eGames, Inc.

Annual Report
Fiscal 2009

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For the Fiscal Year Ended June 30, 2009

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PART I

This annual report contains forward-looking statements about future events and our future financial performance that involve risks and uncertainties. Actual events and our actual future financial results may differ substantially from the events and results discussed in the forward-looking statements due to various factors, including, but not limited to, those discussed in "Factors Affecting Future Performance" beginning on page 8.

Item 1. Business

GENERAL

eGames, Inc. ("eGames") is a Pennsylvania corporation incorporated in July 1992 that develops, publishes, markets and sells software games primarily for the personal computer ("PC"). Historically, eGames has focused on publishing casual software games for the PC platform, and selling the greatest volume of its' PC games in major mass-merchant retail stores. eGames now publishes third-party PC game titles and also develops its own proprietary PC game titles for distribution at retail and on the Internet. . Additionally, eGames has developed some titles for the Nintendo DS and Wii gaming systems and the Apple iPhone. In North America, our PC games are distributed to retail stores primarily through third-party software distributors who service the major mass-merchant retailers, while our Nintendo DS and Wii games are published and distributed worldwide by third-party publishers. In territories outside North America, we license our PC games to third-party software distributors that are responsible for the manufacture and distribution of our PC games within specific geographic territories. We market and sell our game titles under the eGames™ brand.

INDUSTRY BACKGROUND

The worldwide interactive game software market is very competitive. We compete with companies having operations varying from small companies with limited resources to large companies with much greater resources than we have. The constantly changing worldwide interactive game software market has been impacted by many factors, such as: an increasing number of technologically advanced PCs with more powerful operating systems, enhanced graphics and video cards, and expanded memory chips, as well as higher capacities and faster speeds for CD, DVD and hard drives in the home and office; greater access by consumers to the Internet through high-speed access modes (such as cable modems, fiber optics and DSL connections); increased interest in online game play; the increasing number of game console devices in the home; and the development of increasingly advanced technologies supporting game play (such as hand held game devices, mobile phones, and personal digital assistants).

Additionally, continued growth in the installed base of technologically advanced yet affordably priced PCs has made PC software games a mass-market commodity that continues to sell in greater volumes via Internet download. The development of this mass market for PC software games has contributed to increased competition in the casual PC game market. This increased competition has emphasized the importance of marketing, merchandising and brand name recognition. Faced with the challenges of marketing and distribution, many independent software developers for PC games are pursuing relationships with publishing companies with stronger distribution capabilities than ours, including better access to mass market retailers and large online game portals. At the same time, retailers with limited shelf space in their stores have an increasing number of software titles to select from. This factor has increased the competition for the declining amount of retail shelf space allocated to value-priced PC software games.

To offset the declines in revenues related to declining amounts of retail shelf space allocated to value-priced PC software games, we have attempted to increase the distribution of our games on the Internet by developing relationships with Internet game distributors and publishers, and have also undertaken the development of our own propriety content for PC games. We have also developed games for console, hand-held gaming platforms, and Apple iPhone. All of our proprietary game content is developed by independent contractors located in southern Brazil. During fiscal 2009 and 2008, we released a total of eleven proprietary game titles developed for the PC, Nintendo DS and Wii, and Apple iPhone. We expect to release a total of three proprietary game titles during fiscal 2010.

BUSINESS STRATEGY

We have transitioned our business model from one that relied entirely on licensing all of our published PC game software titles from independent software developers to a model where we hire independent contractors to develop our own proprietary game titles while continuing to also publish third-party licensed content. We now also develop our own titles for the Nintendo DS™ and Wii™ platforms. We distribute our own game titles as well as third-party licensed game properties across many of the major game portals on the Internet, which target North American and key worldwide markets, and internationally through licensees, while working to expand our retail presence at the major North American retail stores.

In August 2007, we began distributing the eGames toolbar as a convenient way to distribute and install our games and as a direct marketing vehicle on the Internet. The eGames toolbar installs within a user's Internet browser and, in addition to other valued user features, provides a convenient search window within the toolbar. User's utilizing the eGames toolbar search window will generate search advertising revenues for the sponsored search provider which is currently Yahoo. eGames shares in the search revenues generated from the eGames toolbar.

World economic conditions, as well as a decline in overall sales of videogames, have caused our revenues to decrease during the past fiscal year, causing us to reduce our development spending to conserve cash while once again focusing on licensing high-quality third-party titles for distribution at retail. We continue to work towards executing a business plan that focuses on:

- Gaining brand name recognition of our titles;
- Developing top-selling titles for the PC and alternate gaming platforms;
- Strengthening existing Internet and retail distribution and retail relationships and developing new ones;
- Expanding our online presence through partnerships with the major Internet game portals and improving our own website; and
- Seeking opportunities to acquire intellectual property, brands or other assets that will enable us to broaden our product offering at retail and on the Internet.

Continued development of our own proprietary game titles will be dependent on our ability to either increase revenues to increase our working capital available for development spending, or to raise capital in other ways. We are also evaluating marketplace sales data and Internet download rankings to determine which products to license or develop.

We design our games so they are easy to install and play, requiring little or no technical experience or subsequent support. We provide basic product support to consumers who purchase our products, and based on consumer feedback we may incorporate different or upgraded features within future titles.

During fiscal 2009, we have continued to distribute our games via the largest Internet game portals. Our retail distribution model enables North American retailers to buy our published titles either directly from us or from a distributor they prefer to supply their packaged software requirements. Almost all of our North American retail revenues today are derived from distribution and licensing relationships, with only minimal retail revenues recognized directly from retailers.

OUR WEBSITE

Our website, **www.egames.com**, is a comprehensive game portal website where visitors can try game demos, play games for free, buy a wide variety of game products, register software purchases, obtain product support, or review investor relations information such as corporate financial information, press releases and corporate governance documents. We seek to maintain a website that provides value added services and information to new and repeat visitors with our primary objective to sell more downloadable games. Our goal is to continually improve the quality of our website to increase sales of high-quality, compelling and easy-to-use casual PC games that are affordably priced and easily downloaded.

The Internet today is a dominant distribution channel for PC games. In calendar 2007, we launched our new website, targeting casual gamers looking for a site that offers all of the top-selling casual PC games in an easy-to-use format. Our website includes our own titles and a constantly-updated collection of high quality games licensed from top independent software developers. During fiscal 2010, we plan to release three new proprietary game titles, one of which will be a PC game that will be released on our website and on the top Internet game portals.

MARKETING

Our marketing efforts focus on:

- Coordinating marketing programs with Internet game portals and retailers;
- Participating in development conferences and trade shows;
- Improving our website (www.egames.com);
- Issuing press releases announcing new games and significant marketing deals;
- Distributing our PC games on the Internet via Internet game portals and our own website; and
- Distributing the eGames game toolbar via downloads serving as a direct marketing tool.

We design programs intended to increase Internet game portal, retailer, and consumer demand for our software products.

REVENUES AND DISTRIBUTION

Internet Revenues. Our primary objective is to sell our own game titles through the largest Internet game portals. There are seventeen major casual games portals in the Logler.com Global Casual Games Top Ten Index which ranks the top ten performing downloadable games based on weekly sales rankings provided by each website. The major casual game portals include: AOL Games, Arcadetown, Big Fish Games, EA's Pogo, Gamehouse, Grab.com, iWin, MSN Gaming Zone, Oberon Games, Playfirst, RealArcade, Reflexive, Shockwave, Trygames, Wildgames, Yahoo Games, and Zylom. There are many other casual game portals beyond this listing, and we seek online distribution on many of them.

North American Retail Revenues and Distribution. We also sell our products through national software distributors servicing North American mass-merchant and other major retailers, and we have direct sales relationships with certain retailers. During the year ended June 30, 2009, customers representing 10% or more of our net revenues were: Navarre, accounting for $979,000, or 27% of net revenues, and Ditan/Synergex, accounting for $343,000, or 10% of net revenues. During the year ended June 30, 2008, customers representing 10% or more of our net revenues were: Navarre, accounting for $1,015,000, or 26% of net revenues, and Ditan/Synergex, accounting for $499,000, or 13% of net revenues.

International Revenues. Our international distribution efforts are managed through licensing agreements covering various territories outside of North America, with the majority of our international revenues originating from the United Kingdom, Germany and Australia. Our international net revenues for the years ended June 30, 2009 and 2008, were $266,000 and $143,000, respectively, and represented 7% and 4% of net revenues, respectively.

COMPETITION

The video game industry is intensely competitive. The market for casual PC games is especially competitive as the largest game companies have all entered the casual PC game market with their own offerings, competing against the once-predominant smaller independent game developers. We believe the principal competitive factor for casual PC games is content quality, which is a combination of compelling game play, appealing graphics and sounds, technical compatibility and trouble-free operation, brand name recognition, price, merchandising, ease-of-use and reliability.

We compete with a variety of software game publishers, including Electronic Arts, Vivendi, Microsoft, Take-Two Interactive, THQ, Activision, Atari, NCSoft, Ubisoft, LucasArts, Mumbo Jumbo, Topics Entertainment, SelectSoft, Interplay, Oberon Games, Playfirst, RealArcade, and Shockwave. In the retail markets we are facing greater competition as a result of many factors, including less retail shelf space for the category as well as an increase in the number of competitive casual game offerings. We also face additional competition for consumer’s entertainment

purchases from other dominant gaming platforms, such as game consoles, handheld game devices and mobile phones.

The market for licensing product content from independent PC software game developers is also extremely competitive. As more of our competitors either contract with or acquire independent developers to develop casual game content for them, it becomes more difficult for us to license or have developed for us high-quality game content. This competition can also result if our competitors achieve better access to distribution channels, have greater financial resources, or have developed or acquired a widely recognized brand more attractive to a potential developer or licensor.

PRODUCT DEVELOPMENT

Our product development expenses for the years ended June 30, 2009 and 2008 were $1,466,000 and $1,498,000, respectively. Product development expenses consist of: personnel costs related to product development of Company owned titles, product management, content acquisition, quality assurance testing, packaging design, and website design and administration, along with outside services for product ratings, language localization, and quality assurance testing. Product development expenses may also include non-recoverable costs related to titles that did not achieve distribution into their intended retail channels.

Our product development and sales teams meet regularly to review new product opportunities, discuss new competitive products and recent market data, develop strategies for new products, and review the status and performance of current titles. This product development process, which is managed by the product development team by continually evaluating updated product review data, gives management valuable visibility into:

- Products currently being sold on the Internet and at the major North American retailers;
- Genres represented by upcoming titles;
- New product availability for presentation to the major North American retailers for upcoming quarters based on retailer shelf reset dates; and
- Timing and scope of financial commitments to license or develop future titles.

The content for our products is either developed by independent contractors under work-for-hire agreements so that we own the content that is developed (which costs are reflected in the Statements of Operations as "product development expenses"), or licensed from independent developers who retain ownership of the content and receive royalty payments from us (which costs are reflected in the Statements of Operations as "cost of revenues") based upon net revenues for titles containing their content.

All of our products are thoroughly tested by our quality assurance personnel before they are released for distribution on the Internet or to retailers. Products are typically tested for performance, compatibility with numerous popular PC brands and configurations, typical installation issues, functionality, and ease-of-use. Marketing and development employees are responsible for reviewing customer feedback, competitive products, product performance, and market positioning in order to help introduce additional titles that reflect current consumer trends while remaining consistent with our business strategy.

In addition to the development of our products' content, considerable effort is also spent on seeking ways to continually improve the presentation quality of our jewel case and box packaging. Since our products usually sell at a price of $20 or less, our retail products are considered consumer "impulse buys". Therefore, our main opportunity to capture the retail consumer's attention is through attractive packaging that effectively describes the title's key features and attributes relative to competitors' products. Internet consumers are enticed to download one hour trial versions which must exhibit robust game play and compelling storylines and characters in order to achieve a conversion to purchase online.

BACKLOG

Backlog applies only to retail order and revenues activity and we typically ship our products within several days after accepting a retailer or distributor purchase order, which is common in the PC software game industry. Consequently,

we do not generate a backlog of distributor or retailer purchase orders that have a significant impact on our future revenues or earnings.

PRODUCT SUPPORT

We provide telephone and Internet product support to consumers who purchase our products either on the Internet or at a retailer's store at no additional charge to them. The cost to provide this service is included in the price we charge to our distributors and retailers. We believe high quality user-friendly product support can provide valuable feedback to our marketing and software development personnel for use in the product development process. Accordingly, the support we provide to consumers is typically simple and low-level in nature and when it occurs it usually occurs shortly after consumers purchase our products. These services are rendered by our customer support staff and through the frequently asked questions section of our website, and the costs to provide these services have historically been minimal (about 1% of net revenues).

OPERATIONS

Our accounting, purchasing, inventory control, scheduling, order processing, and development activities are conducted at our sole physical location in Langhorne, Pennsylvania. Our information management system supports revenues and purchase order processing, inventory control, accounts receivable, accounts payable, general ledger, and financial reporting. We coordinate with our major suppliers through a customized material planning system which provides us with timely, accurate inventory information on a daily basis. This same system also incorporates a synchronized material requirements forecasting module that projects product availability and helps to minimize our product delivery lead times.

Subject to credit terms and product availability, distributor and retailer purchase orders are typically shipped from one of our third-party vendors' facilities shortly after we receive them. Based upon specific instructions from Company personnel, third-party vendors:

- Replicate our PC software game titles onto CDs and DVDs;
- Print our jewel case and box packaging;
- Assemble our completed jewel case and box products;
- Process and ship product orders received from retailers and distributors;
- Process products returned by retailers and distributors; and
- Warehouse inventory units and report all activity for Company titles on a weekly basis.

We have not experienced any material delays in production, assembly or delivery.

SEASONALITY

Our business and the videogame industry in general are highly seasonal primarily because there is more store traffic during the period commencing with back-to-school shopping beginning in August and continuing through the holiday selling season before culminating in January. Online downloads of software also typically increase during this timeframe as new computer purchases increase demand for software games. We typically experience our highest revenues during our second fiscal quarter, which ends on December 31st. Our financial results can also vary based on many factors, such as: the timing of retailer decisions to reset their software department offerings; changes in consumer demand for our products; the success or failure of our titles based on product sell-through results to consumers, which would then impact retail buyer's decisions on replenishment orders for those titles and their willingness to place additional orders for our new titles in the future.

