host media events throughout the year at which print, broadcast and online journalists can preview, review and evaluate our products prior to their release.

In addition to regular face-to-face meetings and communications with our sales force, we employ extensive trade marketing efforts including: direct marketing to buyers and store managers; trade shows; various store manager shows; and distribution and sales incentive programs.

We sell our products primarily to large retail chains, specialty retail stores, video game rental outlets and distributors. Our sales team has strong relationships with major retailers and communicates with them frequently. To supplement our sales team, we currently utilize six sales representative organizations located throughout the United States. The firms we use were chosen based on their performance and retailer relationships. On average, two sales representatives per organization are assigned to our accounts. It is customary for the sales representatives and resellers of our games who are assigned specific customers to also distribute games produced by other publishers. Distribution channels are dominated by a select group of companies, and a publisher's access to retail shelf space is a significant competitive factor.

International

We do business internationally through our office in the United Kingdom by entering into license and distribution agreements with leading international publishers for distribution in Europe and the PAL territories. We distribute our products through either distribution or licensing agreements. These agreements may vary by product and by territory. In a distribution agreement, we manufacture the product, and sell it into the distributors at a wholesale price, with our distribution partner being responsible for retail sell-in and marketing the product. In a licensing agreement, our licensing partner is responsible for the manufacture and sale of the product and we receive royalties and usually an up-front royalty advance.

Digital

We also distribute online and mobile games through Microsoft's Xbox Live Arcade (XBLA) and Sony's Playstation Network (PSN), Steam, Facebook, and across mobile networks such as Apple's iOS. We utilize various methods to market and drive awareness of our titles on these emerging platforms, including online advertising on Facebook, on platform homepages in the cases of XBLA and PSN, and on online sites. We also acquire users through both paid and unpaid channels, due to the viral nature of social and mobile games.

Customers

Our customers are comprised of national and regional retailers, specialty retailers and video game rental outlets. We believe we have developed close relationships with a number of retailers, including Amazon, Best Buy, GameStop, Target, Toys R Us, and Walmart. We also have strong relationships with Cokem, Ingram and SVG, who act as resellers of our products to smaller retail outlets. For the fiscal year ended 2011, our top four retail accounts were Walmart, GameStop, Best Buy, and Target, accounting for approximately 18%, 21%, 11% and 10% of our revenue, respectively. Revenue from 505 Games in Europe represented approximately 11% of revenue in 2011. A substantial reduction in purchases, termination of purchases, or business failure by any of our significant customers could have a material adverse effect on us.

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Competition

In general, our products compete with other forms of entertainment for leisure time and discretionary spending of consumers. These other forms of entertainment include movies, television, music, online content and social media. More specifically, the market for interactive entertainment products is highly competitive and relatively few products achieve significant market acceptance. We continue to face significant competition with respect to our products, which may also result in price reductions, reduced gross margins and loss of market share. Many of our competitors have significantly greater financial, marketing and product development resources than we do.

We compete with many other first and third party publishers and developers in the handheld, console and online segments. In the console and handheld segment, we compete with first party publishers such as Nintendo, Microsoft and Sony, each of which develop software for their respective platforms, as well as third party publishers such as Activision Blizzard, Electronic Arts, Sega, Take-Two Interactive, THQ, and Ubisoft. In the digital segment, we compete with a large range of developers and publishers, which include Crowdstar, Electronic Arts, Gameloft, Glu Mobile, ngmoco, Playdom, Rovio and Zynga. We expect competition to increase in this area in the future.

Current and future competitors may be able to:

respond more quickly to new or emerging technologies or changes in customer preferences;

carry larger inventories;

gain access to wider distribution channels;

undertake more extensive marketing campaigns;

adopt more aggressive pricing policies;

devote greater resources to securing the rights to valuable licenses;

develop stronger relationships with leading software developers;

make higher royalty payments; and

secure more and better shelf space.

Competitive factors such as the foregoing may have a material adverse effect on our business.

Seasonality

The interactive entertainment business is highly seasonal, with sales typically higher during the peak holiday selling season during the fourth quarter of the calendar year. Traditionally, the majority of our sales for this key selling period ship in our fiscal fourth and first quarters, which end on October 31 and January 31, respectively. Significant working capital is required to finance the manufacturing of inventory of products that ship during these quarters.

Employees

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We had 84 full-time employees in the United States and 1 full-time employee in the United Kingdom as of October 31, 2011. We have not experienced any work stoppages and consider our relations with our employees to be good.

Financial Information About Geographic Areas

See Note 1 Principal Business Activity and Basis of Presentation in the notes to the consolidated financial statements included on Page F-8.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, referred to herein as the SEC. Our SEC filings, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act are available to the public free of charge over the Internet at our website at <http://www.majescoentertainment.com> or at the SEC's web site at <http://www.sec.gov>. Our SEC filings will be available on our website as soon as reasonably practicable after we have electronically filed or furnished them to the SEC. Information contained on our website is not incorporated by reference into this 10-K. You may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You can view our Code of Conduct and Ethics and the charters for each of our committees of the Board of Directors free of charge on the corporate governance section of our website.

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Item 1A. Risk Factors.

Our business and operations are subject to a number of risks and uncertainties as described below. However, the risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we may currently deem immaterial, may become important factors that could harm our business, financial condition or results of operations. If any of the following risks actually occur, our business, financial condition or results of operations could suffer.

We have experienced recent net losses and we may incur future net losses, which may cause a decrease in our stock price.

