

GALAXY GAMING INC. (OTC BB: GLXZ)

INDUSTRY: GAMING EQUIPMENT

DISCLOSURES: 1, 4AD, 10

RATING: STRONG BUY

RISK: HIGH

CLOSING PRICE 09/30/10	TRAILING P/E (TTM)	SHARES OUT (MILS.)	MARKET CAP (MILS.)	3-5 YEAR REV. GROWTH	PRICE TARGET (PROJECTED)
\$0.42	N/A	36.3	\$15.3	65%	\$0.80

ANNUAL DATA – DEC YEAR END			
	2009A	2010E	2011E
EPS	\$ (0.01)	\$ 0.00	\$ 0.05
P/E	N/M	N/M	25.0x
REVENUE (MIL.)	\$2.8	\$3.1	\$5.9
P/S	5.5	4.9	1.6

EARNINGS					
	Q1	Q2	Q3	Q4	ANNUAL
2011E	\$0.00	\$0.01	\$0.01	\$0.02	\$0.05
2010E	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
2009A	\$0.00	\$0.00	\$0.00	\$(0.01)	\$(0.01)

GALAXY GAMING, INC: SPENDING SEVERAL DAYS WITH “SAUCIER THE SPHINX.”

Recommendation: “Strong Buy”—GLXZ shares seem notably poised to benefit from multiple attributes affecting future of Company valuation. Factors include:

1. Finally, Las Vegas’ casino operations witnessed small pick-up in gaming and room operations reversing long down-trend caused from economic decline.
2. State governments hoping to add revenues to cover deficits have made a mad rush to throw-down “welcome mats” to casino operations in almost every jurisdiction expanding the market for GLXZ and its new, table game products.
3. An industry winning game (“Triple Attack Blackjack” that soon should have Gaming Control Board clearance in NV), the introduction of a new table game (“Kokomo Stud”) and the addition of both PA and CO (and potentially CT) should help further spur GLXZ’s growth of its table game base.
4. The expansion of GLXZ’s Bonus Jackpot System into NV could create real competitive pressure against ShuffleMaster (Nasdaq: SHFL--\$8.41).
5. And, the successful “test” and eventual re-launch of the Inter-Casino Jackpot Network, which should be in Q-4, was shown to be a real crowd pleaser and money maker in July.

This last product alone should make the shares very attractive for equity investors—it combines a hint of the USA Mega Jackpot “lifestyle altering win” potential on top of GLXZ’s table game operating focus and major role as bankrolling facilitator: Combined with the other four aspects outlined above, GLXZ is very appealing for intermediate and long-term capital gains.

WHY THE “SPHINX”

Aren’t all the big players in Las Vegas supposed to have some sort of ‘Handle?’ I mean the people of lesser quality (You can’t mention that kind by their real name in any association with GLXZ since it is a public company and an entity with commission oversight.) who all had “other names” like Bugsy, the Ant, Lefty, Doc, and so on...

Anyway, after working with Robert Saucier, GLXZ’s CEO for a while, you come to learn not to expect—either good or bad—a lot in ebullient effervescence in emotion. I don’t know if it has to do with the amount of time he has played at poker tables, or negotiating deals or just his natural character of being always neutral in his mannerisms. To me, the guy, expressively, is a Sphinx.

You remember the gargantuan stone structure, the Sphinx of Giza, that is a symbol representing the essence of Egypt for thousands of years. The monumental sculpture is a mythological creature that is depicted as a recumbent feline with a human head. But the face, be it of this beast or one of the many others found about the world, always appears to know much more than it tells. This is so true of Saucier and my trying to read him. And, I guess in his business with the gambling commissions that he has to deal with across the country and the characteristics of his own operation, that's not a bad attribute to possess.

Regarding Robert's occasionally expressive reactions, I did notice him really chortle during the conference luncheon while an economist delivered a pretty good punch line at the cost of the current Administration. Indeed, everyone at the presentation chuckled but few are laughing during their everyday, daily lives.