EMPLOYEES AND INDEPENDENT PC SOFTWARE DEVELOPERS

At June 30, 2009, we had 12 full-time and 2 part-time employees, of which 4 were employed in product development, 4 in sales, marketing and customer support, and 6 in operations, finance and administration. In addition, we regularly utilize independent software developers in connection with our product development activities. No employees are represented by labor unions, and we have never experienced a work stoppage.

INTELLECTUAL PROPERTY RIGHTS

We rely primarily on a combination of trademark, copyright, trade secret and other proprietary rights laws, license agreements, third-party nondisclosure agreements, employee invention and confidentiality agreements and other methods to protect our proprietary rights. United States copyright law, international conventions and international treaties, however, may not provide meaningful protection against unauthorized duplication or infringement of our software. Policing unauthorized use of an easily duplicated and broadly disseminated product such as PC software is very difficult. Software piracy is expected to be a persistent problem for the software industry for the foreseeable future. If a significant amount of unauthorized copying of our products were to occur, our operating results and financial condition would be adversely affected.

Historically, all of our published software titles have been licensed from independent PC software game developers, and in such case we did not acquire the copyrights for the underlying content. These licenses are typically limited to use of the licensed rights in products for specific time periods. While we may have renewal rights for most of our content licenses, the publishing of our externally developed products is dependent on our ability to continue to obtain the intellectual property rights from these third parties on mutually agreeable terms and at satisfactory contractual rates. During fiscal 2006, we began using independent contractors to develop our titles under agreements that provide us with ownership rights to these titles. We have filed copyright and trademark applications for the game titles we have developed since then and plan to continue to file these applications to protect our intellectual property rights in those titles.

PC game developers and publishers are subject to infringement claims, and there has been substantial litigation in the industry regarding copyright, trademark and other intellectual property rights. When claims or litigation, with or without merit, are brought against us, such claims can and have been costly and result in a diversion of management's attention and our financial resources, which could have a material adverse effect on our business, operating results and financial condition. We can and have incurred substantial expenses in evaluating and defending such claims, regardless of the merit of the claims. In the event that there is a determination that we have infringed on a third party's intellectual property rights, we could incur significant monetary liability and be prevented from using these rights in the future.

FACTORS AFFECTING FUTURE PERFORMANCE

Our business is subject to many risks and uncertainties that could affect our future financial performance. If any of the events or circumstances identified below occurs, our business and financial performance could be adversely impacted, our actual results could differ materially from our expectations and the market value of our common stock could decline. Also, there may be additional risks and uncertainties that we are not currently aware of or that we currently do not believe are material that may negatively impact our future business and financial performance.

We have incurred net losses for the last five fiscal years. During the past five fiscal years, we have funded our business activities from cash previously generated from operations as well as a private offering of preferred stock during the 2008 fiscal year. If we are unable to return to profitability in the near future, we will not be able to continue to fund our operations at their current levels without securing additional outside financing. Our accumulated deficit at June 30, 2009 was $12,135,189. Our operations today are subject to all of the risks inherent in the operation of a thinly-capitalized small business in a highly competitive industry dominated by much larger and financially stronger competitors. The risk of business failure for a company such as ours is even greater in the current economic environment, with weak retail sales and decreased consumer spending. The primary risks we face include difficulties in licensing and developing quality content for our products, due to increased competition or lack of funding, or both; distributing and marketing our products on terms that are profitable and commercially reasonable to us; competition from other products in the same genres and at the price points that we sell our products; and unanticipated costs and expenses associated with product development, distribution, sales or marketing. Our future success will depend on our ability to become profitable in the development, marketing, distribution and sales of our current and future software products.

If we do not become profitable we will need additional funds, and we may not be able to obtain such funding when we need it. We currently do not have a line of credit with any outside lenders**.** Therefore, our capital requirements are funded from the cash flow generated from product revenues. If we are not able to achieve cash flows from operations at a level sufficient to support our business activities, we will require additional outside funds. Our current financial condition and the net losses we have incurred in the last five fiscal years, combined with the current economic climate and credit crisis, could adversely affect our ability to obtain additional financing, which makes us more vulnerable to industry downturns and competitive pressures. Additionally, we may only be able to raise needed funds on terms that would result in significant dilution or otherwise be unfavorable to existing shareholders. Our inability to secure additional funding when needed, or generate adequate funds from operations, would adversely impact our operation's viability.

We may not be able to continue to fund the development of game titles that we own. We have been using funds from our operations, royalty advances from other publishers, and a private offering completed in April 2008 to pay for the development of new game titles by independent contractors. While we believed this use of funds was in our best interests during fiscal 2009, we have not achieved the financial return on this investment in product development that we had expected. As of June 30th, 2009, only five of the fourteen titles we have developed internally and subsequently released have generated a combination of cash received and/or revenues earned in excess of the development costs for these titles. Our inability to fund the development of our own proprietary game titles may impact our ability to create a portfolio of intellectual game properties that could create more value for us than the licensing and publishing of third-party developed game properties.

A significant part of our revenues come from a limited number of customers because of consolidation in the retail marketplace. We continue to have a concentration of customers consisting of a few large software distributors and retailers. During the year ended June 30, 2009, customers representing 10% or more of our net revenues were: Navarre - $979,000, or 27% of net revenues, and Ditan/Synergex - $343,000, or 10% of net revenues, compared to the year ended June 30, 2008, when customers representing 10% or more of our net revenues were: Navarre - $1,015,000, or 26% of net revenues, and Ditan/Synergex - $499,000, or 13% of net revenues. Our financial condition, financial results and ability to continue as a going concern could be significantly affected if: we lost our distribution capability to the major North American retailers; if the amount of net revenues to Navarre, Ditan-Synergex, Visicom, Jack of All Games and Fry's were to substantially decrease; or if any of these major accounts were not able or willing to make timely receivable payments to us in the normal course of business.

We believe that our ability to collect, in a timely manner, the net account receivable owed by our major software distributors and licensees, and in particular our net accounts receivables with Navarre, Ditan-Synergex, Visicom, Jack of All Games, and Fry's, would significantly impact our ability to meet our financial obligations and to fund our operations for the foreseeable future.

If we cannot continue viable business relationships with our primary software distributors and retailers, this would materially harm our business. The terms of our business relationships with the primary software distributors and retailers of our products do not require them to purchase our products. Additionally, software distributors' and retailers purchases of our products are driven by consumer demand for our titles. If these software distributors and retailers were to stop distributing our products, our revenues would decline substantially and in a brief period of time. In addition, if software distributors and retailers were only willing to distribute our products on terms that were commercially unacceptable to us, our financial condition would be materially harmed. Our inability to negotiate commercially viable software distribution relationships with major software retailers and distributors, or the loss of, or significant reduction in revenues to, any of our primary software distributors or retailers, would adversely affect our business, operating results and financial condition.

The shelf space retailers are allocating to value priced PC software games continues to shrink, which has had a significant negative impact on our business. The reduced amount of shelf space being allocated to our category of products in retail stores during this fiscal year has continued to cause our net revenues to decrease significantly compared to prior fiscal years. We continue to see indications that the amount of retail shelf space being allocated to PC software games is decreasing, and we expect this trend to continue negatively impacting our results for the foreseeable future unless we are able to capitalize on one of our other strategies, including: increasing Internet and licensing revenues; developing titles for popular console platforms; and seeking alternative retail channels and

revenues sources. We cannot predict whether any of these other opportunities or strategies will be effective in increasing net revenues or in improving our financial condition or financial performance.

We depend on the market acceptance of our game titles, which typically have relatively short product life cycles. Our profitability depends on our ability to publish new game titles that are distributed into retail stores and on the Internet and are ultimately purchased by consumers. Our success is also dependent on increasing revenues of our products via the Internet, to keep pace with the growing number of sales of casual games through this medium and to make up for our loss of revenues from the North American retail channel. Although in fiscal 2010 we will continue to evaluate various product and marketing strategies to increase consumer demand for our products, both at retail and on the Internet, there is no assurance that any of these initiatives will be effective, particularly because consumer preferences for PC games are difficult to predict and only a few products achieve sustained market acceptance. Typical product lifecycles are no more than six to twelve months, and have recently been trending towards even shorter retail lifecycles. New products we introduce may not achieve any significant degree of market acceptance, or the product lifecycles may not be long enough for us to recover advance royalty, development, inventory, marketing and/or promotional costs. If a product does not sell through to consumers at a rate satisfactory to our retailers or distributors, we could be forced to accept substantial product returns or be required to issue significant price markdowns to maintain our distribution relationships with these distributors and retailers. We may also lose further retail shelf space if our products do not sell through to consumers at rates that satisfy retailers. The failure of new products to achieve or sustain market acceptance can materially and adversely impact our business, operating results and financial condition.

The consumer entertainment market is highly competitive and changes rapidly. A constantly increasing number of game titles on multiple gaming platforms are competing for consumers' entertainment spending dollars. Retailer changes to shelf space allocations, such as the reductions in retail shelf space for PC games, can continue to negatively affect our future revenues and operating results. Additionally, as revenues from sales of casual PC games increase on the Internet, we must be able to sell more of our products in that market in order to continue to compete in this industry. The competition for retail shelf space, as well as product placement on key Internet game portals, continues to intensify. We continue to see shifts in the market for PC software games that are likely to continue to negatively affect our operating results. Competition also results in greater leverage for software retailers, distributors and Internet game sites in negotiating terms of sale, including price markdowns, product return policies, purchase prices and revenue share, and our larger competitors may have more leverage than we do to negotiate better terms than we do. Our retail and distribution customers have no obligations to purchase our products, and may discontinue purchasing our products at any time. If our competitors develop more successful products than ours, offer competitive products at lower price points than ours, or if we are unable to develop consistently high-quality and well-received products, then our net revenues, operating results, and financial condition will decline.

If our major software distributors or retailers are not able or willing to pay us within the normal course of business, this would materially harm our financial condition. Software distributors and retailers in the consumer entertainment PC software industry and in mass-market retail channels can and have experienced significant fluctuations in their businesses and some of these companies have ceased operations. If any significant software retailer or distributor of our products experienced financial difficulties, became insolvent, or went out of business, this would significantly harm our business, operating results and financial condition. Our revenues are typically made on credit, with terms that vary depending upon the customer and the nature of the product. We do not hold collateral to secure payment. We maintain an allowance for bad debts for uncollectible accounts receivable, if any, which we believe to be adequate. The actual allowance for bad debts required for any one customer's account or on all of the accounts receivable in total, may ultimately be greater than our allowance for bad debts at any point in time. If any of our major software distributors, retailers, or licensees failed to pay an outstanding receivable, particularly Navarre, Ditan-Synergex, Visicom, Jack of All Games or Fry's, our business, operating results and financial condition would be significantly harmed.

Price markdowns and product returns could materially reduce our net revenues and results of operations. Many of our distribution and retail relationships allow for product returns and price markdowns, although most of our net product revenues are now related to consignment sales agreements, which means we do not record the revenues from shipments of these products until these inventory units have sold through to consumers. For our non-consignment revenue customers, we establish allowances for future product returns and price markdowns at the time

net revenues associated with retail product shipments are recognized. These allowances are based on many factors, including historical product returns and price markdowns, product sell-through results at retail store locations, field inventory at distributors' warehouses and at retail stores, the length of time that products have been released at retail along with their estimated remaining retail life, outstanding return material and price markdown authorizations, the introduction of new and/or competing software products that could negatively impact the revenues of our products, and the extent to which our newer products with higher retail prices or unproven genres remain in the retail channel. Our revenues to these customers are reported net of product return and price markdown provisions made at time of product shipment. Since the allowances we establish for product returns and price markdowns are estimates, actual product returns and price markdowns could ultimately exceed our established allowances for these anticipated amounts, which would negatively impact our results of operations.

Our operating results fluctuate from quarter to quarter, which makes our future operating results uncertain and difficult to predict. Our quarterly operating results have varied significantly in the past and will likely vary significantly in the future depending on numerous factors, many of which are not under our control. Comparative sequential and year-to-year quarterly operating results may provide little meaningful information or guidance because of our relatively small size and the impact on our net revenues resulting from the timing of purchase orders from software retailers and distributors and other changes in market forces. Fluctuations in quarterly operating results will depend upon many factors including, but not limited to:

- Seasonality of consumer demand for software games;
- Timing of changes to shelf space allocations for software games by major retailers;
- Number of competitor titles being offered within the core gaming genres in which we compete and at the same price points;
- Timing of product releases;
- Timing and the amount of product development and marketing expenditures required to bring future products to market;
- Timing of receiving and fulfillment of major software distributor and retailer purchase orders;
- Amount and timing of software retailer and distributor product returns and price markdown requests; and
- Timing of our competitors' new product introductions and product enhancements.

The seasonal nature of the retail game software market can have a negative impact on our financial results if our product releases and shipments do not maximize revenues during key selling periods. The retail game software industry is highly seasonal with revenues tending to be higher during the quarter ending December 31st. Delays in product development or manufacturing can affect the timing of the release of our products, causing us to miss out on key selling periods, such as the year-end holiday season. If retailers decide not to sell our products, or substantially reduce the number of our titles that they sell during this key holiday selling season, our net revenues would decline substantially and our operating results would be adversely affected. If we miss product deliveries during these key selling periods, or if our products are not ready for shipment to meet these critical selling periods, our net revenues and operating results would also be adversely affected. Additionally, if our products do not get adequate distribution into the major North American software retailers' stores or do not sell-through to consumers during these key selling periods, our financial results for the entire fiscal year would be adversely affected.

Our business is dependent on commercially viable product development and licensing arrangements. Independent software developers develop all of the content for our software titles, whether the software is licensed to us as a finished product or developed for us via work for hire agreements. Our success in introducing new software game titles depends on our ability to maintain relationships and enter into new product development and licensing agreements on favorable terms with skilled independent software developers. If we are not able to obtain quality content on commercially viable terms from independent software developers, this would also adversely affect our business and financial results.