While we generated net income for fiscal year 2011, we incurred net losses of \$1.0 million in fiscal year 2010 and \$7.2 million in 2009. We may not be able to continue to generate revenues sufficient to offset our costs and may sustain net losses in future periods. Any such losses may have an adverse effect on our future operating prospects, liquidity and stock price.

Our business activities may require additional financing that might not be obtainable on acceptable terms, if at all, which could have a material adverse effect on our financial condition, liquidity and our ability to operate going forward.

Although there can be no assurance, our management believes that based on our current plan there are sufficient capital resources from existing levels of cash and operations, including our factoring and purchase order financing arrangements, to finance our operational requirements through at least the next 12 months. If we are unable to maintain profitability, or if unforeseen events occur that would require additional funding, we may need to raise capital or incur debt to fund our operations. We would expect to seek such capital through sales of additional equity or debt securities and/or loans from financial institutions, but there can be no assurance that funds will be available to us on acceptable terms, if at all, and any sales of such securities may be dilutive to investors.

Failure to obtain financing or obtaining financing on unfavorable terms could result in a decrease in our stock price and could have a material adverse effect on future operating prospects, or require us to significantly reduce operations.

We are heavily reliant on our factoring arrangement.

We utilize credit under a factoring agreement with Rosenthal & Rosenthal, Inc. (referred to herein as Rosenthal) whereby we sell our receivables for immediate payment of a portion of the invoice amount and, in some instances, the ability to take additional cash advances. This is our primary source of financing. If Rosenthal suffered financial difficulty, or our relationship with Rosenthal deteriorated, this could significantly impact our liquidity.

We have experienced volatility in the price of our stock.

The price of our common stock has experienced significant volatility. In the 12 months ended October 31, 2011, the high and low bid quotations for our common stock as reported by the Nasdaq Capital Market ranged between a high of \$4.53 and a low of \$0.58. The historic market price of our common stock may be higher or lower than the price paid for our shares and may not be indicative of future market prices, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time;

actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;

our, or a competitor's, announcement of new products, services or technological innovations;

departures of key personnel;

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general economic, political and market conditions and trends; or

other risks and uncertainties as may be detailed from time to time in our public announcements and filings with the SEC.

We may not be able to sustain or increase the value of our common stock. Declines in the market price of our stock could adversely affect our ability to retain personnel with stock incentives, to acquire businesses or assets in exchange for stock and/or to conduct future financing activities with or involving our common stock.

In addition, purchases or sales of large quantities of our stock could have a significant effect on our stock price.

We seek to manage our business with a view to achieving long-term results, and this could have a negative effect on short-term trading.

Our focus is on creation of stockholder value over time, and we intend to make decisions that will be consistent with this long-term view. As a result, some of our decisions, such as whether to make or discontinue operating investments or pursue or discontinue strategic initiatives, may be in conflict with the objectives of short-term traders. Further, this could adversely affect our quarterly or other short-term results of operations.

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We may not be able to maintain our listing on the Nasdaq Capital Market.

Our common stock currently trades on the Nasdaq Capital Market, referred to herein as Nasdaq. This market has continued listing requirements that we must continue to maintain to avoid delisting. The standards include, among others, a minimum bid price requirement of \$1.00 per share and any of: (i) a minimum stockholders' equity of \$2.5 million; (ii) a market value of listed securities of \$35 million; or (iii) net income from continuing operations of \$500,000 in the most recently completed fiscal year or in the two of the last three fiscal years. Our results of operations and our fluctuating stock price directly impact our ability to satisfy these listing standards.

As mentioned above, our stock is volatile, and there is no guarantee that we will continue to meet the minimum bid price requirement or the other continued listing requirements of Nasdaq. If we fail to do so, we may be subject to delisting.

A delisting from Nasdaq would result in our common stock being eligible for listing on the Over-The-Counter Bulletin Board (OTCBB) or other markets that are generally considered to be less efficient than markets such as Nasdaq or other national exchanges because of lower trading volumes, transaction delays and reduced security analyst and news media coverage. These factors could contribute to lower prices and larger spreads in the bid and ask prices for our common stock. Additionally, trading of our common stock in these markets may make us less desirable to institutional investors and may, therefore, limit our future equity funding options and could negatively affect the liquidity of our stock.

A significant portion of our revenue in 2011 was generated from games based on the *Zumba Fitness* property.

Approximately 70% of our net revenue in 2011 was generated from the *Zumba Fitness* games, the first of which was commercially released in November 2010. We license the rights to publish these games from a third party. In November 2011, we released the sequel for the Wii platform, *Zumba Fitness 2*. In addition, we have secured rights to publish other games based on this property. However, we cannot guarantee that any of the new versions will be as successful as the previous version. If the new versions are not successful, this may have a significant impact on our revenues. In addition, even if successful, we may be unable to secure the rights to publish further sequels to these games, which may adversely affect our business and financial performance.

Customer accommodations could materially and adversely affect our business, results of operations, financial condition and liquidity.

When demand for our offerings falls below expectations, we may negotiate accommodations to retailers or distributors in order to maintain our relationships with our customers and access to our sales channels. These accommodations include negotiation of price discounts and credits against future orders commonly referred to as price protection. At the time of product shipment, we establish provisions for price protection and other similar allowances. These provisions are established according to our estimates of the potential for markdown allowances based upon historical rates, current sell-through of retailer inventory of our products, expected sales, retailer inventories of products and other factors. We cannot predict with certainty whether existing provisions will be sufficient to offset any accommodations we will provide, nor can we predict the amount or nature of accommodations that we will provide in the future. If actual accommodations exceed our provisions, our earnings would be reduced, possibly materially. Any such reduction may have an adverse effect on our business, financial condition or results of operations. The granting of price protection and other allowances reduces our ability to collect receivables and impacts our availability for advances from our factoring arrangement. The continued granting of substantial price protection and other allowances may require additional funding sources to fund operations, but there can be no assurance that such funds will be available to us on acceptable terms, if at all.