Another good laugh that I witnessed occurred when one of Galaxy's long-time, Industry Analysts observed after Saucier announced that the Company obtained 99% gross margins during their 2010 Second Quarter and 98% recurring revenue; the Wag announced that, "He didn't believe that most Crack Cocaine Dealers could expect 99% gross margins and 98% recurring revenues!" Yes, it also brought out a very good laugh throughout the audience.

But most of the time Saucier is pretty stoic about the many aspects of Galaxy's outlook.

THAT DOESN'T MEAN HE'S NOT OPTIMISTIC ABOUT THE FUTURE.

One doesn't have to look too far to see that GLXZ's operations are well aligned to assemble some fairly interesting stair-step improvements to its results. As we worked together in Southern California, I became more and more convinced that the Company was about to hit some very positive strides regarding incremental profitability:

- Earlier we produced a memo and model on the "Manufacturers Bonus Jackpot" (as the product keeps evolving, it has had many names such as Manufacturer's Gambling Promotion, Jackpot Financing Program, Inter-Casino Jackpot Network and it may be introduced to players as "Galaxy Gaming's Gazillions") and the significant contribution this new game adds to the Company's operating line. Although Saucier has not said, my guess is that the Washington Commission has cleared the way for the "re-start" but the CEO is just waiting for a new operating demarcation where there will be clarity as to the definite contribution to the business. When 'GG' does start up, watch out. This is a good program for the sponsoring casino and a really good program for GLXZ. Like all progressive play games, the rising size of a truly life-altering jackpot is posted on the electronic tabulating display; the tables will no doubt attract hundreds, and then thousands of plays per day. (Within the 20 days of play during July when the test was operating in Washington, the average plays per day had already crested 600.) This not only speeds the increasing growth of the jackpot but also augments the rate of play.
- We noted that Pennsylvania and Colorado have both allowed authorization of GLXZ within the State. Already nine casinos in PA are currently operating table games out of a possible fourteen facilities, which means that a variety of opportunities are available for GLXZ. (In addition, the Sphinx kept watching his phone all during a recent conference expecting news on a couple other major east coast states that would allow the permitting of Galaxy games as well.) The point here is that states not previously known as gambling states are depending evermore on their "take" from legitimate casino operations in significantly assisting to help fight their States' budget shortfalls. More states are turning toward legalized gambling: This means more equipment and games are being purchased to facilitate the casinos role as "tax collector." This bodes very well for GLXZ. The Company has strong interest from casinos and expects game sales soon.
- Galaxy's "Triple Attack Blackjack" won "Best New Game for 2010" just this last week. This is an important and prestigious award for the Company and the new game: It means GLXZ has a "winner game" on its hands. But just as important is the fact that the game is really being "introduced" inside

out, meaning from Las Vegas (the “Gambling Capital of the World”) to the perimeter markets—that is to say that “Triple Attack” was really being introduced from the “Major Leagues” to the hinterlands unlike GLXZ’s past new entrées where they were introduced from the hinterlands and then marketed in toward Las Vegas. As well as the fact that Harrah’s, the world’s largest provider of branded casino entertainment, is field testing this very game for the Company’s Nevada Gaming Control Board review. Reports are Harrah’s seems excited and pleased about the game’s performance and returns. It is our guess that winning both the “Best New Game” title and the positive readings received from Harrah’s casino floor that *Triple Attack* will be used by a number of casinos in short order. The Company received a number of orders from attending casino operators at the conference where the award was presented. It is presumed that GLXZ may have Gaming Control Board approval by January and that the new game could be a significant contributor early in 2011 and for many years thereafter.