Our present or future competitors may develop products that are comparable or superior to ours. Our competitors may offer higher quality products, lower priced products or adapt more quickly than we do to new technologies or evolving customer requirements. Our competitors typically have more financial resources to spend on marketing promotions, sales incentives, packaging treatments, licensing more recognizable brands, and

advertising efforts. Competition has continued to intensify as our industry has consolidated, since we have remained a small software publisher and most of our competitors have either grown larger or have gone out of business. In order to be successful in the future, we must be able to better respond to technological changes, customer requirements and competitors' current products and innovations. We may not be able to compete effectively in this market, which would adversely affect our operating results and financial condition.

Our common stock has experienced low trading volumes and unpredictable volatility on the Pink Sheets. Our shares of Common Stock are currently traded on the Pink Sheets under the symbol EGAM, and we currently do not qualify for listing on any of the major exchanges, such as Nasdaq or the American Stock Exchange. Many stocks traded on the Pink Sheets – including our stock - have experienced significant price and trading volume fluctuations. These fluctuations are often unrelated or disproportionate to the operating performance of individual companies. Our stock price may be adversely affected by such fluctuations, regardless of our operating results. Additionally, many common stocks traded on the Pink Sheets are thinly traded, such as our common stock, which can make it difficult to sell shares of our stock.

We may have difficulty protecting our intellectual property rights. We either own or have licensed the rights to copyrights for our product content, trademarks and our corporate name and logo. We may not have sufficient financial, legal and administrative resources to adequately protect our intellectual property rights, and our existing or future copyrights, trademarks, trade secrets or other intellectual property rights may not be of sufficient scope or strength to provide meaningful protection or commercial advantage to us. If we are not able to sufficiently protect our intellectual property rights, this would have an adverse effect on our business and operating results and on the overall value of our company.

We may incur substantial expenses and be required to use our internal resources to defend infringement claims, and settlements may not be favorable or attainable. We may from time to time be notified that we are infringing the intellectual property rights of others. Combinations of content acquired through past or future acquisitions and content licensed from or developed by independent software developers may give rise to claims of infringement. In past years, we have incurred significant defense costs and utilized substantial internal resources in defending trademark and copyright claims and lawsuits. Other third parties may initiate infringement actions against us in the future. Any future claims could result in substantial costs to us, and diversion of our limited resources. If we are found to be infringing the rights of others, we may not be able to obtain licenses on acceptable terms or at all, and significant damages for past infringement may be assessed, or further litigation relating to any such licenses or usage may occur. Our failure to obtain necessary licenses or other rights, or the initiation of litigation arising from any such claims, could materially and adversely affect our operating results.

We are exposed to the risk of product defects. Products we offer can contain errors or defects. The PC hardware environment is characterized by a wide variety of non-standard peripherals, such as sound and graphics cards, and configurations that make pre-release testing for programming or compatibility errors difficult and time-consuming. Despite the extensive testing performed by our quality assurance personnel, new products or releases may contain errors discovered after shipments have commenced, resulting in a loss of or delay in market acceptance or product recalls, which would adversely affect our business, operating results and financial condition.

We depend on key management and technical personnel. We rely on our management and other key personnel for the operation of our business, especially since we have so few employees. We are dependent upon the expertise and skills of several key sales, marketing and product development employees, and there can be no assurance that we will be able to continue to retain these personnel at current compensation levels, or at all. Failure to retain qualified personnel could materially adversely affect our business and prospects.

We may experience risks related to our international revenues and distribution efforts. International net revenues, primarily consisting of licensing revenues, represented $266,000, or 7% of net revenues for the fiscal year ended June 30, 2009, compared to $143,000, or 4% of net revenues for the fiscal year ended June 30, 2008. We anticipate that in fiscal 2010 our international business will continue to be transacted primarily through third-party licensees, which is subject to some risks that our domestic business is not, including: varying regulatory requirements; difficulties in managing foreign distributors; potentially adverse tax consequences; and difficulties in collecting delinquent accounts receivable. Additionally, because our international business is concentrated among a

small number of third-party licensees, the business failure of any one of these licensees, and the resulting inability for us to collect the related outstanding licensing receivable, could have a material adverse effect on our financial condition.

Properties

As of June 30, 2009, we leased 5,000 square feet of office space in Langhorne, Pennsylvania under an operating lease scheduled to expire on September 30, 2010. We believe that our current operating facility will be adequate for our anticipated needs through at least June 30, 2010. For the years ended June 30, 2009 and 2008, rent expense for our operating facility was $57,000 and $56,000, respectively.

Legal Proceedings

None

Submission of Matters to a Vote of Security Holders

None.

Transfer Agent

Our Transfer Agent is:

StockTrans, Inc.
44 West Lancaster Avenue
Ardmore, Pennsylvania 19003
Phone: 1-800-733-1121
Fax: 610-649-7302
Website: www.stocktrans.com

PART II

Market for Common Equity, Related Stockholder Matters and Purchases of Equity Securities

Our common stock, which has no par value, began trading on the Pink Sheets' electronic quotation service under the symbol "EGAM" during February 2007. Our common stock traded on the Over the Counter Bulletin Board ("OTCBB") under the symbol "EGAM" from April 2001 until February 2007, after having traded on the Nasdaq SmallCap Market under the same symbol from the time the Company went public in October 1995. The quotations below reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

The following table sets forth the quarterly high and low closing price per share of our common stock for the fiscal years ended June 30, 2009 and 2008, as reported by the Pink Sheets:

	High	Low
Fiscal Year Ended June 30, 2009		
First Quarter	$ 0.70	$ 0.45
Second Quarter	$ 0.65	$ 0.25
Third Quarter	$ 0.35	$ 0.10
Fourth Quarter	$ 0.28	$ 0.10
Fiscal Year Ended June 30, 2008		
First Quarter	$ 1.40	$ 0.84
Second Quarter	$ 1.03	$ 0.82
Third Quarter	$ 0.90	$ 0.52
Fourth Quarter	$ 0.70	$ 0.50

At June 30, 2009, we had approximately 160 shareholders of record.

We currently intend to retain earnings, if any, for use in funding our business and do not anticipate paying cash dividends to common stock shareholders in the foreseeable future.

As discussed in Note 13 in the "Notes to Financial Statements", we currently intend to continue making or accumulating quarterly dividend payments to shareholders of our Preferred Stock in accordance with the terms of the Preferred Stock.

Management's Discussion and Analysis or Plan of Operation

FORWARD-LOOKING STATEMENT SAFE HARBOR

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Reform Act"). All statements made in this report, other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial condition, are forward looking and are intended to be made pursuant to the safe harbor provisions of the 1995 Reform Act. We use the words "believe", "expect", "anticipate", "intend", "will", "should", "may" and similar expressions to identify forward-looking statements. These forward-looking statements are subject to business volatility, economic risk, and world events, which are inherently uncertain and difficult to predict. Our actual results could differ materially from management's expectations due to such risks. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. In particular, these forward-looking statements include, among others, statements about:

- Our estimate that fiscal 2010 product development expense may decrease to the range of $800,000 to $1,000,000 and our intention to focus instead on licensing selected third-party titles for distribution at retail;
- Our intention during fiscal 2010 to continue seeking retail placement for both retail boxed game titles at the $19.99 retail price point and jewel case titles at the $9.99 price point;

- Our expectation that during fiscal 2010 our revenues from consignment and sell-through agreements will continue representing the majority of our net traditional product revenues;
- Our intention to continue to place our PC games on the most popular Internet game portals and on our own game portal at www.egames.com, and to seek new opportunities to generate additional revenues from installations of the eGames toolbar;
- Our expectation that our toolbar revenues may stay flat or decline in fiscal 2010 based on recent trends;
- Our expectation that we will receive additional quantities of discontinued titles back from retailers that need to be liquidated, along with any quantities of those titles remaining in our warehouse;
- Our plan to continue selling our products to software distributors and retailers that charge promotional and merchandising fees, and accordingly we expect these types of costs to continue reducing our net revenues;
- Our belief that our ability to collect, in a timely manner, the net account receivable owed by our major software distributors and licensees will significantly impact our ability to meet our financial obligations and to fund our operations for the foreseeable future;
- Our belief that our ability to pay our trade vendors' invoices in a timely manner has become significantly more difficult between June 30, 2008 and June 30, 2009;
- Our evaluation of alternatives to secure outside financing sufficient to support the operating requirements of our current business plan;
- Our expectation that if we are unable during fiscal 2010 to increase our net revenues associated with the retail channel, while at the same time increasing our Internet revenues and licensing revenues, we will not be able to continue funding the significant development expenditures associated with our product development efforts, which in the past two fiscal years has been a critical component of our strategy to enable us to continue operating in an increasingly competitive videogame industry; and
- Our expectation that the adoption of recent accounting pronouncements will not have a material impact on our financial statements.

The following important factors, as well as those factors discussed under "Factors Affecting Future Performance" beginning on page 8 in this report, could cause our actual results to differ materially from those indicated by the forward-looking statements contained in this report:

- the market acceptance and successful sell-through of our products at retail stores and on the Internet
- the shelf space allocated to our products at retail;
- our ability to place Company owned game titles on key Internet game portals;
- our ability to increase our retail and Internet revenues and licensing revenues;
- maintaining commercially viable relationships with our principal software distributors, retailers and licensees;
- collecting timely receivable payments from our concentrated group of software distributors, retailers and licensees;
- maintaining acceptable payment terms with our trade vendors;
- declines in toolbar installations from declining sales of our game titles wrapped with the eGames toolbar;
- increased competition from other toolbar providers;
- the amount of unsold product that is returned to us by retailers and distributors;
- the amount of price markdowns granted to retailers and distributors;
- our ability to accurately estimate the amount of product returns and price markdowns that will occur and the adequacy of the allowances established for such product returns and price markdowns;
- our ability to control the development, promotional, manufacturing and distribution costs of our software titles;
- our ability to retain a sufficient number of knowledgeable employees to operate our business;
- our ability to increase the distribution of our products into key North American mass-merchant retailers and Internet game portals, and to enter into new distribution and direct sales relationships on commercially acceptable terms;

- the ability of our international product distribution through licensing agreements to earn a royalty and the ability of our licensees to pay us such royalties within agreed upon terms;
- the ability to deliver products in response to customer orders within a commercially acceptable time frame;
- fluctuating costs of developing, producing and marketing our products;
- our ability to license or develop quality content for our products;
- the success of our efforts to increase website traffic and product revenues over the Internet on our websites;
- consumers' continued demand for casual game software;
- increased competition in the affordable software category; and
- various other factors, many of which are beyond our control.

About eGames

eGames, Inc. ("eGames") is a Pennsylvania corporation incorporated in July 1992 that develops, publishes, markets and sells software games primarily for the personal computer ("PC"). Historically, eGames has focused on publishing casual software games for the PC platform, and selling the greatest volume of its' PC games in major mass-merchant retail stores. eGames now publishes third-party PC game titles and also develops its own proprietary PC game titles for distribution at retail and on the Internet. Additionally, eGames has developed some titles for the Nintendo DS and Wii gaming systems and the Apple iPhone. In North America, our PC games are distributed to retail stores primarily through third-party software distributors who service the major mass-merchant retailers, while our Nintendo DS and Wii games are published and distributed worldwide by third-party publishers. In territories outside North America, we license our PC games to third-party software distributors that are responsible for the manufacture and distribution of our PC games within specific geographic territories. We market and sell our game titles under the eGames™ brand.

Significant Trends and Events in our Business

<u>Development and Licensing of Game Titles</u>

Prior to fiscal 2007, the majority of our published titles were licensed from third-party game developers and so we incurred lower product development costs on those titles. During fiscal 2007, we began to significantly expand the development of our own proprietary PC game titles by using independent contractors under work-for-hire agreements, and in fiscal 2009 that development has continued. During fiscal 2008 and 2009, we completed the development of eleven proprietary game titles. These titles have been released on the Internet for consumers to download, and/or have been distributed internationally via third-party licensing agreements and domestically at retail stores, either directly or through third party licensees. Product development expense for the year ended June 30, 2009 was $1,466,000 compared to $1,498,000 for the year ended June 30, 2008. We currently estimate that our fiscal 2010 product development expense may decrease to the range of $800,000 to $1,000,000, in order to conserve our limited cash resources and focus instead on licensing selected third-party titles for distribution at retail, which have historically cost less for us to bring to market than developing our own proprietary titles.

Product development expenses consist of personnel costs related to product development of company-owned titles, product management, content acquisition, quality assurance testing, packaging design, website design and administration, and outside services for product ratings, language localization, and quality assurance testing.

The content for our products is either developed by independent contractors under work-for-hire agreements so that we own the content developed (which costs are reflected in the statements of operations as "product development expenses"), or licensed from independent developers who retain ownership of the content and receive royalty payments from us (which costs are reflected in the statements of operations as "cost of revenues") based upon net revenues for titles containing their content.

Critical Accounting Policies and Estimates

Our significant accounting policies and methods used in the preparation of the Financial Statements are discussed in Note 1 of the Notes to Financial Statements. We believe our policies for revenue recognition, inventory valuation and recoverability of advanced licensing and royalty payments require us to make significant judgments and estimates that could materially affect the amount of revenue we recognize, the cost of revenues we expense, and the reported net values for inventory, accounts receivable, prepaid and other expenses. Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates for product returns, price markdowns, customer bad debts, inventory obsolescence, recoverable values of advanced licensing and royalty payments, income tax expense, contingencies and litigation risks. We base our estimates on historical experience and on various other factors and assumptions that we believe are appropriate. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition (Net Revenues, Product Returns and Price Markdowns)

We distribute the majority of our products through third-party software distributors to the major North American mass-merchant retailers and directly to certain North American PC software retailers. The distribution of our products is governed by purchase orders, distribution agreements or direct sale agreements, most of which allow for product returns and price markdowns and have shipping terms of FOB destination. For product shipments to software distributors and retailers having non-consignment terms, we record a provision for product returns and price markdowns as a reduction to gross revenues at the time the title of our product transfers to the distributor or retailer.

However, if we determine that the underlying terms of a retailer's or distributor's purchase order, distribution or sales agreement do not qualify as a sale, or if we determine that we are not able to estimate an appropriate provision for product returns and price markdowns for any retailer or distributor, we then recognize revenues for product deliveries to these retailers or distributors on a consignment basis (revenue is reported to the extent that the software distributor or retailer has reported to us that our product has sold through to consumers).