If we do not consistently meet our product development schedules, our operating results will be adversely affected.

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring during the end of the year holiday period. In addition, we often seek to release our products in conjunction with specific events, such as the release of a related movie. If we miss these key selling periods for any reason, including product development delays, our sales will suffer disproportionately. Likewise, if a key event to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a number of factors, including the creative processes involved, the ability of third party developers to deliver work in a timely fashion and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, harm our profitability, and cause our operating results to be materially different than anticipated.

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Accessories related to two of our most successful titles expose us to hardware manufacturing and shipping risks.

Both *Zumba Fitness* and *Zumba Fitness 2* require a belt accessory for use on the Nintendo Wii platform. The manufacturer of the belt accessory is located in China. Anything that impacts the ability of the manufacturer to produce or otherwise supply the belt accessories for us or increases their costs of production, including the utilization of such manufacturer's capacity by another company; changes in safety, environment or other regulations applicable to the accessories and the manufacturing thereof; natural or manmade disasters that disrupt manufacturing, transportation or communications; labor shortages, civil unrest or other issues negatively impacting Chinese companies; increases in the prices of raw materials; increases in fuel prices and other shipping costs; and increases in local labor costs in China, may increase the prices we must pay for the accessories or otherwise impede our ability to supply the accessories to the market. If we are unable to supply such accessories, sales of the titles will be impacted.

Video games that are not high quality may not sell according to our forecast, which could materially impact our profitability in any given quarter.

In the past few years, the quality standards of games aimed at the mass market consumer have improved and it is clear that consumers prefer high-quality games. If our games are not high quality, consumers may not purchase as many games as we expect, which could materially impact our revenue and profitability in any given quarter.

Increased competition for limited shelf space and promotional support from retailers could affect the success of our business and require us to incur greater expenses to market our products.

Retailers typically have limited shelf space and promotional resources, such as circulars and in-store advertising, to support any one product among an increasing number of newly introduced entertainment offerings.

Competition for retail support and shelf space is expected to increase, which may require us to increase our marketing expenditures or reduce prices to retailers. Competitors with more extensive lines, popular products and greater financial resources frequently have greater bargaining power with retailers. Accordingly, we may not be able to achieve or maintain the levels of support and shelf space that our competitors receive. As a result, sales of our products may be less than expected, which would have a material adverse effect on our business, financial condition and results of operations.

Fluctuations in our quarterly operating results due to seasonality in the interactive entertainment industry and other factors related to our business operations could result in substantial losses to investors.

We have experienced, and may continue to experience, significant quarterly fluctuations in sales and operating results. The interactive entertainment market is highly seasonal, with sales typically significantly higher during the year-end holiday buying season. Other factors that cause fluctuations in our sales and operating results include:

the timing of our release of new titles as well as the release of our competitors' products;

the popularity of both new titles and titles released in prior periods;

the profit margins for titles we sell;

the competition in the industry for retail shelf space;

fluctuations in the size and rate of growth of consumer demand for titles for different platforms; and

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the timing of the introduction of new platforms and the accuracy of retailers' forecasts of consumer demand.

We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. We may not be able to maintain consistent profitability on a quarterly or annual basis. In addition, our operating results may be below the expectations of public market analysts and investors causing the price of our common stock to fall or significantly fluctuate.

A weak global economic environment could result in a reduced demand for our products and increased volatility in our stock price.

Current uncertainty in global economic conditions poses a risk to the overall economy as consumers and retailers may defer or choose not to make purchases in response to tighter credit and negative financial news, which could negatively affect demand for our products. Additionally, due to the weak economic conditions and tightened credit environment, some of our retailers and customers may not have the same purchasing power, leading to lower purchases of our games for placement into distribution channels. Consequently, demand for our products could be materially different from expectations, which could negatively affect our profitability and cause our stock price to decline.

A significant portion of our sales is derived from our international operations, which may subject us to economic, currency, political, regulatory and other risks.

As we do not directly distribute our games outside of North America, our success and profitability internationally are wholly dependent on the competence and efforts of our international distributors. Moreover, our international operations are vulnerable to a number of additional factors outside of our control, including different consumer preferences; language and cultural differences; foreign currency fluctuations; changes in regulatory requirements; and taxes and tariffs. Such factors may have a negative impact on the sales of our games outside of North America.

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Our business may be affected by issues in the economy that affect consumer spending.

Our products involve discretionary spending on the part of consumers. We believe that consumer spending is influenced by general economic conditions and the availability of discretionary income. This makes our products particularly sensitive to general economic conditions and economic cycles. Certain economic conditions, such as United States or international general economic downturns, including periods of increased inflation, unemployment levels, tax rates, interest rates, gasoline and other energy prices or declining consumer confidence could reduce consumer spending. Reduced consumer spending may result in reduced demand for our products and may also require increased selling and promotional expenses. A reduction or shift in domestic or international consumer spending could negatively impact our business, results of operations and financial condition. Consumers are generally more willing to make discretionary purchases, including purchases of products like ours, during periods in which favorable economic conditions prevail. If economic conditions worsen, our business, financial condition and results of operations could be adversely affected.

The loss of any of our key customers could adversely affect our sales.