- The Bonus Jackpot System (GLXZ’s progressive electronic system that tracks each player’s wager and ties it to GLXZ’s data center: It also displays Jackpot and bonusing data to each player seated at the table.) is taking a well deserved step in the right direction. Surprisingly, the Company received Gaming Control Board approval in NV as we went to press...this “Win” in the state is monumental for several reasons. First, GLXZ received approval based on gaming lab tests only and required no field trials. This reduced the “time-to-market” for their platform by four months. Second, it allows GLXZ a progressive bonus table game system that competes against ShuffleMaster’s monopoly hold in the Gaming Capital of the World. Think of it. GLXZ’s new platform should be well received by casinos and compete well against Shuffle Master’s stranglehold position. Management believes that the BJS’s first installation in Nevada could be within a month or two. And as we go to press, we just learned that GLXZ’s “Andromeda Series version of its BJS (allowing for the electronic tracking of multiple side wagers at a time) received approval in Washington, as well. We believe this is a winner product for GLXZ paving the way for greater technical advancements.
- As we said, the “Jackpot Financing” system or “Inter-Casino Jackpot Network” system experienced a short and successful “test” In Washington. It seemed to be everything GLXZ wanted it to be. The program was interrupted by that States commission, but is expected to be reinstated shortly. Otherwise, GLXZ believes that there were reasons that the program returns should have worked even better than the original “test” produced. For instance, the casinos GLXZ used were clustered around Seattle and the start was in July (beautiful weather meaning too many outdoor alternatives caused a vacation diversion.) They also tested with two initial Jackpots (\$25,000 and \$50,000). The decision is to re-start the game with one, \$100,000 Jackpot, since that begins to represent a Life-Altering Win, and should really attract the players from the launch.

Once the program does resume, we believe it will likely boost the fourth quarter numbers and provide 2011 with a much more interesting earnings number even though management is projecting the addition of telephone service and backup support people to help provide maintenance and assistance to their casino clients.

GALAXY GAMING ANNOUNCES Q2 2010 FINANCIAL RESULTS

The Company reported Q 2 FY2010 financial results on August 10, 2010.

- Q2 2010 revenues were \$735.6 thousand vs. \$674.5 thousand, a +9.1% improvement from last year. Recurring revenues increased by 18% YTY to \$723 thousand from \$611 thousand versus last year.
- Gross profit was \$725 thousand vs. \$610 thousand, up 19% from last year; margin percentage increased to 99% from 90% last year due to a richer sales mix consisting of a higher proportion of recurring revenues. Last year’s period included lower margin product sale revenues from the deployment of 31 BJS systems; this year no BJS systems were reported.

- EBITDA profit was \$56 thousand compared with a loss of \$22 thousand last year due to strong expense controls.
- Net Profit was \$21 thousand compared to a loss of \$155 thousand last year, representing the Company's first profitable quarter.
- Current ratio for the period was 0.97x, down from 0.98x sequentially but up from 0.76x at calendar 2009 year-end, primarily reflecting increased cash (\$579k vs \$117k last year), and lower current liabilities.
- LT debt at period's end was \$1.175 million, versus \$1.172 million in 1Q 2010.

THOUGHTS ON VALUATION

Right now, it's very tough to see Galaxy exceeding our original EPS estimate for 2010 of \$0.01. But for 2011, there are a number of positive events packed into the mix (the improved environment, new jurisdictions, games, the BJS, the re-launch, etc.) that we would expect to raise GLXZ's trajectory for next year...potentially with a stronger dogleg in the latter half of the year.

Here's our cut on influences that should help the up-coming periods:

1. In the current quarter, there should be very marginal—but measurable—increase in business due to the one month's "test" dedicated to July's Manufacture's Financed Bonus Jackpot program as well as signs of very tepid growth.
2. In the last quarter, there should be a restart of the MFBJ but at the \$100,000 level (so it picks-up both the original 20 tables and begins to add new casino tables, as well)—the new regulated package is not as lucrative for Galaxy to start but it spurs the growth of other table game product due to the excitement the MFBJ attracts to the table game arena. In addition, some smaller BJS systems are placed in NV. The first shipment of table games are placed in PA, CO and CT begins with a small order. Kokomo Stud is introduced as a potential new game and submitted to several jurisdictions, but there is no actual financial impact. Additionally, two new sales people are added this quarter to help better balance and cover territories. Leadership of Ron Marx as sales and marketing manager starts: We witness some better coordination of effort, better habits and strategies, but no real measurable improvement because tangible gains in sales for the period are actually off-set by the seasonal decline,
3. For the first quarter in 2011, a seasonal pick-up for gambling across all territories actually occurs (seasonal and economic improvement is witnessed) plus the continued roll-out of MFBJ in WA but at a faster clip. Some of the larger casinos in NV should be enticed to add the BJS to their floors. "Triple Attack" starts to be sold in NV to several smaller and mid-sized casinos. Another major order for PA and small order for CT and CO for games. Two more sales people are added to the team.
4. New sales people begin to add a measurable contribution during the second quarter. Towards end of period, Kokomo Stud receives approval by NV and WA for play. New MFBJ is really beginning to catch-on: playing hands per day is not only tripled from original "test" numbers but "reserve" requirement for "default" problems is sufficiently covered and finally in last month revenues are rebounding at greater contribution than experienced in April or May.
5. By the third quarter, the Company is beginning to hit more than singles: We would not be surprised if GLXZ has purchased an additional up and operating game or two. There is contribution by the new BJS and MFBJ. Real bottom-line contribution is occurring.
6. Ditto for the fourth quarter but a much improved economic tenor has returned to Las Vegas and that is helping the level of play.

We are using at this time \$0.05 for an earnings estimate for 2011. It is possibly thought to be aggressive by most observers given Galaxy Gaming's history and the mere fact that it just turned profitable last quarter. BUT, it is rare where an analyst has seen so many factors line-up that can singularly act as catalysts to propel a company's fortune well beyond the linear growth trend onto some more interesting trajectory. With GLXZ, the