During fiscal 2009, we continued to recognize a substantial portion of revenue on a consignment basis. Revenues from product shipments pursuant to these types of agreements are only recognized to the extent that the distributor or retailer has reported to us that our product has sold through to consumers. For the years ended June 30, 2009 and 2008, revenues recognized under these consignment and sell-through agreements were $1,130,000 and $1,216,000, respectively, and represented 61% and 49% of net traditional product revenues. We anticipate that during fiscal 2010 our revenues from consignment and sell-through agreements will continue representing the majority of our net traditional product revenues.

Key Assumptions

Our provision for anticipated product returns and price markdowns is based on the assumptions we make after evaluating various factors, including: our analysis of historical product return and price markdown results; current product sell-through activity at retail store locations; current field inventory quantities at distributors' warehouses and at retail store locations; the length of time that products have been released at retail along with their estimated remaining retail life; the introduction of new and/or competing software products that could negatively impact the revenues of our current products; and outstanding return material and price markdown authorizations.

The adequacy of our allowance for product returns and price markdowns is reviewed throughout each reporting period and any necessary adjustment to this allowance is reflected within the current reporting period's provision for product returns and price markdowns. Significant management judgments and estimates must be made and used in order to determine how much revenue can be recognized in any reporting period. Material differences may result in the amount and timing of our revenue for any period if management's judgments or estimates for product returns or price markdowns prove to be insufficient or excessive compared to actual results.

Inventory Valuation

Our inventory valuation policy requires management to make estimates and assumptions about the recoverability of the carrying value of inventory as of the end of each reporting period and cost of revenues expensed during each reporting period. The individual components of our software titles that are usually reflected in our net inventory valuation include some combination of the manufactured costs of: CD's; DVD's; jewel cases; box packaging; print materials; shrink-wraps; wafer-seals; assembly and other miscellaneous items particular to specific titles. Our inventory could be valued differently at the close of any reporting period and the amount of expense recorded as cost of revenues during any reporting period could differ, if management's judgments or estimates for the impairment of inventory value (recorded through the provision for inventory obsolescence within our Statement of Operations) are insufficient or excessive when compared to actual results.

Key Assumptions

Our provision for inventory obsolescence is based on the assumptions we make after evaluating the remaining value of existing inventory units (consisting of unsold warehouse units, consignment units and estimated product return units remaining at retailers' stores), which involves: assessing the remaining product life of existing titles based on how long the titles have been released at retail; analyzing the trend of current product sell-through activity to consumers for existing titles; identification of competitors' new products with greater capabilities or more recognizable brands that could replace or shorten the lifecycles of our existing titles; assessing the potential for litigation that may affect our ability to sell existing titles containing certain product content; monitoring expiration dates of licensing agreements with software developers for content within existing titles; and tracking the current market value for remaining units of discontinued titles based on recent revenues of similar products to inventory liquidators and discount retailers.

Although we attempt to accurately match production requirements of our products to forecasted consumer demand, at the end of a product's lifecycle we usually have some level of excess inventory units that we will attempt to dispose of through the inventory liquidation channel. If we cannot liquidate such inventory, or if we are unable to sell any remaining units due to legal or other reasons, we would then write down the remaining inventory value to zero. The adequacy of our allowance for inventory obsolescence is reviewed throughout each reporting period, and any necessary adjustment to this allowance is reflected in the current reporting period's provision for inventory obsolescence.

Advance Licensing and Royalty Payments

We make advance licensing and royalty payments to independent software developers and other licensors for the licensing of software content and intellectual properties for use within some of our PC software titles. These advance payments are initially classified on our balance sheet as "Prepaid and other expenses", and are then usually expensed within the "Cost of revenues" category of our Statements of Operations at the greater of the contractual or effective royalty rate.

Key Assumptions

We continually evaluate the recoverability of our advance licensing and royalty payments by reviewing the information available about each title and the underlying licensed content in existing titles. In particular, we evaluate the potential future revenues of a title or subsequent titles containing the same licensed content based on current and potential revenue programs, along with historical sell-through results of a title and similar titles, if any, to consumers. For titles that have achieved distribution into their intended retail channels, we charge to cost of revenues the remaining costs we determine to be non-recoverable in future periods. In the rare circumstance that a title does not achieve distribution into its intended retail channels, we charge to product development expense the remaining costs we determine to be non-recoverable in future periods. Non-recoverable costs are expensed in the reporting period in which management determines that it is not likely that we will be able to recover these costs in future periods.

Results of Operations

The following discussion should be read together with our Financial Statements and Notes beginning on page 28. Amounts, other than percentages, discussed within the "Management's Discussion and Analysis or Plan of Operation" have been rounded to the nearest thousand ("000") dollars.

Year Ended June 30, 2009 Compared to the Year Ended June 30, 2008:

Net Revenues

Net revenues decreased by $394,000, or 10%, to $3,562,000 for the fiscal year ended June 30, 2009, compared to $3,956,000 for the year ended June 30, 2008. The $394,000 decrease in net revenues resulted from a decline in traditional product revenues of $622,000, traceable to a reduction in retail distribution and lower consumer demand for our PC game titles, combined with a reduction in liquidation product revenues of $27,000. Partially offsetting these revenue decreases was a $180,000 increase in Internet revenues related to greater toolbar and egames.com revenues, and a $75,000 increase in licensing revenues related to proprietary titles developed for the Nintendo DS and Wii game consoles.

The following table represents our net revenues by distribution channel for the fiscal years ended June 30, 2009 and 2008:

Net Revenues by Distribution Channel

	Years Ended June 30,					
Distribution Channel	**2009**	**%**	**2008**	**%**	**Increase (Decrease)**	**% Change**
Traditional product revenues	$ 1,850,000	52%	$ 2,472,000	62%	($ 622,000)	(25%)
Licensing revenues	553,000	16%	478,000	12%	75,000	16%
Internet revenues	1,041,000	29%	861,000	22%	180,000	21%
Liquidation product revenues	118,000	3%	145,000	4%	(27,000)	(19%)
Totals	**$ 3,562,000**	**100%**	**$ 3,956,000**	**100%**	**($ 394,000)**	**(10%)**

Traditional Product Revenues

For the year ended June 30, 2009, traditional product revenues amounted to $1,850,000, representing a decrease of $622,000 or 25% compared to the year ended June 30, 2008. The $622,000 decrease in traditional product revenues resulted from a reduction in retail distribution and lower consumer demand for our PC game titles. It remains a challenge to achieve or even maintain retail shelf space placement of our published titles in North American value-priced PC software departments, due to a continual decline in this department's size as retailers increase the shelf space allocated to promoting products in other entertainment categories. During fiscal 2010, we intend to continue seeking retail placement for both retail boxed game titles at the $19.99 retail price point and jewel case titles at the $9.99 price point.

Licensing Revenues

Licensing revenues are generated from sales made by third-party licensees under a series of licensing agreements covering both North American and international retail markets. For the years ended June 30, 2009 and 2008, we recognized licensing revenues of $553,000 and $478,000, representing 16% and 12%, respectively, of net revenues. This $75,000 increase in licensing revenues was traceable to licensing agreements related to our proprietary titles developed for the Nintendo DS and Wii game consoles.

Internet Revenues

For the years ended June 30, 2009 and 2008, Internet revenues were $1,041,000 and $861,000, representing 29% and 22%, respectively, of net revenues. This $180,000 increase in Internet revenues was traceable to greater revenues generated from consumer installations of the eGames game toolbar that is available with all eGames published game titles along with increased sales of popular casual games on www.egames.com. These increases were partially offset by decreased revenues generated from sales of proprietary game titles distributed on third party game portals.

During fiscal 2010, we intend to focus on continuing to place our PC games on the most popular Internet game portals, and placing our own as well as top-selling third party titles on our own game portal at www.egames.com. We will also seek new opportunities to generate additional revenues from installations of the eGames toolbar. Although toolbar revenues increased during fiscal 2009 compared to fiscal 2008, we expect toolbar revenues to flatten or decline in fiscal 2010 based on recent trends. Factors contributing to this recent negative trend are increased competition from other toolbar providers, combined with declines during fiscal 2009 in toolbar installations due to decreased sales of our game titles wrapped with the eGames toolbar.

Liquidation Product Revenues

For the years ended June 30, 2009 and 2008, liquidation product revenues were $118,000 and $145,000, representing 3% and 4%, respectively, of net revenues. Liquidation product revenues consist of product shipments of residual inventory titles that have been discontinued (in part or entirely) at traditional software retail stores because these titles had reached the end of their product lifecycles. As retailers continue to routinely change the assortment of software titles displayed on their store shelves - usually on a quarterly basis - we expect to receive discontinued titles back from retailers that will then need to be liquidated, along with any quantities of those titles remaining in our warehouse. The amount of liquidation product revenues can vary greatly, period to period, and are usually made at discounted prices with no right of product return or price markdown.

Product Returns and Price Markdowns

Throughout each reporting period we continue to evaluate our product return and price markdown exposure for software units we had previously sold to software distributors and retailers, until physical units of our PC game titles are returned to us from software distributors or retailers, or until they sell through to consumers. During the years ended June 30, 2009 and 2008, our provision for product returns and price markdowns amounted to $37,000 and $134,000, or 2% and 5%, respectively, of related gross product revenues to software distributors and retailers.

The fiscal 2009 decrease in the provision for product returns and price markdowns resulted from: a decrease in this fiscal year's product revenues; and a reduction in this fiscal year's provision percentage for product returns and price markdowns due to a greater proportion of this year's product revenues coming from shipments accounted for under consignment revenue recognition rules. We anticipate that our provision for product returns and price markdowns, as a percentage of product revenues, will continue to decrease in fiscal 2010 due to continued growth in the proportion of consignment related revenues as related to total product revenues. Revenues for consignment related product shipments are not recognized until our product sells through to the end consumer, and therefore no provision for product returns or price markdowns is associated with these consignment revenues.

Revenue Incentives and Promotional Costs

For the years ended June 30, 2009 and 2008, our revenue incentives and promotional costs were $244,000 and $159,000, respectively, or 11% and 6%, respectively, of related product revenues. In order to maintain retail shelf space for our titles, we incur revenue incentives and promotional costs from software distributors and retailers, such as pricing rebates and slotting fees, which are recognized as reductions to gross product revenues. We plan to continue selling our products to software distributors and retailers that charge such fees, and accordingly we expect these types of costs to continue reducing our net revenues.

Cost of Revenues

Cost of revenues consists of the following costs that are associated with publishing our PC games: product costs; royalty costs incurred with third parties for licensing product content or other intellectual properties; assembly costs; freight and handling costs; inventory obsolescence provision, reclamation fees, and other costs.

The following table represents our cost of revenues for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net Revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 1,509,000	42.4%	$ 1,568,000	39.6%	($ 59,000)	(3.8%)

During the year ended June 30, 2009, cost of revenues decreased by $59,000, compared to the year ended June 30, 2008. This $59,000 cost of revenues decrease was caused by a decline in product costs associated with a decrease in traditional product revenues, which was partially offset by an increase in the provision for inventory obsolescence due to writing down the value of excess inventory and an increase in royalty costs due to higher contractual royalty rates related to game titles sold during the current fiscal year.

Product Development

Product development expenses consist of personnel costs related to product development of our proprietary game titles, product management, content acquisition, quality assurance testing, packaging design, and website design and administration, along with outside services for product ratings, language localization, and quality assurance testing. Product development expenses can also include non-recoverable costs related to titles that did not achieve distribution into their intended retail channels.

The following table represents our product development expenses for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 1,466,000	41.2%	$ 1,498,000	37.9%	($ 32,000)	(2.1%)

The $32,000 decrease in product development expenses for the year ended June 30, 2009 resulted from the combination of lower internal headcount costs related to the termination of one employee at the beginning of fiscal 2009, partially offset by increased third-party contractor costs related to the development of proprietary game titles for the PC and various game console platforms.

During fiscal 2009, we continued to implement our strategy of increasing our product development of proprietary titles for the PC and popular game consoles to distribute at North American retail stores, on major Internet game portals and internationally via third-party licensing agreements. We currently estimate that our fiscal 2010 product development expense may decrease to the range of $800,000 to $1,000,000, in order to conserve our limited cash resources and focus instead on licensing selected third-party titles for distribution at retail, which have historically cost less for us to bring to market than developing our own proprietary titles.

Selling, General and Administrative

Selling, general and administrative expenses consist primarily of personnel related costs, insurance costs, stock-based compensation expense, advertising and promotional fees, commission expense, depreciation expense and professional service fees for legal, accounting and public relations costs, as well as occupancy costs including rent, utilities and phones, and other administrative expenses.

The following table represents our selling, general and administrative expenses for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 1,821,000	45.4%	$ 1,797,000	45.4%	$ 24,000	1.3%

The $24,000 increase in selling, general and administrative expenses for the year ended June 30, 2009 was traceable to an increase in bad debt expense.

Intangibles Impairment

During fiscal 2009's annual assessment of the value assigned to the intangible assets related to the Cinemaware game properties that we acquired in October 2005, management determined that this intellectual property's value had been impaired and no longer had any remaining value as of June 30, 2009. Accordingly, we wrote down the book value of these assets to zero and recorded a $420,000 charge to operating expenses during fiscal 2009. In October 2009, we sold the Cinemaware assets for $150,000 cash, which transaction is further discussed as a subsequent event in Note 19 in the "Notes to Financial Statements".

The following table represents our intangibles impairment expense for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 420,000	11.8%	$ - 0 -	0.0%	$ 420,000	n/a

Interest Income, net

The following table represents our net interest income for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 2,000	0.0%	$ 4,000	0.1%	($ 2,000)	n/a

Income Tax Expense

The following table represents our income expense for the years ended June 30, 2009 and 2008:

June 30, 2009	% of net revenues	June 30, 2008	% of net revenues	Increase (Decrease)	% Change
$ 54,000	1.5%	$ - 0 -	0.0%	$ 54,000	n/a

During fiscal 2009, we recorded $54,000 in income tax expense related to the non-cash write-off of the Company's alternative minimum tax related deferred tax asset.