Our sales to Wal-Mart, GameStop, Best Buy and Target accounted for approximately 18%, 21%, 11% and 10%, respectively, of our revenue for the fiscal year 2011. Although we seek to broaden our customer base, we anticipate that a small number of customers will continue to account for a large concentration of our sales given the consolidation of the retail industry. We do not have written agreements in place with several of our major customers. Consequently, our relationship with these retailers could change at any time. In addition, revenue from 505 Games in Europe represented approximately 11% of revenue in 2011. Our business, results of operations and financial condition could be adversely affected if:

we lose any of our significant customers;

any of these customers purchase fewer of our offerings;

any of these customers encounter financial difficulties, resulting in the inability to pay vendors, store closures or liquidation; or

we experience any other adverse change in our relationship with any of these customers.

Significant competition in our industry could continue to adversely affect our business.

The market for interactive entertainment products is highly competitive and, relatively few products achieve significant market acceptance. We face significant competition with respect to our products, which may also result in price reductions, reduced gross margins and loss of market share. Many of our competitors have significantly greater financial, marketing and product development resources than we do. As a result, current and future competitors may be able to:

respond more quickly to new or emerging technologies or changes in customer preferences;

undertake more extensive marketing campaigns;

devote greater resources to secure rights to valuable licenses and relationships with leading software developers;

gain access to wider distribution channels; and

have better access to prime shelf space.

We compete with many other third party publishers in both our handheld and console market segments. In addition, console and handheld manufacturers, such as Microsoft, Nintendo and Sony, publish software for their respective platforms. Further, media companies and film studios are increasing their focus on the video game software market and may become significant competitors. We expect competition to increase as more competitors enter the interactive entertainment market.

We cannot assure you that we will be able to successfully compete against our current or future competitors or that competitive pressures will not have a material adverse effect on our business, results of operations or financial condition.

If our marketing and advertising efforts fail to resonate with our customers, our business and operating results could be adversely affected.

Our products are marketed through a variety of advertising and promotional programs such as television and online advertising, print advertising, retail merchandising, website development and event sponsorship. Our ability to sell our products is dependent in part upon the success of these programs. If the marketing for our products fail to resonate with our customers, particularly during the critical holiday season or during other key selling periods, or if advertising rates or other media placement costs increase, these factors could have a material adverse impact on our business and operating results.

Increasing development costs for games which may not perform as anticipated can decrease our profitability and could result in potential impairments of capitalized software development costs.

Video games can be increasingly expensive to develop. Because the current generation console platforms and computers have greater complexity and capabilities than the earlier platforms and computers, costs are higher to develop games for the current

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generation platforms and computers. If these increased costs are not offset by higher revenues and other cost efficiencies in the future, our margins and profitability will be impacted, and could result in impairment of capitalized software development costs. If these platforms, or games we develop for these platforms, do not achieve significant market penetration, we may not be able to recover our development costs, which could result in the impairment of capitalized software costs.

Our business is dependent on the viability of console hardware.

Our business depends on hardware on which consumers play our games. Our business can be adversely affected by various factors affecting hardware as follows:

Software pricing. Software prices for the current console games are higher than prices for games for the predecessor platforms. There is no assurance that consumers will continue to pay the higher prices on these games. Additionally, as it gets later in the console cycle, consumers may be unwilling to continue to pay the higher prices that they paid closer to the launch of the consoles.

Significant development costs. The complexity and capabilities of the current consoles lead to higher development costs for games to make use of the consoles. Greater costs can lead to lower operating margins, negatively affecting our profitability.

Our business is highly dependent on the continued growth of current generation video game platforms and our ability to develop commercially successful products for these platforms.

We derive most of our revenue from the sale of products for play on video game platforms manufactured by third parties. The success of our business is dependent upon the continued growth of these platforms and our ability to develop commercially successful products for these platforms.

Termination or modification of our agreements with platform hardware manufacturers, who are also competitors and frequently control the manufacturing of our titles, may adversely affect our business.

We are required to obtain a license in order to develop and distribute software for each of the manufacturers of video game hardware. We currently have licenses from Sony to develop products for PlayStation, PlayStation 2, PlayStation 3 and PSP, from Nintendo to develop products for the GBA, the DS, DSi, 3DS and Wii and from Microsoft to develop products for the Xbox and the Xbox 360. These licenses are non-exclusive and, as a result, our competitors also have licenses to develop and distribute video game software for these systems. These licenses must be periodically renewed, and if they are not, or if any of our licenses are terminated or adversely modified, we may not be able to publish games for such platforms or we may be required to do so on less attractive terms.

Our contracts with these manufacturers grant them approval rights with respect to new products and often also grant them control over the manufacturing of our products. While we believe our relationships with these manufacturers are good, the potential for delay or refusal to approve or support our products exists, particularly since these manufacturers are also video game publishers and, hence, are also our competitors. We may suffer an adverse effect on our business if these manufacturers:

do not approve a project for which we have expended significant resources;

refuse or are unable to manufacture or ship our products;

increase manufacturing lead times or delay the manufacturing of our products; or

require us to take significant risks in prepaying and holding an inventory of products.

The video game hardware manufacturers set the royalty rates and other fees that we must pay to publish games for their platforms, and therefore have significant influence on our costs. If one or more of these manufacturers change their fee structure, our profitability will be materially impacted.

In order to publish products for a video game system such as the Xbox 360 or Wii, we must take a license from Microsoft and Nintendo, respectively, which gives these companies the opportunity to set the fee structures that we must pay in order to publish games for that platform. Similarly, these companies have retained the flexibility to change their fee structures, or adopt different fee structures for new features for their video game systems. The control that hardware manufacturers have over the fee structures for their video game systems could adversely impact our costs, profitability and margins.