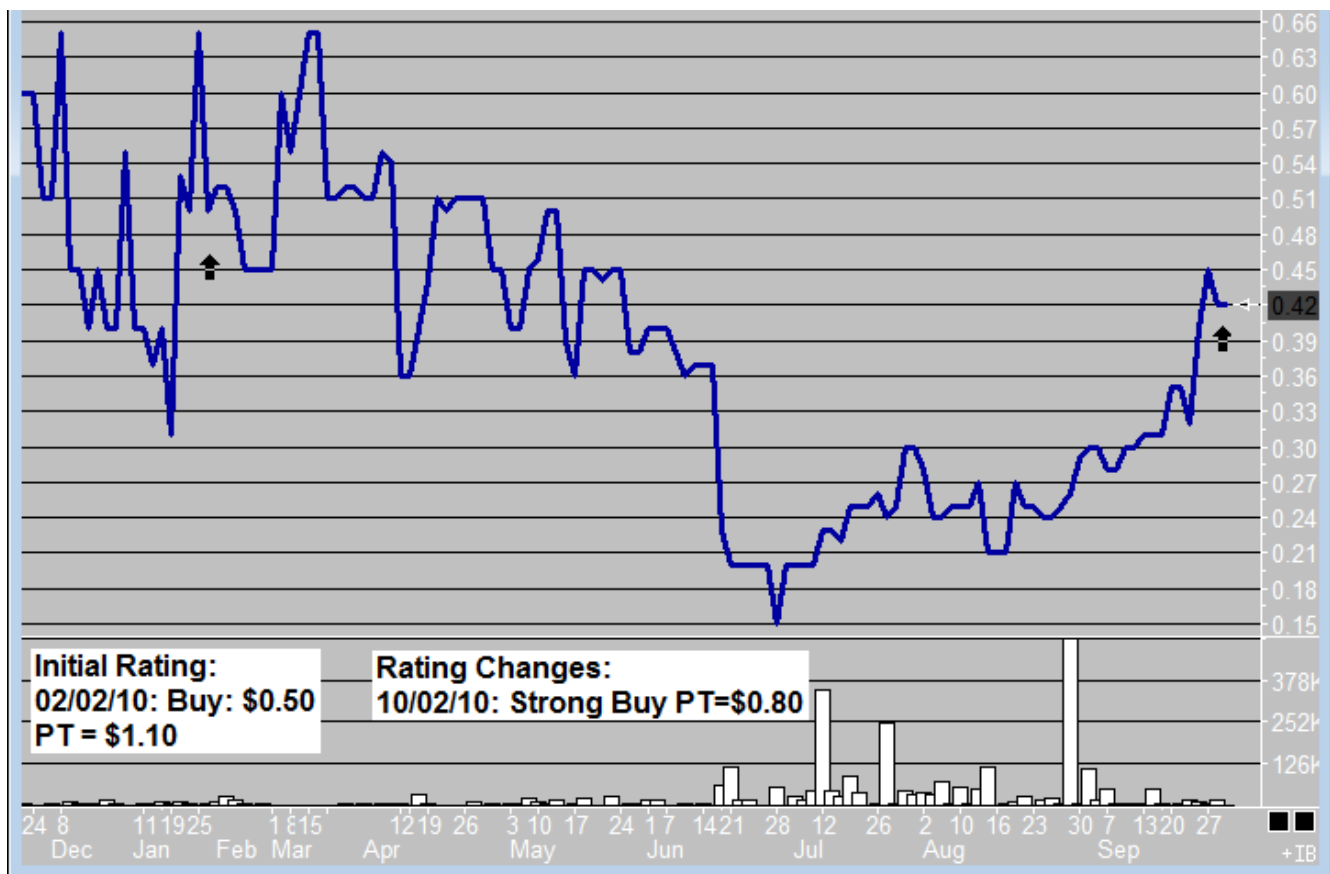
factors that could, or should, affect the earnings trajectory just seem all pointing to a higher target in the firmament.

I've actually heard the Sphinx utter that there is a "Syzygy" (my celestial term) combination of positive factors that are coming together but all grounded on the foundation of GLXZ's high profit margin and high recurring business platform.

From a valuation standpoint, the stock has been as high as \$1.10 during the last year. With \$0.05Est in earnings (and that does not include the potential for a blow-out for the MFBJ or some other event), it means that GLXZ would have to return to only a 20-times P/E multiple on next year's (or 2011) earnings. That seems quite reasonable. If the most probable occurrences happen and the year builds as we portrayed and the latter half of 2011 seems to be getting stronger, there is every likelihood that \$0.10 to \$0.15 could be a reasonable guess for 2012 and we'd see a more aggressive stance on valuation.

Right now, our official price target is \$0.80 for the intermediate-term on Galaxy Gaming shares.

GLXZ Price Chart



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Detailed Income Statement Model - Proforma for Continuing Operations

(\$ in thousands except for per share amounts)