Weighted Average Common Shares

The weighted average common shares outstanding on a diluted basis increased by 151,962 for the year ended June 30, 2009 to 11,973,451 from 11,821,489 for the year ended June 30, 2008. This 151,962 increase in the diluted basis calculation of weighted average common shares resulted from: the full year's impact of common stock shares issued during fiscal 2008 as part of a consulting agreement and placement agent fees related to the preferred stock offering completed during fiscal 2008; and the partial year's impact from common stock shares issued in fiscal 2009 in payment of the quarterly dividend to holders of the Company's preferred stock. Both years' calculations of

weighted average common shares outstanding on a diluted basis excluded common share equivalents based on their potential anti-dilutive impact on these years' losses.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies when tax benefits should be recorded in financial statements, requires certain disclosures of uncertain tax matters and indicates how any tax reserves should be classified in a balance sheet. FIN 48 became effective for our Company in the first quarter of fiscal 2008. The adoption of FIN 48 did not have a material impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* ". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 became effective for Company in the first quarter of fiscal 2009. The adoption of SFAS No. 159 did not have a material impact on our financial statements.

In December 2007, the FASB ratified Emerging Issues Task Force's ("EITF") consensus conclusion on EITF 07-01, "*Accounting for Collaborative Arrangements* ". EITF 07-01 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. Under this conclusion, a participant to a collaborative arrangement should disclose information about the nature and purpose of its collaborative arrangements, the rights and obligations under the collaborative arrangements, the accounting policy for collaborative arrangements, and the income statement classification and amounts attributable to transactions arising from the collaborative arrangement between participants for each period an income statement is presented. EITF 07-01 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2008 and requires retrospective application to all prior periods presented for all collaborative arrangements existing as of the effective date. We do not anticipate the implementation of EITF 07-01 to have a material impact on our financial statements.

In February 2008, the FASB issued FASB Staff Position ("FSP") Financial Accounting Standard ("FAS") 157-2, "*Effective Date of FASB Statement No. 157*". FSP FAS 157-2 delays the effective date of SFAS No. 157, " *Fair Value Measurements* ", for certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FSP FAS 157-2 defers the effective date of certain provisions of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for items within the scope of this FSP. We do not expect the adoption of SFAS No. 157 or FSP FAS 157-2 to have a material impact on our financial statements.

In April 2008, the FASB issued FSP FAS 142-3, "*Determination of the Useful Life of Intangible Assets*". FSP FAS 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, "*Goodwill and Other Intangible Assets* ". This guidance for determining the useful life of a recognized intangible asset applies prospectively to intangible assets acquired individually or with a group of other assets in either an asset acquisition or business combination. FSP FAS 142-3 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008, and early adoption is prohibited. We are currently evaluating the impact FSP FAS 142-3 will have on our financial statements.

In May 2009, the FASB issued SFAS 165, *Subsequent Events* which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS is effective for interim or annual financial periods ending after June 15, 2009.

Liquidity and Capital Resources

	As of June 30,		
	2009	2008	Change
Cash and cash equivalents	**$ 344,000**	**$ 874,000**	**($ 530,000)**
Percent of total assets	**26.4%**	**32.5%**	

	Years Ended June 30,		
	2009	2008	Change
Net cash used in operating activities	($ 453,000)	($ 572,000)	$ 119,000
Net cash used in investing activities	(15,000)	(15,000)	- 0 -
Net cash (used in) provided by financing activities	(62,000)	817,000	(879,000)
Net increase (decrease) in cash and cash equivalents	**($ 530,000)**	**$230,000**	**($ 760,000)**

Changes in Cash Flow, Operating Activities

During the year ended June 30, 2009, we had $453,000 of net cash used in operating activities compared to $572,000 of net cash used in operating activities for the year ended June 30, 2008. The $453,000 of net cash used in operating activities for the year ended June 30, 2009 resulted from our $1,707,000 net loss which included non-cash charges such as: $420,000 in intangibles impairment; $105,000 in stock-based compensation; $54,000 in alternative minimum tax expense, and $24,000 in depreciation expense.

The net loss's impact on cash used in operating activities during the year ended June 30, 2009 was mitigated by cash provided by operating activities of: a $382,000 increase in unearned revenues (due to advance royalty cash receipts from licensees of our proprietary game titles); along with decreases in accounts receivable of $188,000 and inventory of $39,000.

Accounts Receivable, net

At June 30, 2009, net accounts receivable totaled $280,000, compared to $468,000 at June 30, 2008. This $188,000 decrease in net accounts receivable resulted from a $229,000 decrease in gross accounts receivable along with an $8,000 decrease in the allowance for product returns and price markdowns and a $33,000 decrease in the allowance for bad debts. The $229,000 decrease in gross accounts receivable resulted from lower gross revenues invoiced during the latter part of fiscal 2009 compared to the similar period in fiscal 2008.

Historically, we have been able to collect net accounts receivable in the ordinary course of business, but periodically we have experienced slowness in accounts receivable collections from software distributors, retailers and licensees, particularly since the world-wide economic downturn that began in fiscal 2008. During the years ended June 30, 2009 and 2008, we have provided for and subsequently written off accounts receivable totaling $55,000 and $33,000, respectively. Throughout each reporting period, we communicate with software distributors, retailers and licensees in order to expedite their payments of past due amounts or to process receivable credits for authorized product returns and price markdowns. Since we do not hold any collateral to secure payment from any of our customers and because most of our customers have the right to return products and receive price markdowns that can be used to reduce their receivable payments to us, the realizable value of our net accounts receivable is continually reviewed in order to help anticipate future liquidity issues that could result from our inability to collect a net receivable balance in the normal course of business.

Concentration of Customers

We continue to have a concentration of customers consisting of a few large software distributors, retailers and licensees. During the year ended June 30, 2009, customers representing 10% or more of our net revenues were:

Navarre - $979,000, or 27% of net revenues, and Ditan/Synergex - $343,000, or 10% of net revenues, compared to the year ended June 30, 2008, when customers representing 10% or more of our net revenues were: Navarre - $1,015,000, or 26% of net revenues, and Ditan/Synergex - $499,000, or 13% of net revenues.

We believe that our ability to collect, in a timely manner, the net account receivable owed by our major software distributors and licensees, and in particular our net accounts receivables with Navarre, Ditan-Synergex, Visicom, Jack of All Games, and Fry's, would significantly impact our ability to meet our financial obligations and to fund our operations for the foreseeable future.

Inventory, net

During the year ended June 30, 2009, our net inventory decreased by $39,000. This decrease was caused by the overall lower inventory stock level required to meet demand for our products in the North American retail market.

Prepaid and other expenses

During the year ended June 30, 2009, our prepaid and other expenses decreased by $196,000, which related to a decrease in advance royalty payments made to third party software developers and the write-off of the Company's alternative minimum tax related deferred tax asset.

Accounts Payable

During the year ended June 30, 2009, our accounts payable decreased by $34,000 due to decreased product development work being performed by third-party contractors. Although our overall accounts payable balance decreased from June 30, 2008 to June 30, 2009, our ability to pay our vendors in a timely manner has become significantly more difficult during that period. For example, as of June 30, 2009 our accounts payable invoices over sixty days old grew to $357,000, or 64%, of total accounts payable, compared to June 30, 2008, when our accounts payable invoices older than sixty days amounted to only $97,000, or 16.4%, of total accounts payable.

Unearned Revenues

During the year ended June 30, 2009, our unearned revenues increased by $382,000 due to additional advance royalty payments received from various international licensees for our proprietary game titles for the PC and the Nintendo DS and Wii gaming systems. The majority of the increase in unearned revenues related to our licensing agreements with Destineer, Inc., which is publishing certain of our proprietary titles on the Nintendo DS and Wii platforms.

Accrued Expenses

During the year ended June 30, 2009, our accrued expenses decreased by $79,000 due to a decline in customers with credit balances; along with decreases in accrued balances for marketing promotions, royalties and travel.

Changes in Cash Flow, Non-Operating Activities

During both of the years ended June 30, 2009 and 2008, we had $15,000 in net cash used in investing activities that related to equipment and software upgrades to our computer network.

During the year ended June 30, 2009, we had $62,000 in net cash used in financing activities due to $29,000 in payments to vendors related to the prior year's issuance of convertible preferred shares and $33,000 in dividend payments made to shareholders of our convertible preferred stock.

During the year ended June 30, 2008, we had $817,000 in net cash provided by financing activities due to $814,000 in net proceeds from the issuance of our convertible preferred shares and $7,000 in net proceeds from the exercise of common stock options, which were partially offset by $4,000 in dividend payments made to shareholders of our convertible preferred stock.

Contractual Obligations and Commitments

We occupy our 5,000 square foot office facility located in Langhorne, Pennsylvania under an operating lease that is scheduled to expire on September 30, 2010. Additionally, we currently rent certain office equipment through various operating lease agreements. At June 30, 2009, we had future operating lease commitments of $108,000.

Under various work-for-hire agreements related to product development of future game titles designed for the PC, Internet and various game console platforms, we are required to make progress payments to third party developers based on agreed upon development milestones for specific game titles. At June 30, 2009, we had $126,500 in outstanding commitments for future game development which are all scheduled to be paid during fiscal 2010.

Under various licensing agreements with independent software developers, we are required to pay royalties for the use of licensed content in our products. Most of these licensing agreements require us to make advance licensing and royalty payments to these software developers prior to the time we recognize any net revenues of software titles containing this licensed content. At June 30, 2009, we had future commitments to pay $45,000 in advance licensing and royalty payments to various third-party licensors. We plan to fund our third party royalty payments from cash flows generated through operations.

The following table represents a summary of our off-balance sheet contractual obligations and commitments at June 30, 2009.

Contractual Obligations

Fiscal Years Ending June 30,	Operating Leases	Developer Commitments	Advanced Licensing & Royalties	Totals
2010	$ 62,000	$ 126,500	$ 45,000	$ 233,500
2011	29,000	- 0 -	- 0 -	29,000
2012	11,000	- 0 -	- 0 -	11,000
2013	3,000	- 0 -	- 0 -	3,000
2014	3,000	- 0 -	- 0 -	3,000
Totals	**$ 108,000**	**$ 126,500**	**$ 45,000**	**$ 279,500**

Liquidity Risk

As shown in the accompanying financial statements, we have incurred net losses of $1.7 million and $0.9 million, respectively, for fiscal years 2009 and 2008. During fiscal 2009, we continued to experience negative cash flow from operations largely due to our continued investment spending for product development of game titles for the PC and other popular gaming platforms, combined with the less than expected sell-through of our products at retail and on the Internet. Those facts, along with our lack of access to a bank credit facility, create an uncertainty about our ability to continue as a going concern. Accordingly, we are currently evaluating our alternatives to secure outside financing sufficient to support the operating requirements of our current business plan.

Our ability to achieve positive cash flow remains essential to our survival as a going concern since we do not have access to a credit facility. Achieving positive cash flow depends upon a variety of factors, including the timing of the collection of outstanding accounts receivable, the ability to secure advance royalty payments from licensees of our proprietary game titles to fund product development, the creditworthiness of our primary software distributors and retailers, consumer demand for our products, and the costs of developing, producing, marketing and promoting our PC software titles. We continue to evaluate the appropriateness of all non-operational cash expenditures.

There are significant challenges that we will need to successfully manage in order to fund our operations in the future. Our most significant challenge will be to increase net revenues and gross profit margins sufficiently to achieve and sustain profitability thereby reversing our losses for the last five fiscal years. If during fiscal 2010 we are unable to increase our net revenues associated with the retail channel, while at the same time increasing our Internet revenues and licensing revenues, we will not be able to continue funding the significant development expenditures

associated with our product development efforts, which in the past two fiscal years has been a critical component of our strategy to enable us to continue operating in an increasingly competitive videogame industry. Additional challenges include, but are not limited to, maintaining commercially viable relationships with our principal software distributors and retailers, collecting timely receivable payments from our concentrated group of software distributors and retailers, and maintaining acceptable payment terms with our trade vendors. For example, our liquidity would be severely impacted if one of our largest software distributors or retailers did not make receivable payments to us on a timely basis, or if other business conditions caused them to fail to pay us at all.

Although our overall accounts payable balance decreased by $34,000 from June 30, 2008 to June 30, 2009, our ability to pay our vendors in a timely manner has become significantly more difficult during that period. For example, as of June 30, 2009 our accounts payable invoices over sixty days old grew to $357,000 or 64.0% of total accounts payable, compared to June 30, 2008 when our accounts payable invoices older than sixty days amounted to only $97,000 or 16.4% of total accounts payable.

Additionally, as of June 30, 2009 our combined balances for cash and accounts receivable had decreased to $624,000 compared to $1,342,000 at June 30, 2008. This decrease of $718,000 in our cash and accounts receivable balances has been a significant factor contributing to our inability to pay our financial obligations in a timely manner.

There are market factors beyond our control that could also significantly affect our operating cash flow. The most significant market factors are: the shelf space allocated to our products at retail and on key Internet game portals; and the market acceptance and sell-through rates of our products to consumers, both at retail and on the Internet. If major retailers where our products are sold further reduce or eliminate entirely the shelf space allocated to PC software games, or if consumers do not buy our games via the Internet, either on our own website or on other major gaming portals, our cash flow and future financial prospects could be significantly impacted. Also, if any of our software titles do not sell through to consumers at a rate acceptable to retailers, then we could be exposed to unanticipated product return and price markdown credit requests that could then be used by distributors and retailers to reduce their future receivable payments to us. This could also cause a reduction in retailer and/or distributor replenishment orders for these products. If we experience a negative trend in any of these factors, we may not be able to achieve positive cash flow. Outside financing to supplement our cash flow from operations may not be available if and when we need it. Even if such financing were available from a bank or other financing source, such financing may cause significant stockholder dilution or may have other costs associated with such financing that would not be commercially acceptable to us.

Trading of Our Common Stock

Our common stock trades on the Pink Sheets Electronic OTC Markets® (www.pinksheets.com) under the symbol EGAM.

Financial Statements

eGames, Inc.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders
eGames, Inc.
Langhorne, Pennsylvania

We have audited the accompanying balance sheets of eGames, Inc. as of June 30, 2009 and 2008, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of eGames, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of eGames, Inc. as of June 30, 2009 and 2008 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 18 to the financial statements, the Company has suffered recurring losses from operations which raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 18. The financial statements do not include any adjustment that might result from the outcome of this uncertainty.