Our platform licensors control the fee structures for online distribution of our games on their platforms.

Pursuant to certain of our publisher license agreements, such platform licensors retain sole discretion to determine the fees to be charged for both base level and premium online services available via their online platforms. Each licensor's ability to set royalty rates makes it challenging for us to predict our costs, and increased costs may negatively impact our operating margins. As a result of such varying fee structures, we may be unable to distribute our games in a cost-effective manner through such distribution channels.

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We may be unable to develop and publish new products if we are unable to secure or maintain relationships with third party video game software developers.

We utilize the services of independent software developers to develop our video games. Consequently, our success in the video game market depends on our continued ability to obtain or renew product development agreements with quality independent video game software developers. However, we cannot assure you that we will be able to obtain or renew these product development agreements on favorable terms, or at all, nor can we assure you that we will be able to obtain the rights to sequels of successful products that were originally developed for us by independent video game developers.

Many of our competitors have greater financial resources and access to capital than we do, which puts us at a competitive disadvantage when bidding to attract independent video game developers. We may be unable to secure or maintain relationships with quality independent developers if our competitors can offer them better shelf access, better marketing support, more development funding, higher royalty rates, more creative control or other advantages. Usually, our agreements with such developers are easily terminable if either party declares bankruptcy, becomes insolvent, ceases operations or materially breaches the terms of such agreements.

In addition, many independent video game software developers have limited financial resources. Many are small companies with a few key individuals without whom a project may be difficult or impossible to complete. Consequently, we are exposed to the risk that these developers will go out of business before completing a project, lose key personnel or simply cease work on a project for which we have hired them.

If we are unable to maintain or acquire licenses to intellectual property, we may publish fewer titles and our revenue may decline.

Many of our video game titles are based on or incorporate intellectual property and other character or story rights acquired or licensed from third parties. We expect that many of our future products will also be based on intellectual property owned by others. The cost of acquiring these licenses is often high, and competition for these licenses is intense. Many of our competitors have greater resources to capitalize on licensing opportunities. Our licenses are generally limited in scope to specific platform and/or geographic territories and typically last for two to three years. We may not be able to obtain new licenses, renew licenses when they expire or include new offerings under existing licenses. If we are unable to obtain new licenses or maintain existing licenses that have significant commercial value at reasonable costs, we may be unable to sustain our revenue growth in the future other than through sales or licensing of our independently created material.

A decrease in the popularity of our licensed brands and, correspondingly, the video games we publish based on those brands could negatively impact our revenues and financial position.

Four games released in 2011 were based upon popular licensed brands. As previously mentioned, approximately 70% of our net revenue in 2011 was generated from the *Zumba Fitness* games commercially released in November 2010. A decrease in the popularity of the *Zumba Fitness* property or other licensed properties could negatively impact our ability to sell games based upon such licenses and could lead to lower net sales, profitability, and/or an impairment of our licenses, which would negatively impact our profitability.

We rely on business partners in many areas of our business and our business may be harmed if they are unable to honor their obligations to us.

We rely on development partners, distribution partners, licensors, third-party service providers, and vendors, among other business partners, in many areas of our business. The failure of these business partners to provide adequate services, such as the failure of an international distribution partner to meet deadline release dates, or the failure of a licensor to market the game containing its licensed property in accordance with our agreement, could disrupt or otherwise adversely impact our business operations and the sales of our games. Furthermore, as many of our business partners reside and/or operate outside of North America, the global economy and other international issues may present obstacles that would prevent them from honoring their obligations to us. Alternative arrangements may not be available to us due, for example, to the unique properties of a business partner such as a licensor. In addition, with respect to other business partners, alternative arrangements may not be available to us on commercially reasonable terms or we may experience business interruptions during any transition to a new business partner. If we experience disruptions with or lose any such business partner, our business could be negatively affected.

If we are unable to successfully introduce new products on a timely basis, or anticipate and adapt to rapidly changing technology, including new hardware platform technology, our business may suffer.

A significant component of our strategy is to continue to bring new and innovative products to market, and we expect to incur significant development, licensing and marketing costs in connection with this strategy.

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The process of introducing new products or product enhancements is extremely complex, time consuming and expensive, and will become more complex as new platforms and technologies emerge. In the event we are not successful in developing new titles and other products that gain wide acceptance in the marketplace, we may not recoup our investment costs in these new products, and our business, financial condition and results of operations may be materially adversely affected as a result thereof.

Furthermore, interactive entertainment platforms are characterized by rapidly changing technology. We must continually anticipate the emergence of, and adapt our products to, new interactive entertainment platforms and technologies. The introduction of new technologies, including new console and handheld technology, software media formats and delivery channels, could render our previously released products obsolete, unmarketable or unnecessary. In addition, if we incur significant expense developing products for a new system or hardware that is ultimately unpopular, sales of these products may be less than expected and we may not be able to recoup our investment. Conversely, if we choose not to publish products for a new system or hardware that becomes popular, our revenue growth, reputation and competitive position may be adversely affected. Even if we are able to accurately predict which video game platforms will be most successful, we must deliver and market offerings that are accepted in our extremely competitive marketplace.

Data breaches involving the source code for our products or customer data stored by us could adversely affect our reputation and revenues.