	<i>Estimates-></i>											
	CY2008	CY2009	3/31/10	6/30/10	9/30/2010E	12/31/2010E	CY2010E	3/31/2011E	6/30/2011E	9/30/2011E	12/31/2011E	CY2011E
Gross revs	2,067	2,766	754	736	750	850	3,090	1,133	1,354	1,651	1,801	5,938
COGs	119	224	48	11	38	72	168	130	153	180	129	591
Gross Profit	1,948	2,542	706	725	713	778	2,922	1,003	1,201	1,471	1,672	5,347
Gross Margin	94.2%	91.9%	93.6%	98.5%	95.0%	91.6%	94.6%	88.5%	88.7%	89.1%	92.8%	90.0%
Oper. Exp.	2,359	2,742	783	680	680	720	2,863	800	870	925	1,000	3,595
Oper. Exp. %	114.1%	99.2%	103.9%	92.5%	90.6%	84.7%	92.7%	70.6%	64.3%	56.0%	55.5%	60.5%
Net Oper. Profit (Loss)	(411)	(200)	(77)	45	33	58	59	203	331	546	672	1,752
Net Oper. Profit %	-19.9%	-7.2%	-10.2%	6.1%	4.4%	6.8%	1.9%	17.9%	24.5%	33.1%	37.3%	29.5%
Other Inc. (Exp.)	(93)	(147)	(22)	(24)	(24)	(24)	(94)	(27)	(27)	(27)	(27)	(108)
Net profit (loss) Bef. Inc. tax	(504)	(348)	(100)	21	9	34	(36)	176	304	519	645	1,644
Prov. for Inc. Tax	-	-	-	-	-	-	-	-	-	-	-	0
Taxes %	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Profit (Loss) from Cont. O	(504)	(348)	(100)	21	9	34	(36)	176	304	519	645	1,644
Net Margin %	-24.4%	-12.6%	-13.2%	2.8%	1.2%	4.0%	-1.2%	15.5%	22.5%	31.4%	35.8%	27.7%
Wtd avg shares out. FD	162,862	30,475,812	33,076,186	36,275,473	36,300,000	36,400,000	35,512,915	35,850,000	36,125,000	36,300,000	36,500,000	36,193,750
EPS from continuing ops	(3.09)	(0.01)	(0.00)	0.00	0.00	0.00	(0.00)	0.00	0.01	0.01	0.02	0.05
Revs YTY % Chg	4.9%	33.8%	23.8%	9.1%	-4.0%	21.3%	11.7%	50.2%	84.0%	119.9%	112.0%	92.2%
Oper. Exp. YTY % Chg	29.5%	16.2%	26.3%	7.6%	0.6%	-11.6%	4.4%	2.2%	27.9%	36.0%	38.9%	25.6%
Oper. Profit (Loss) YTY % Ch	395.2%	-51.3%	120.6%	-303.4%	119.5%	-136.7%	NM	-363.0%	640.2%	1556.6%	1056.8%	NM
Net Income (Loss) YTY % Ch	500.0%	-31.0%	46.3%	-137.7%	-127.9%	-117.7%	-89.7%	-276.9%	1365.6%	5706.4%	1791.7%	-4703.4%
EPS from cont. ops. YTY % C	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Tables in play EOP	1,521	1,700	1,750	1,750	1,765	1,930	1,930	2,080	2,252	2,437	2,532	2,532
New Non Premium tables	-	-	47	-	15	135	197	75	85	85	55	300
New BJS	-	131	3	-	30	30	33	75	87	100	40	302
Avg Tables in Play	NA	1,611	1,725	1,750	1,758	1,848	1,815	2,005	2,166	2,345	2,485	2,231
\$/Table Period Avg		\$ 1,717.28	\$ 437.12	\$ 420.33	\$ 427.00	\$ 460.00	\$ 1,702.42	\$ 565.00	\$ 625.00	\$ 704.00	\$ 725.00	\$ 2,661.75
Gross Profit/table		\$ 1,578.37	\$ 409.24	\$ 414.17	\$ 405.65	\$ 421.17	\$ 1,609.79	\$ 500.28	\$ 554.59	\$ 627.21	\$ 673.05	\$ 2,396.68

Sources: GLXZ documents and CFS estimates

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- Accumulate** Purchase of the stock is recommended for above average appreciation over the next 12 to 18 months, but the buyer may have an opportunity to acquire the stock within a 10% trading range.
- Hold** Holding the stock is recommended because the share price has moved above the specific "Buy" range and, therefore, appreciation potential is less than or equal to the market.
- Sell** The stock has reached the target price objective and/or conditions have changed sufficiently to alter the outlook for the stock.

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- Moderate** The security has about the same volatility as the market and/or the company carries a level of leverage in line with its peer group.
- Low** The security is less volatile than the market and/or the company is less leveraged than its peer group.

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