/s/ STOCKTON BATES, LLP

Philadelphia, Pennsylvania
November 13, 2009

eGames, Inc.
Balance Sheets
(Audited)

ASSETS	As of June 30, 2009	As of June 30, 2008
Current assets:		
Cash and cash equivalents	$ 344,432	$ 874,188
Accounts receivable, net	279,827	467,506
Inventory, net	551,552	590,601
Prepaid and other expenses	88,017	284,380
Total current assets	1,263,828	2,216,675
Furniture and equipment, net	18,478	27,548
Intangibles	24,089	444,089
Total assets	**$ 1,306,395**	**$ 2,688,312**
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 557,449	$ 591,494
Unearned revenues	630,542	248,454
Accrued expenses	359,993	439,208
Total current liabilities	1,547,984	1,279,156
Stockholders' equity (deficit):		
Convertible preferred stock	704,568	704,568
Common stock	9,179,827	9,179,827
Additional paid-in capital	2,562,142	2,462,406
Accumulated deficit	(12,135,189)	(10,384,708)
Treasury stock	(552,937)	(552,937)
Total stockholders' equity (deficit)	(241,589)	1,409,156
Total liabilities and stockholders' equity (deficit)	**$ 1,306,395**	**$ 2,688,312**

See accompanying notes to financial statements.

eGames, Inc.
Statements of Operations
(Audited)

	Years Ended June 30,	
	2009	**2008**
Net revenues	$ 3,561,607	$ 3,956,204
Cost of revenues	1,508,921	1,567,693
Gross profit	2,052,686	2,388,511
Operating expenses:		
Product development	1,465,633	1,498,027
Selling, general and administrative	1,821,253	1,796,861
Intangibles impairment	420,000	- 0 -
Total operating expenses	3,706,886	3,294,888
Operating loss	(1,654,200)	(906,377)
Interest income, net	1,596	4,127
Loss before income taxes	(1,652,604)	(902,250)
Income tax expense	54,126	- 0 -
Net loss	**($ 1,706,730)**	**($ 902,250)**
Net loss per common share:		
- Basic	**($ 0.14)**	**($ 0.08)**
- Diluted	**($ 0.14)**	**($ 0.08)**
Weighted average common shares outstanding – Basic	11,973,451	11,821,489
Dilutive effect of common share equivalents	- 0 -	- 0 -
Weighted average common shares outstanding - Diluted	11,973,451	11,821,489

See accompanying notes to financial statements.

eGames, Inc.
Statements of Stockholders' Equity (Deficit)
(Audited)

	Convertible Preferred Stock		Common Stock		Additional Paid-in	Accumulated	Treasury Stock		Stockholders'
	Shares	Amount	Shares	Amount	Capital	Deficit	Shares	Amount	Equity (Deficit)
Balances at June 30, 2007	- 0 -	$ - 0 -	11,956,093	$ 9,179,827	$ 2,205,242	($ 9,467,234)	(231,900)	($ 501,417)	$ 1,416,418
Net loss						(902,250)			(902,250)
Shares issued and retired in connection with stock option exercises			95,000		58,750		(46,000)	(51,520)	7,230
Common stock options issued to employees and directors					79,585				79,585
Shares issued in connection with consulting agreement			60,000		38,792				38,792
Shares issued in connection with preferred stock offering	875,000	875,000							875,000
Costs incurred and common stock shares and warrant issued in connection with preferred stock offering		(170,432)	124,000		80,037				(90,395)
Dividends declared on preferred stock						(15,223)			(15,223)
Rounding						(1)			(1)
Balances at June 30, 2008	875,000	$ 704,568	12,235,093	$ 9,179,827	$ 2,462,406	($ 10,384,708)	(277,900)	($ 552,937)	$ 1,409,156
Net loss						(1,706,730)			(1,706,730)
Common stock options issued to employees and directors					88,798				88,798
Dividends declared on preferred stock			95,947		10,938	(43,752)			(32,814)
Rounding						1			1
Balances at June 30, 2009	875,000	$ 704,568	12,331,040	$ 9,179,827	$ 2,562,142	($ 12,135,189)	(277,900)	($ 552,937)	($ 241,589)

See accompanying notes to financial statements.

eGames, Inc.
Statements of Cash Flows
(Audited)

	Years Ended June 30,	
	2009	**2008**
OPERATING ACTIVITIES:		
Net loss	($ 1,706,730)	($ 902,250)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	104,959	102,216
Depreciation and amortization	23,914	21,524
Intangibles impairment	420,000	- 0 -
Alternative minimum tax	54,126	- 0 -
Changes in operating assets and liabilities:		
Accounts receivable, net	187,679	(141,501)
Inventory, net	39,049	6,375
Prepaid and other expenses	131,076	(14,593)
Accounts payable	1,221	325,207
Unearned revenues	382,088	205,954
Accrued expenses	(90,153)	(175,069)
Net cash used in operating activities	**(452,771)**	**(572,137)**
INVESTING ACTIVITIES:		
Purchase of furniture and equipment	(14,843)	(15,077)
Net cash used in investing activities	**(14,843)**	**(15,077)**
FINANCING ACTIVITIES:		
Net proceeds from exercise of stock options	- 0 -	7,230
Net proceeds (payments) from issuance of preferred stock	(29,558)	814,163
Dividend payments to preferred stock shareholders	(32,584)	(4,515)
Net cash provided by (used in) financing activities	**(62,142)**	**816,878**
Net increase (decrease) in cash and cash equivalents	**(529,756)**	**229,664**
Cash and cash equivalents:		
Beginning of period	874,188	644,524
End of period	**$ 344,432**	**$ 874,188**

See accompanying notes to financial statements.

eGames, Inc.
Notes to Financial Statements

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

eGames, Inc. (“eGames”) is a Pennsylvania corporation incorporated in July 1992 that develops, publishes, markets and sells software games primarily for the personal computer (“PC”). Historically, eGames has focused on publishing casual software games for the PC platform, and selling the greatest volume of its’ PC games in major mass-merchant retail stores. eGames now publishes third-party PC game titles and also develops its own proprietary PC game titles for distribution at retail and on the Internet. Additionally, eGames has developed some titles for the Nintendo DS and Wii gaming systems and the Apple iPhone. In North America, our PC games are distributed to retail stores primarily through third-party software distributors who service the major mass-merchant retailers, while our Nintendo DS and Wii games are published and distributed worldwide by third-party publishers. In territories outside North America, we license our PC games to third-party software distributors that are responsible for the manufacture and distribution of our PC games within specific geographic territories. We market and sell our game titles under the eGames™ brand.

A summary of our significant accounting policies applied in the preparation of our Financial Statements follows:

Basis of Presentation

The accompanying audited annual financial statements were prepared in accordance with generally accepted accounting principles as promulgated in the United States of America. These statements include all adjustments that management believes are necessary for a fair presentation of the statements. Certain dollar amounts discussed within the “Notes to Financial Statements” have been rounded to the nearest thousand (“000”).

Fair Value of Financial Instruments

The recorded amounts of cash and net accounts receivable at June 30, 2009 approximate fair value due to the relatively short period of time between origination of the instruments and their expected realization. All liabilities are carried at cost, which approximate fair value for similar instruments.

We maintain cash balances at various financial institutions located in Pennsylvania. Our cash accounts at these financial institutions are secured by the Federal Deposit Insurance Corporation (“FDIC”) up to $250,000 per account. During the normal course of business, our account balances may exceed the insured amount.

Cash and Cash Equivalents

For purposes of the statements of cash flows, we consider all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable, net

Accounts receivable is reflected net of allowances for product returns, price markdowns and customer bad debts. The adequacy of these allowances is reviewed throughout each reporting period and any necessary adjustments to these allowances are reflected within the current period’s provisions for product returns and price markdowns (reflected as a reduction to gross revenues); and customer bad debts (if any, reflected as an operating expense). Actual product returns, price markdowns and customer bad debts are recorded as reductions to these allowances as well as reductions to the customers’ individual accounts receivable balances (see Note 2).

Inventory, net

Inventory, net consists primarily of finished goods and is valued at the lower of cost or market. Cost is determined by the first-in, first-out method (FIFO). Our inventory valuation policy requires management to make estimates and

assumptions about the recoverability of the carrying value of inventory as of the end of each reporting period and cost of revenues expensed during each reporting period. The individual components of our software titles that are usually reflected in our net inventory valuation include some combination of the manufactured costs of: CD's; DVD's; jewel cases; box packaging; print materials; shrink-wraps; wafer-seals; assembly and other miscellaneous items particular to specific titles. Our inventory could be valued differently at the close of any reporting period and the amount of expense recorded as cost of revenues during any reporting period could differ, if management's judgments or estimates for the impairment of inventory value (recorded through the provision for inventory obsolescence within our Statement of Operations) are insufficient or excessive when compared to actual results.

Unearned Revenues

Unearned Revenues consist of advance royalty payments that we received from third-parties for licensing rights within certain geographic territories for proprietary game titles we have internally developed. We recognize revenues from these amounts by determining the greater of: actual royalties we have earned based on sales within their licensed territories as reported by the licensees or the pro-rata amount of the royalty advance spread over the duration of the licensing agreement. At June 30, 2009, we had a total of $631,000 in unearned revenues relating to various game titles developed for the PC and other popular gaming systems.

Furniture and Equipment, net

Furniture and equipment, net is stated at cost and net of accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets ranging from three to five years (see Note 5).

Long-Lived Assets, net

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we record impairment losses on long-lived assets, including intangible assets, used in operations when the fair value of those assets, less the cost to sell, is lower than our carrying value for those assets.

Intangibles

SFAS No. 142, "Goodwill and Other Intangible Assets" requires that purchased goodwill and intangibles with indefinite lives not be amortized. Rather, goodwill and intangible assets with indefinite lives are subject to at least an annual assessment for impairment by applying a fair-value-based test. SFAS No. 142 requires a two-step approach to testing goodwill for impairment for each reporting unit. The first step tests for impairment by applying fair value-based tests at the reporting unit level. The second step (if necessary), measures the amount of impairment by applying fair value-based tests to individual assets and liabilities within each reporting unit.

Software Development Costs

Software development costs are expensed as incurred. SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed" , provides for the capitalization of certain software development costs incurred after technological feasibility of the software is established or for development costs that have alternative future uses. However, under our existing process of developing new game titles, the technological feasibility of the underlying game software is not established until substantially all product development is complete. Accordingly, we did not capitalize any software development costs during the fiscal years ended June 30, 2009 and 2008.

Revenue Recognition

Product Revenues

We distribute the majority of our products through third-party software distributors to the major North American mass-merchant retailers and directly to certain North American PC software retailers. The distribution of our products is governed by purchase orders, distribution agreements, or direct sales agreements, most of which allow for product returns and price markdowns. We recognize revenues from product shipments to various software distributors and retailers at the time title to our inventory transfers to the software distributor or retailer, less a provision for anticipated product returns and price markdowns. However, if we determine that we are not able to

estimate an appropriate provision for product returns and price markdowns for any retailer or distributor or if we determine that the underlying terms of a purchase order, direct sales agreement or distribution agreement do not qualify as a sale, we then recognize revenues for product deliveries to these retailers or distributors on a consignment basis.

Title to our products for non-consignment shipments usually transfers to software distributors and retailers upon their receipt of our products, because retailer and distributor purchase orders typically reflect shipping terms of FOB destination. In order to recognize revenues associated with customer purchase orders having terms of FOB destination, we perform sales cut-off tests, in which we obtain proof of deliveries for product shipments made during the last two weeks of a reporting period from the freight companies that deliver our products to our retail and distribution customers. Revenues and costs associated with product shipments received by our customers after the end of a reporting period and having FOB destination terms are excluded from the current period's net revenues and cost of revenues, and are deferred until the subsequent reporting period.

We recognize revenues in accordance with the criteria of SFAS No. 48 at the time title to our inventory passes to software distributors or retailers, based on the following: the selling price is fixed at the date of sale; the buyer is obligated to pay us; title of the product transfers to the buyer; the buyer has economic substance apart from us; we do not have further obligations to assist the buyer in the resale of the product; and product returns and price markdowns can be reasonably estimated at the time of sale. After product deliveries to our distribution and retail customers are made, we do not provide any further services or materials that are essential to our products' functionality. However, we do provide basic telephone and web-based support as a means of improving consumer satisfaction and brand loyalty.

During fiscal 2009, we continued to recognize an increasing proportion of net traditional product revenues on a consignment basis. Accordingly, revenues from product shipments pursuant to these types of agreements are only recognized to the extent that the distributor or retailer has reported to us that our product has sold through to consumers. For the years ended June 30, 2009 and 2008, revenues recognized under these consignment and sell-through agreements were $1,130,000 and $1,216,000, respectively, and represented 61% and 49% of net traditional product revenues.

Provision for Product Returns and Price Markdowns

Our provision for anticipated product returns and price markdowns (reflected as a reduction to gross revenues) is primarily based on our analysis of: historical product return and price markdown results; current product sell-through activity at retail store locations; current field inventory quantities at distributors' warehouses and at retail store locations; the length of time that products have been released at retail along with their estimated remaining retail life; outstanding return material and price markdown authorizations; and the introduction of new and/or competing software products that could negatively impact the revenues of one or more of our current products. For the years ended June 30, 2009 and 2008, our provisions for product returns and price markdowns were $37,000 and $134,000, respectively, or 2% and 5%, respectively, of related gross product revenues.

The adequacy of our allowance for product returns and price markdowns is reviewed throughout each reporting period and any necessary adjustment to this allowance is reflected within the current reporting period's provision for product returns and price markdowns. At the end of each reporting period, the allowance for product returns and price markdowns is reflected as a reduction to our gross accounts receivable.

At June 30, 2009, the allowance for product returns and price markdowns amounted to $114,000, or 29% of our gross accounts receivable. Historically, the allowance for product returns and price markdowns has represented a large percentage of our gross accounts receivable because we continue to have product return and price markdown exposure for the software units related to paid receivables while previously sold units remain in the retailers' stores or in the retailers' or distributors' warehouses. Throughout each reporting period we continue to evaluate our product return or price markdown exposure for software units we had previously sold to software distributors and retailers, until physical units of our PC game titles are returned to us from software distributors or retailers, or until they sell through to consumers. During reporting periods, through retailer and distributor provided reports, we have regular and timely visibility of product sell-through activity and remaining quantities of our titles in the retail channel that help us assess our exposure for future product returns and price markdowns.