We store the source code and game assets for our games throughout the course of the games' development and retain them thereafter on our systems. In addition, as we increase our presence in the social and mobile games market, we expect that we will store the confidential information of our customers. A breach of the systems on which such source code and game assets, customer information and other sensitive data is stored could lead to piracy of our software or litigation against us in connection with data security breaches. Data intrusion into a server for a game with online features could also disrupt the operation of such game. If we are subject to any such data security breaches, we may experience a loss in sales or be forced to pay damages in any such lawsuits, which will adversely impact our revenues. In addition, damage to our reputation resulting from a data breach could have a negative impact on our future profitability. We may also incur costs in implementing additional security measures to ensure that such breach is not repeated.

Technology changes rapidly in our business and if we fail to anticipate new technologies or the manner in which people play our games, the quality, timeliness and competitiveness of our products and services will suffer.

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. If we fail to anticipate and adapt to these and other technological changes, our market share and our operating results may suffer. Our future success in providing online games, wireless games and other content will depend on our ability to adapt to rapidly changing technologies, develop applications to accommodate evolving industry standards and improve the performance and reliability of our applications.

We have invested in products for systems utilizing new motion-based game technology, and if these new systems prove to be commercially unsuccessful, then sales of our products will suffer,

We are developing products for systems utilizing motion-based game technology, such as Microsoft's Kinect for Xbox 360 and Sony's Move for PlayStation 3. Consumers may not embrace and purchase these new systems and/or the products for them for a variety of reasons, such as:

being accustomed to and satisfied with non-motion-based gaming systems;

being accustomed to and satisfied with the Nintendo Wii, which has been the sole player in the motion-based game system genre for the past four years;

with particular respect to exercise games, failing to appreciate the convergence of technology and exercise, choosing traditional, non-simulated modes of exercise instead; or

lacking the additional physical space required to play motion-based games.

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If these motion-based systems ultimately fail to achieve consumer acceptance, then the sales of our products for such systems will be negatively impacted.

We have invested in products for the Nintendo 3DS, and if this system proves to be commercially unsuccessful, then sales of our products will suffer.

We are developing products for the Nintendo 3DS, a new system that allows for three dimensional game playing. Consumers may be reluctant to purchase the 3DS system for a variety of reasons, including being accustomed to and satisfied with current two dimensional systems and being wary of eye fatigue, a potential side effect of the 3DS cited in Nintendo's warning guidelines. Furthermore, the warning guidelines advise that children under six, whose eye muscles are still developing, should not use the 3D

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mode. Nintendo's DS, the precursor to the 3DS, has traditionally been popular with young audiences, however parents of young children may be reluctant to purchase the 3DS system. If for these and/or other reasons the system ultimately fails to achieve consumer acceptance, then sales of our 3DS products will be negatively impacted.

Competition with emerging forms of home-based entertainment may reduce sales of our products.

We also compete with other forms of entertainment and leisure activities. For example, we believe the overall growth in the use of the Internet and online services, including social networking, by consumers may pose a competitive threat if customers and potential customers spend less of their available time using interactive entertainment software and more of their time using the Internet and online services.

Our adoption of new business models could fail to produce positive results.

We are developing products for new platforms, including online distribution. These new platforms, such as Facebook, utilize new business models such as generating revenue through micro-transactions by end users, and subscription services. Forecasting our revenues and profitability for these new business models is inherently uncertain and volatile. Our actual revenues and profits for these businesses may be significantly greater or less than our forecasts. Additionally, these new business models could fail for one or more of our titles, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, and the opportunity cost of diverting management and financial resources away from our core businesses.

The growth of digital distribution of games may have an adverse effect on our business and financial performance.

Historically, our products have been sold to and through traditional retail channels, such as physical retail stores. The majority of our console video games are purchased through retailers, however the digital distribution of titles through online services is becoming an increasing form of consumption for consumers. As technology improves, we expect digital distribution to become more prevalent and if we are unable to enhance our distribution to deliver games digitally, this will strongly impact our ability to sell our products and our resulting operating performance. In addition, certain of our significant customers could be adversely affected.

Our business is hit driven. If we do not deliver hit titles, or if consumers prefer competing products, our sales could suffer.

While many new products are regularly introduced, only a relatively small number of hit titles account for a significant portion of net revenue. Competitors may develop titles that imitate or compete with our hit titles, and take sales away from us or reduce our ability to command premium prices for those titles. Hit products published by our competitors may take a larger share of consumer spending than we anticipate, which could cause our product sales to fall below our expectations. If our competitors develop more successful products or offer competitive products at lower prices, or if we do not continue to develop consistently high-quality and well received products, our revenue, margins, and profitability will decline.

Intellectual property claims may increase our product costs or require us to cease selling affected products, which could adversely affect our earnings and sales.

Development of original content, including publication and distribution, sometimes results in claims of intellectual property infringement. Although we make efforts to ensure our products do not violate the intellectual property rights of others, it is possible that third parties still may allege infringement. These claims and any litigation resulting from these claims, could prevent us from selling the affected product, or require us to redesign the affected product to avoid infringement or obtain a license for future sales of the affected product. For example, if we were enjoined from selling one of our franchise titles this could have a significant financial impact on our business.

Any of the foregoing could have a material adverse effect on our business, financial condition, results of operations and future business prospects. Any litigation resulting from these claims could require us to incur substantial costs and divert significant resources, including the efforts of our technical and management personnel.

Our intellectual property is vulnerable to misappropriation and infringement which could adversely affect our business prospects.

Our business relies heavily on proprietary intellectual property, whether our own or licensed from third parties. Despite our efforts to protect our proprietary rights, unauthorized parties may try to copy our products, or obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries may not protect our proprietary rights to as great an extent as the law of the United States. Our rights and the additional steps we have taken to protect our intellectual property may not be adequate to deter misappropriation, particularly given the difficulty of effectively policing unauthorized use of our properties. If we are unable to protect our rights in intellectual property, our business, financial

condition or results of operations could be materially adversely affected.