Prepaid and Other Expenses

Prepaid and other expenses represent advance payments made to third parties for items such as licensing of software and intellectual properties used in our products, estimated tax payments, consulting services, certain insurance coverage, retail market reporting, certain advertising costs and various service contracts. Prepaid and other expenses are usually expensed as operating expenses on a straight-line basis over the period of time covered by a contract. Advance licensing and royalty payments are usually expensed as cost of revenues at the higher of the contractual or effective rate (see Notes 4 and 7). Tax payments are reflected as income tax expense when appropriate.

We continually evaluate the recoverability of our advanced licensing and royalty payments by reviewing the information available about each title and the underlying licensed content. In particular, we evaluate the expected future revenues of a title or potential subsequent titles containing the same licensed content based on current and potential revenue programs, along with historical sell-through results of similar titles to consumers. For titles that have achieved distribution into their intended retail channels, we charge to cost of revenues the remaining capitalized costs we determine to be non-recoverable in future periods. In the rare circumstance that a title does not achieve distribution into its intended retail channels, we charge to product development expense the remaining capitalized costs we determine to be non-recoverable in future periods. Capitalized costs determined to be non-recoverable are expensed in the reporting period in which the decision is reached by management that recoverability of these costs in future periods is unlikely.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for net operating loss and credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

Computation of Net Income (Loss) per Common Share

Net income (loss) per common share is computed in accordance with SFAS No. 128, "Earnings per Share". Basic earnings per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares and common share equivalents ("CSEs") outstanding during each period that we report net income. CSEs may include common stock options and common stock warrants using the treasury stock method.

Management's Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and assumptions are made in: determining allowances for inventory obsolescence, product returns, price markdowns and customer bad debts; disclosure of contingent assets and liabilities; initial valuation and subsequent measurement of goodwill and other intangible assets; evaluating the recoverable value of advanced licensing and royalty payments at the end of the reporting period; in addition to determining the amounts of revenues and expenses recognized during each reporting period. We recognize the critical nature and potential impact from making these and any other estimates and attempt to make reliable estimates, based upon the information available to us as of any reporting period. However, we also recognize that actual results could differ from any of our estimates and that such differences could have either a negative or positive impact on future financial results.

2. Accounts Receivable, net

Accounts receivable, net consists of the following:

Accounts receivable, gross	$	394,000
Allowance for product returns and price markdowns		(114,000)
Accounts receivable, net	**$**	**280,000**

3. Inventory, net

Inventory, net consists of the following:

Raw materials – warehouse	$	259,000
Finished goods – warehouse		324,000
Consignment product – retailer and distributor locations		139,000
Product returns – retailer and distributor locations		9,000
Inventory, gross		731,000
Allowance for obsolescence		(179,000)
Inventory, net	**$**	**552,000**

4. Prepaid and Other Expenses

Prepaid and other expenses consists of the following:

Royalties	$	59,000
Other		13,000
Insurances		11,000
Rent		5,000
Prepaid and other expenses	**$**	**88,000**

5. Furniture and Equipment, net

Furniture and equipment consists of the following:

Furniture and equipment, gross	$	439,000
Accumulated depreciation		(421,000)
Furniture and equipment, net	**$**	**18,000**

6. Accrued Expenses

Accrued expenses consist of the following:

Vacations	$	100,000
Royalties		90,000
Customers with credit balances		75,000
Professional services		44,000
Other		22,000
Marketing promotions		16,000
Litigation		13,000
Accrued expenses	**$**	**360,000**

7. Commitments and Contingencies

We occupy our 5,000 square foot office facility located in Langhorne, Pennsylvania under an operating lease through September 30, 2010. Additionally, we currently rent certain office equipment through various operating lease agreements. For the years ended June 30, 2009 and 2008, total rent expense (reflected in our statements of operations as "selling, general and administrative expenses") amounted to $81,000 and $80,000, respectively. At June 30, 2009, we had future operating lease commitments of $108,000 scheduled to be paid as follows: $62,000 in fiscal 2010; $29,000 in fiscal 2011, $11,000 in fiscal 2012, $3,000 in fiscal 2013 and $3,000 in fiscal 2014.

Under various work-for-hire agreements related to product development of future game titles designed for the PC, Internet and various game console platforms, we are required to make progress payments to third party developers based on agreed upon development milestones for specific game titles. At June 30, 2009, we had $126,500 in outstanding commitments for future game development which are all scheduled to be paid during fiscal 2010.

Under various licensing agreements with independent software developers, we are required to pay royalties (reflected in our statements of operations as "cost of revenues") for the use of licensed content in our products. Most of these licensing agreements require us to make advance licensing and royalty payments to these developers prior to the time we recognize any net revenues of software titles containing this licensed software content. At June 30, 2009, we had future commitments to pay $45,000 in advance licensing and royalty payments to various independent licensors and software developers, all scheduled to be paid in fiscal 2010.

8. Credit Facility

On December 1, 2006, our credit facility agreement with TD Banknorth ("TD"), matured and subsequently we were not able to renew this credit facility due to not being able to reach acceptable terms with TD. This credit facility had been established to provide working capital for our operations. At June 30, 2009, we had did not have access to any credit facility, and we did not have an outstanding balance under any credit facility.

9. Advertising Costs

We generally expense advertising costs (such as in-store circulars and point of sale materials) as incurred, except for costs associated with media campaigns (such as print ads, online banner ads and video loops) which would be recognized as prepaid assets (to the extent these items were paid in advance) and expensed during the period in which the ad or video loop is released to consumers. During the years ended June 30, 2009 and 2008, advertising expenses amounted to zero and $24,000, respectively.

10. Concentration of Customers

During the year ended June 30, 2009, customers representing 10% or more of our net revenues were: Navarre - $979,000, or 27% of net revenues, and Ditan/Synergex - $343,000, or 10% of net revenues, compared to the year ended June 30, 2008, when customers representing 10% or more of our net revenues were: Navarre - $1,015,000, or 26% of net revenues, and Ditan/Synergex - $499,000, or 13% of net revenues.

11. Intangibles

At June 30, 2009, we had intangibles of approximately $24,000 related to our trademark registration activities with the United States Patent and Trademark Office.

During the year ended June 30, 2009, based on management's assessment of impairment, we recorded a $420,000 impairment charge for intangibles related to the Cinemaware game properties which the Company acquired in October 2005. This $420,000 charge was reflected in our Statements of Operations as an operating expense. These intangible assets had consisted principally of intellectual property and contract rights for various game titles. During fiscal 2009, we had attempted to utilize these acquired Cinemaware assets for game development and distribution on the popular and dominant non PC gaming platforms such as the Nintendo Wii and DS, while continuing to use these Cinemaware game properties for developing and publishing of high quality game titles for the PC, but were

unsuccessful in our efforts. Please see Note 19 in the Notes to Financial Statements regarding the sale of these assets that occurred in October 2009.

12. Income Taxes

The provision (benefit) for income taxes is comprised of the following components for the years ended June 30, 2009 and 2008, respectively:

	2009	2008
Current		
Federal	$ - 0 -	$ - 0 -
State	- 0 -	- 0 -
	- 0 -	**- 0 -**
Deferred		
Federal	- 0 -	- 0 -
State	- 0 -	- 0 -
	- 0 -	**- 0 -**
Valuation allowance	54,000	- 0 -
Provision (Benefit) for income taxes	**$ 54,000**	**$ - 0 -**

The reconciliation between the statutory federal income tax rate and our effective federal rate for income tax provision for the years ended June 30, 2009 and 2008, respectively, is as follows:

	2009	2008
Statutory federal income tax rate	34%	34%
Increase (decrease) in taxes resulting from:		
Change in valuation allowance and other	(34%)	(34%)
Effective federal rate for income tax provision	**- 0 -%**	**- 0 -%**

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2009 and 2008 is as follows:

	2009	2008
Net deferred tax assets:		
Alternative minimum tax credit	$ 54,000	$ 54,000
Accrued expenses and other	337,000	14,000
Allowances for accounts receivable and inventory	124,000	146,000
Net operating losses	2,798,000	2,085,000
Gross deferred tax assets	3,313,000	2,299,000
Less: Valuation allowance	(3,313,000)	(2,245,000)
Net deferred tax assets	**$ - 0 -**	**$ 54 ,000**

The deferred tax asset is offset by a full valuation allowance against timing differences and the alternative minimum tax credit as of June 30, 2009, as management currently believes that it is more likely than not that all the deferred tax assets will not be realized. During fiscal 2009, the valuation allowance for net deferred tax assets increased by approximately $1,014,000. The decrease was a result of net changes in the temporary differences in the accounts reflected in the table above.

As of June 30, 2009, we had approximately $7,403,000 of net operating loss carry-forwards for federal income tax purposes, (expiring through fiscal year ending June 30, 2029), which are available to offset future federal taxable income, and $2,811,000 in net operating loss carry-forwards for state purposes, (expiring through the fiscal year ending June 30, 2029), which are available to offset future state taxable income.

13. Preferred Stock

Series A 5% Cumulative Convertible Preferred Stock Offering Completed on April 25th, 2008:

On April 25th, 2008, we completed a private offering of 875,000 shares of our Series A 5% Cumulative Convertible Preferred Stock (the "Preferred Stock") in which we received a total of $875,000 in gross cash proceeds. The shares of Preferred Stock are convertible into our Common Stock at a current conversion ratio of two shares of Common Stock for each share of Preferred Stock. Beginning one year after the date of issuance of the Preferred Stock, we will have the right to require the conversion of these shares at the then current conversion rate if our Common Stock has a market price equal to or greater than $3.00 for 30 (thirty) consecutive days. Additionally, the Preferred Stock would be converted into our Common Stock at the then current conversion rate or redeemed at our discretion, in the event of an underwritten public offering, with gross proceeds of at least $20,000,000 or upon a change of control, which includes certain mergers, acquisitions of a majority of the voting stock of eGames or the sale of all or substantially all of eGames' assets. If we elected to redeem the Preferred Stock, we would pay cash equal to the original purchase price ($1.00) plus all accrued and unpaid dividends.

We relied on the exemption from registration provided by Rule 506 of Regulation D under the Securities Act of 1933, as amended ("Regulation D"), for sales to "accredited investors" (as such term is defined in Rule 501 of Regulation D). Each purchaser in the offering has represented that it is an "accredited investor."

We retained the services of First Global Securities, Inc. ("First Global") as a non-exclusive placement agent to secure a portion of this Preferred Stock offering. As a result, we compensated First Global by issuing 124,000 shares of our Common Stock (fair valued at $62,000); issuing a five year Common Stock Warrant to purchase 62,000 shares of our Common Stock (fair valued at $18,000); and reimbursing $9,300 in marketing expenses. The shares and warrant issued to First Global were issued pursuant to an exemption under Section 4(2) of the Securities Act of 1933, as amended.

We incurred total cash expenditures of approximately $90,000 in connection with the private offering of our Preferred Stock. We used the net cash proceeds from the Preferred Stock offering to fund product development of new game titles for the PC and other gaming platforms and for general working capital requirements.

The dividends on the Preferred Stock, when and if declared by our Board of Directors, are payable quarterly and are cumulative. On April 29, 2008, our Board of Directors declared a dividend to holders of our Preferred Stock as of March 31, 2008 in the amount of $4,515, which was paid on May 2, 2008. Additionally, on June 17, 2008, our Board of Directors declared a dividend to holders of our Preferred Stock as of June 30, 2008 in the amount of $10,708, which was paid on July 17, 2008.

During fiscal 2009, our Board of Directors declared quarterly dividends to our Preferred Stock holders on each of September 23, 2008, November 19, 2008 and March 21, 2009. On October 30, 2008 and on January 30, 2009, we paid $10,938 to holders of our Preferred Stock as of September 30, 2008 and December 31, 2008, respectively. On April 30, 2009, we paid a quarterly dividend to holders of Preferred Stock as of March 31, 2009 by issuing 95,947 shares of our Common Stock. On July 30, 2009, we paid a quarterly dividend to holders of Preferred Stock as of June 30, 2009 by issuing 60,100 shares of our Common Stock, which dividend was declared by the Board of Directors on July 16, 2009. On October 28, 2009, we paid a quarterly dividend to holders of Preferred Stock as of September 30, 2009 by issuing 87,155 shares of our Common Stock, which dividend was declared by the Board of Directors on September 14, 2009.

14. Common Stock

On June 30, 1995, we amended our Articles of Incorporation to authorize the issuance of 40,000,000 shares of common stock, without par value, and 10,000,000 shares of preferred stock, without par value.

On June 1, 1999, the Board of Directors adopted a Stockholders Rights Plan (the "Plan"). The Plan was intended to protect the interests of our existing stockholders' in the event that we were confronted with coercive or unfair takeover tactics. On March 4, 2005, our Board of Directors approved an amendment to the Stockholders Rights Plan to accelerate the expiration date from June 1, 2009 to March 7, 2005. With this action, the Plan was terminated on March 7, 2005. The Board's decision to terminate the Plan was not made in connection with any business transaction pending at that time.

On October 13, 2005, in consideration for acquiring substantially all of the assets of Cinemaware, Inc., we issued 817,439 shares of our common stock to Cinemaware, Inc.

On December 11, 2007, in consideration for consulting services to be rendered over the next twelve month period, we issued 60,000 shares of our common stock to a consultant.

On May 8, 2008, in consideration for placement agency services rendered during our private offering of Preferred Stock, we issued 124,000 shares of our common stock to a placement agent.

On April 30, 2009, we paid a quarterly dividend to holders of Preferred Stock as of March 31, 2009 by issuing 95,947 shares of our Common Stock.

On July 30, 2009, we paid a quarterly dividend to holders of Preferred Stock as of June 30, 2009 by issuing 60,100 shares of our Common Stock.

On October 28, 2009, we paid a quarterly dividend to holders of Preferred Stock as of September 30, 2009 by issuing 87,155 shares of our Common Stock.