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If our products contain defects, our business could be harmed significantly.

The products that we publish and distribute are complex and may contain undetected errors when first introduced or when new versions are released. Despite extensive testing prior to release, we cannot be certain that errors will not be found in new products or releases after shipment, which could result in loss of or delay in market acceptance. This loss or delay could significantly harm our business and financial results.

Rating systems for digital entertainment software, potential legislation and consumer opposition could inhibit sales of our products.

Trade organizations within the video game industry require digital entertainment software publishers to provide consumers with information relating to graphic violence, profanity or sexually explicit material contained in software titles, and impose penalties for noncompliance. Certain countries have also established similar rating systems as prerequisites for sales of digital entertainment software in their countries. In some instances, we may be required to modify our products to comply with the requirements of these rating systems, which could delay the release of those products in these countries. We believe that we comply with such rating systems and properly display the ratings and content descriptions received for our titles. Several proposals have been made for legislation to regulate the digital entertainment software, broadcasting and recording industries, including a proposal to adopt a common rating system for digital entertainment software, television and music containing violence or sexually explicit material; and the Federal Trade Commission has issued reports with respect to the marketing of such material to minors. Consumer advocacy groups have also opposed sales of digital entertainment software containing graphic violence or sexually explicit material by pressing for legislation in these areas, including legislation prohibiting the sale of certain M rated video games to minors, and by engaging in public demonstrations and media campaigns. Retailers may decline to sell digital entertainment software containing graphic violence or sexually explicit material, which may limit the potential market for any of our titles with an M rating. Further, if any groups, whether governmental entities, hardware manufacturers or advocacy groups, were to target any of our M rated titles, we might be required to significantly change or discontinue a particular title, which could adversely affect our business.

Our business is subject to risks generally associated with the entertainment industry, and we may fail to properly assess consumer tastes and preferences, causing product sales to fall short of expectations.

Our business is subject to all of the risks generally associated with the entertainment industry and, accordingly, our future operating results will depend on numerous factors beyond our control, including the popularity, price and timing of new hardware platforms being released; economic, political and military conditions that adversely affect discretionary consumer spending; changes in consumer demographics; the availability and popularity of other forms of entertainment; and critical reviews and public tastes and preferences, which may change rapidly and cannot be predicted. A decline in the popularity of certain game genres or particular platforms could cause sales of our titles to decline dramatically. The period of time necessary to develop new game titles, obtain approvals of platform licensors and produce finished products is unpredictable. During this period, consumer appeal for a particular title may decrease, causing product sales to fall short of expectations.

If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.

The market for technical, creative, marketing and other personnel essential to the development and marketing of our products and management of our businesses is extremely competitive. We are frequently competing for this talent with other companies with greater resources. Our ability to operate within the highly competitive interactive entertainment industry is dependent upon our ability to attract and retain our employees. If we cannot successfully recruit and retain the employees we need, or replace key employees following their departure, our ability to develop and manage our businesses will be impaired.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results. As a result, current and potential stockholders could lose confidence in our financial reporting, which could have a negative impact on our stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual report on Form 10-K our assessment of the effectiveness of our internal controls over financial reporting. Although we believe that we currently have adequate internal control procedures in place, we cannot be certain that our internal controls over financial reporting will remain effective. If we cannot adequately maintain the effectiveness of our internal controls over financial reporting, we may be subject to liability and/or sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our common stock.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We lease 21,250 square feet of office, development and storage space located at 160 Raritan Center Parkway, Edison, NJ 08837. The lease, which provides for base rents of approximately \$24,000 per month, plus taxes, insurance and operating costs, expires on January 31, 2015. In addition we lease 3,900 square feet of office space in California and 4,400 square feet of office space in Massachusetts under leases that expire in 2014.

Item 3. 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 has certain third-party indemnity rights from a developer for costs incurred under a joint representation agreement. The Company cannot currently estimate a potential range of loss if the claim against the Company is successful.

On November 18, 2011, a complaint for patent infringement was filed in the United States District Court for the Northern District of Ohio by Impulse Technology Ltd. against the Company, Nintendo of America, Inc. and certain other game publisher defendants that have released games for Nintendo's Wii console. The complaint alleges that Wii and correspondingly, our Zumba Fitness 2 and Jillian Michaels Fitness Workout 2009 games, infringe Impulse's patents for certain interactive technology. Impulse is seeking injunctive relief and monetary damages in an unspecified amount for the alleged infringement. 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.

Item 4. (Removed and Reserved).

Table of Contents**PART II****Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is listed for trading on the Nasdaq Capital Market under the symbol COOL. Prior to March 13, 2006, our common stock was listed on the Nasdaq Global Market. Prior to January 26, 2005, our common stock was quoted on the OTCBB. The market for our common stock has often been sporadic, volatile and limited.

The following table shows the high and low bid quotations for our common stock as reported by Nasdaq from November 1, 2009 through October 31, 2011. The prices reflect inter-dealer quotations, without retail markup, markdown or commissions, and may not represent actual transactions.

	High	Low
Fiscal Year 2010		
First Quarter	\$ 1.28	\$ 0.75
Second Quarter	\$ 1.08	\$ 0.77
Third Quarter	\$ 0.88	\$ 0.64
Fourth Quarter	\$ 0.71	\$ 0.49
Fiscal Year 2011		
First Quarter	\$ 1.45	\$ 0.58
Second Quarter	\$ 4.15	\$ 1.18
Third Quarter	\$ 4.53	\$ 2.37
Fourth Quarter	\$ 3.47	\$ 1.61

Holder of Common Stock. On January 6, 2012, we had approximately 117 registered holders of record of our common stock. On January 6, 2012, the closing sales price of our common stock as reported on Nasdaq was \$2.97 per share.

Dividends and dividend policy. We have never declared or paid any dividends on our common stock and we do not anticipate paying dividends on our common stock at the present time. We currently intend to retain earnings, if any, for use in our business. We do not anticipate paying dividends in the foreseeable future.

Securities authorized for issuance under equity compensation plans. The information called for by this item is incorporated by reference from our definitive proxy statement relating to our 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days after our October 31, 2011 fiscal year end.

Recent Sales of Unregistered Securities. All prior sales of unregistered securities have been previously reported on a quarterly report on Form 10-Q.

Table of Contents**Item 6. Selected Financial Data.**

The following tables summarize certain selected consolidated financial data, which should be read in conjunction with our audited consolidated financial statements and the notes thereto and with management's discussion and analysis of financial condition and results of operations included elsewhere in this report.

	Year Ended October 31,				
	2011	2010	2009	2008	2007
	(in thousands, except share data)				
Consolidated Statement of Operations Data:					
Net revenues	\$ 125,291	\$ 75,648	\$ 94,452	\$ 63,887	\$ 50,967
Cost of sales(1)	79,816	57,263	71,543	40,798	33,682
Gross profit	45,475	18,385	22,909	23,089	17,285
Operating expenses(2)	34,115	20,496	29,480	20,312	21,114
Operating income (loss)	11,360	(2,111)	(6,571)	2,777	(3,829)
Interest and financing costs, net	1,255	999	1,318	649	1,552
Other non-operating expense (income)(3)	2,847	(482)	415	(1,250)	(611)
Income (loss) before income taxes	7,258	(2,628)	(8,304)	3,378	(4,770)
Income taxes	426	(1,656)	(1,115)	26	
Net income (loss)	\$ 6,832	\$ (972)	\$ (7,189)	\$ 3,352	\$ (4,770)
Net income (loss) attributable to common stockholders	\$ 6,832	\$ (972)	\$ (7,189)	\$ 3,352	\$ (4,770)
Net income (loss) attributable to common stockholders per share:					
Basic	\$ 0.18	\$ (0.03)	\$ (0.24)	\$ 0.12	\$ (0.20)
Diluted	\$ 0.17	\$ (0.03)	\$ (0.24)	\$ 0.12	\$ (0.20)
Weighted average shares outstanding:					
Basic	38,527,589	37,019,750	29,770,382	27,547,211	23,891,860
Diluted	40,123,968	37,019,750	29,770,382	27,547,211	23,891,860
	40,123,968.0	40,123,968.0	40,123,968.0	40,123,968.0	40,123,968.0
	2011	2010	October 31 2009	2008	2007
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 13,689	\$ 8,004	\$ 11,839	\$ 5,505	\$ 7,277
Working capital	23,791	11,563	11,815	6,702	2,834
Total assets	52,377	30,029	28,527	23,570	16,313
Non-current liabilities	1,949	144	626	211	1,460
Stockholders' equity	23,235	12,008	11,719	7,137	2,591

(1)

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Cost of sales includes \$2.7 million, \$1.0 million and \$2.5 million in 2011, 2010 and 2009, respectively, to recognize impairments to the carrying value of products for future release.

- (2) Operating expenses include: (i) for 2011, an impairment of capitalized software development costs and license fees cancelled games of \$1.5 million; (ii) for 2010, an impairment of capitalized software development costs and license fees cancelled games of \$0.4 million; (iii) for 2009, a settlement of litigation and related charges, net, of \$0.4 million, and impairment of capitalized software development costs and license fees cancelled games of \$1.0 million; (iv) for 2008, a settlement of litigation and related charges, net, of \$1.6 million, and impairment of software development costs and license fees cancelled games of \$0.1 million; and (v) for 2007, a settlement of litigation and related charges, net, of \$2.8 million, a gain from settlement of liabilities of \$0.3 million and impairment of software development costs and license fees cancelled games of \$0.2 million.
- (3) Other non-operating expense includes: (i) for 2011, a loss from a change in fair value of warrants of \$2.8 million; (ii) for 2010, a gain from a change in fair value of warrants of \$0.5 million; (iii) for 2009, a loss from a change in fair value of warrants of \$0.4 million; (iv) for 2008, a gain from a change in fair value of warrants of \$1.3 million; and (v) for 2007, a gain from a change in fair value of warrants of \$0.6 million.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

You should read the following discussion and analysis of our financial condition and results of operations together with Selected Financial Data and our consolidated financial statements and related notes appearing elsewhere in this annual report on Form 10-K. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under Risk Factors and elsewhere in this annual report on Form 10-K.

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, video game rental outlets 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 like 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 provisions 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. 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 the product costs as a percentage of revenue is 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 loss on impairment of software development costs and license fees 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 our cost of supervision of third party video game developers, testing new products and conducting quality assurance evaluations during the development cycle as well as costs incurred at our development studio, which was closed in 2009, that are not allocated to games for which technological feasibility has been established. Costs incurred are primarily employee-related, may include equipment, and are not allocated to cost of sales.

Selling and Marketing Expenses. Selling and marketing expenses consist of marketing and promotion expenses, 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 SEC filings.

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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/(benefit) 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 (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. In fiscal 2011, we reversed our valuation allowance to the extent of our NOL used.

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 of America (GAAP).

The preparation of these consolidated financial statements requires us to m