15. Common Stock Options and Warrants

Common Stock Options

During 1995, we adopted, amended and restated our 1995 Amended and Restated Stock Option Plan (the "1995 Plan"), which expired on June 30, 2005. The 1995 Plan allowed for the granting of options to purchase shares of our common stock through June 30, 2005, after which date any previously granted option remains in effect through its contractual term. At our 1997 Annual Meeting of Shareholders, the shareholders of our company approved an amendment to increase the number of shares available for issuance under the 1995 Plan from the 950,000 shares of common stock approved during the 1996 Annual Meeting of Stockholders to a total of 1,950,000 shares. At our 2000 Annual Meeting of Shareholders, the shareholders of our company approved an amendment to increase the number of shares available for issuance under the 1995 Plan from the 1,950,000 shares of common stock previously approved to a total of 2,950,000 shares. The 1995 Plan was administered by the Board of Directors and provided for the grant of incentive stock options and non-qualified stock options to employees and eligible independent contractors and non-qualified stock options to non-employee directors at prices not less than the fair market value of a share of common stock on the date of grant. The 1995 Plan had also provided for automatic grants of options to non-employee directors of our company. Each non-employee director received common stock options for 10,000 shares of common stock upon appointment or election to the board and, in addition, each director would receive common stock options for 5,000 shares of common stock on the first trading day in January of each year.

Except with respect to automatic grants of common stock options to non-employee directors, the expiration of a common stock option and its vesting period were determined by the Board of Directors at the time of the grant, but in no event will an option be exercisable after 10 years from the date of grant. Common stock option grants under the 1995 Plan vest over periods ranging from six months to ten years. In most cases, upon termination of

employment, vested common stock options must be exercised by the optionee within three months after the termination of the optionee's employment with our company.

On June 19, 2007, we granted a common stock option to one employee to purchase 50,000 shares of our common stock, with an exercise price of $0.73 (the closing price of our common stock on date of grant) and a life of six years. This common stock option was not part of any formal stock option plan.

On June 5, 2008, we granted common stock options to our Board of Directors and members of management to purchase 800,000 shares of our common stock, with an exercise price of $0.62 (the closing price of our common stock on date of grant), vesting over ten years and having a life of eleven years. These common stock options were not part of any formal stock option plan.

Information regarding our common stock options is as follows:

	Number of Options	Weighted Average Exercise Price
Balance, June 30, 2007	**1,473,833**	**$ 0.61**
Granted (not part of any plan)	800,000	$0.62
Canceled	(676,333)	$0.55
Exercised	(95,000)	$0.62
Balance, June 30, 2008	**1,502,500**	**$ 0.64**
Granted	- 0 -	n/a
Canceled	(62,500)	$0.46
Exercised	- 0 -	n/a
Balance, June 30, 2009	**1,440,000**	**$ 0.65**

At June 30, 2009, there were 517,500 of outstanding common stock options vested. The following summarizes information about the common stock options outstanding at June 30, 2009:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Prices	**Number of Shares**	**Weighted Avg. Remaining Contractual Term (in years)**	**Weighted Avg. Exercise Price**	**Number of Shares**	**Weighted Avg. Exercise Price**
$ 0.31 - $ 0.56	165,000	5.88	$ 0.33	165,000	$ 0.33
$ 0.62 - $ 0.62	700,000	9.93	$ 0.62	70,000	$ 0.62
$ 0.73 - $ 0.79	575,000	4.32	$ 0.78	282,500	$ 0.79
$ 0.31 - $ 0.79	1,440,000	7.23	$ 0.65	517,500	$ 0.62

No common stock options were granted during the year ended June 30, 2009. The per share weighted-average fair value of common stock options granted during the year ended June 30, 2008 was $0.48 as determined on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Years Ended June 30,	
	2009	**2008**
Dividend Yield	n/a	0%
Volatility Factor	n/a	104%
Risk-Free Interest Rate	n/a	3.94%
Average Expected Option Life	n/a	5 Years

Common Stock Warrants

Information regarding our common stock warrants is as follows:

	Number of Warrants	Weighted Average Exercise Price
Balance, June 30, 2007	**300,000**	**$ 0.63**
Granted	62,000	$1.10
Canceled	- 0 -	n/a
Exercised	- 0 -	n/a
Balance, June 30, 2008	**362,000**	**$ 0.71**
Granted	- 0 -	n/a
Canceled	- 0 -	n/a
Exercised	- 0 -	n/a
Balance, June 30, 2009	**362,000**	**$ 0.71**

On May 8, 2008, in consideration for placement agency services rendered during our Preferred Stock offering, we issued a common stock warrant to purchase 62,000 shares of our common stock with an exercise price of $1.10 per share and having a term of five years to a placement agent.

No common stock warrants were issued during the year ended June 30, 2009. The per share weighted-average fair value of the common stock warrant granted during the year ended June 30, 2008 was $0.29, as determined on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Years Ended June 30,	
	2009	**2008**
Dividend Yield	n/a	0%
Volatility Factor	n/a	108%
Risk-Free Interest Rate	n/a	3.51%
Average Expected Warrant Life	n/a	3 Years

16. Accounting for Stock-Based Compensation

Prior to July 1, 2002, we accounted for all stock option grants under the recognition and measurement provisions of APB Opinion No. 25, “Accounting for Stock Issued to Employees”, and related Interpretations. Accordingly, no stock-based employee compensation cost is reflected in net income before fiscal 2003, as all stock option grants had an exercise price equal or greater than the market value of the underlying common stock on the date of grant.

Effective July 1, 2002, we adopted within our financial statements the provisions of SFAS No. 123, “Accounting for Stock-Based Compensation” by applying the fair value method prospectively for stock options grants made on or after that date. As of January 1, 2003, we adopted the provisions of SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure”.

During the fiscal years ended June 30, 2009 and 2008, we recognized stock-based compensation expense of $105,000 and $102,000, respectively within our financial statements. As of June 30, 2009, our total unrecognized compensation cost related to common stock options was $502,000 and is expected to be expensed over a weighted average service period of 7.8 years. As of June 30, 2009, we did not have any unrecognized compensation costs related to restricted stock.

17. Operations by Reportable Segment and Geographic Area

SFAS No. 131, “Disclosure about Segments of an Enterprise and Related Information,” establishes standards for reporting information about an enterprise’s operating segments and related disclosures about products, geographic areas and major customers.

Based on our organizational structure, we operate in only one geographic area, which is North America, and only one reportable segment, which is publishing games for the PC, Internet and various game consoles.

18. Going Concern

As shown in the accompanying financial statements, we have incurred net losses of $1.7 million and $0.9 million, respectively, for our fiscal years 2009 and 2008. During fiscal 2009, we continued to experience negative cash flow from operations largely due to our continued investment spending for product development of game titles for the PC and other popular gaming platforms that are expected to benefit future periods. Those facts, along with our lack of access to a bank credit facility, create an uncertainty about our ability to continue as a going concern. Accordingly, we are currently evaluating our alternatives to secure financing sufficient to support the operating requirements of our current business plan, as well as continuing to execute our business strategy of distributing our game titles to traditional retail stores, via online distribution and through international licensing opportunities.

Our ability to continue as a going concern is dependent upon our success in securing sufficient financing and to successfully execute our plans to return to positive cash flows during fiscal 2010. Our financial statements do not include any adjustments that might be necessary if we were unable to continue as a going concern.

19. Subsequent Event

On October 9, 2009, eGames sold the intellectual property rights related to its Cinemaware assets to an undisclosed buyer for $150,000 in cash. This sales transaction will be reflected in the Company’s financial statements for the fiscal quarter ending December 31, 2009. The related assets’ net book value had previously been written down to zero during the year ended June 30, 2009.

The Company extended its evaluation of transactions subsequent to June 30, 2009 through the period ended November 13, 2009 and as a result management determined that other than the October 9th, 2009 event already discussed in this note there were no other events to disclose.

20. Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (FIN 48). FIN 48 clarifies when tax benefits should be recorded in financial statements, requires certain disclosures of uncertain tax matters and indicates how any tax reserves should be classified in a balance sheet. FIN 48 became effective for our Company in the first quarter of fiscal 2008. The adoption of FIN 48 did not have a material impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* ”. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 became effective for Company in the first quarter of fiscal 2009. The adoption of SFAS No. 159 did not have a material impact on our financial statements.

In December 2007, the FASB ratified Emerging Issues Task Force’s (“EITF”) consensus conclusion on EITF 07-01, “*Accounting for Collaborative Arrangements* ”. EITF 07-01 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. Under this conclusion, a participant to a collaborative arrangement should disclose information about the nature and purpose of its collaborative arrangements, the rights and obligations under the collaborative arrangements, the accounting policy for collaborative arrangements, and the income statement classification and amounts attributable to transactions arising from the collaborative arrangement between

participants for each period an income statement is presented. EITF 07-01 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2008 and requires retrospective application to all prior periods presented for all collaborative arrangements existing as of the effective date. We do not anticipate the implementation of EITF 07-01 to have a material impact on our financial statements.

In February 2008, the FASB issued FASB Staff Position ("FSP") Financial Accounting Standard ("FAS") 157-2, "*Effective Date of FASB Statement No. 157*". FSP FAS 157-2 delays the effective date of SFAS No. 157, "*Fair Value Measurements*", for certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FSP FAS 157-2 defers the effective date of certain provisions of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for items within the scope of this FSP. We do not expect the adoption of SFAS No. 157 or FSP FAS 157-2 to have a material impact on our financial statements.

In April 2008, the FASB issued FSP FAS 142-3, "*Determination of the Useful Life of Intangible Assets*". FSP FAS 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, "*Goodwill and Other Intangible Assets*". This guidance for determining the useful life of a recognized intangible asset applies prospectively to intangible assets acquired individually or with a group of other assets in either an asset acquisition or business combination. FSP FAS 142-3 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008, and early adoption is prohibited. We are currently evaluating the impact FSP FAS 142-3 will have on our financial statements.

In May 2009, the FASB issued SFAS 165, *Subsequent Events* which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS is effective for interim or annual financial periods ending after June 15, 2009.

Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None

PART III

Directors, Executive Officers, Promoters and Control Persons

Executive Officers:

Our executive officers are:

Name	Age	Position
Gerald W. Klein	61	President and Chief Executive Officer
Thomas W. Murphy	51	Vice President, Finance and Chief Financial Officer
Richard H. Siporin	50	Vice President, Sales and Marketing

Mr. Klein has been President and Chief Executive Officer of eGames since June 1998. He joined eGames as Vice President and Chief Financial Officer in February 1996 and has been a Director since August 1994. Prior to joining eGames, Mr. Klein was President, Chief Executive Officer and a Director of Megamation Incorporated, a publicly traded company that manufactured automation work cells used in various industries. From August 1991 to October 1994, Mr. Klein served as President and Chief Executive Officer of PricePoint, Inc., a start-up company engaged in the development of electronic retail pricing systems developed to replace paper shelf labels in supermarkets and other retail markets.

Mr. Murphy has been Chief Financial Officer of eGames since July 1999. He joined eGames as Controller in May 1996. Prior to joining eGames, Mr. Murphy was Controller of Megamation Incorporated, a publicly traded company that manufactured automation work cells used in various industries, from January 1995 until April 1996, and Accounting Manager of Ohmicron, Inc., a biotechnology company, from January 1993 until December 1994. From September 1985 to May 1992, Mr. Murphy served in a number of financial positions at Checkpoint Systems, Inc., a provider of security and access control systems, including serving as Accounting Manager from 1991 to 1992.

Mr. Siporin joined eGames in January 2000 as Vice President of Sales and Marketing. Prior to joining eGames, he served as Senior Vice President of Sales for Sunbeam, Inc., Health Division. From 1988 to 1998, Mr. Siporin served in a number of positions at Revlon, Inc., including serving as Vice President of Sales from 1992 to 1998. From 1982 to 1988, Mr. Siporin held a number of sales management positions with Playtex Family Products.

Directors:

There is no family relationship between any director and any other director or executive officer of eGames. The names of the members of our Board of Directors and certain information about them are set forth below. The information about our Board of Directors is based, in part, upon information furnished by the directors.

Director Name	Age	Title	Since
Gerald W. Klein	61	Director, President and Chief Executive Officer	1994
Eugene H. Mauro(1)(4)	40	Director	2005
Thomas D. Parente (2)(3)	62	Director	1995
Lambert C. Thom (1)(2)	63	Director	1997

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(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Chairman of Board of Directors and Audit Committee
(4) Chairman of Compensation Committee

Gerald W. Klein has served as President and Chief Executive Officer of eGames since June 1998. He joined eGames as Vice President and Chief Financial Officer in February 1996 and has been a Director since August 1994. Prior to joining eGames, Mr. Klein was President, Chief Executive Officer and a Director of Megamation Incorporated, a publicly traded company that manufactured automation work cells used in various industries. From August 1991 to October 1994, Mr. Klein served as President and Chief Executive Officer of PricePoint, Inc., a start-up company engaged in the development of electronic retail pricing systems developed to replace paper shelf labels in supermarkets and other retail markets. From 1979 to 1991, Mr. Klein was employed by Checkpoint Systems, Inc., a provider of security and access control systems to retailers, commercial businesses, and libraries and was President and Chief Operating Officer of that company from April 1986 to July 1991.

Eugene H. Mauro is a 14-year veteran of the interactive entertainment industry and has served on the eGames Board since December 2005. During this time he has managed a consumer Internet and video game consulting business, Mauro Media Inc., and has also held operational roles at game companies including: gamerDNA, an online game network where he served as Vice President Marketing and Business Development from October 2008 to October 2009; Bunchball Inc., where Mr. Mauro launched the first social games on Facebook as Vice President of Business Development from December 2006 until June of 2008; Myelin Media, LLC, a video game publishing company where Mr. Mauro served as Chief Executive Officer and Executive Producer from March 2004 until September 2005; and Capital Entertainment Group, an independent video game production studio where Mr. Mauro was the founder and served as CEO from May 2001 until December 2003.

Thomas D. Parente has served as a Director of eGames since June 1995. He served as Chairman of the Board from August 1998 until December 2000, at which time former director Robert M. Aiken, Jr. was elected as Chairman of the Board. Mr. Parente was again elected as Chairman of the Board in December 2005 upon Mr. Aiken's retirement. Mr. Parente is Corporate Secretary and Director of Corporate Development for Ole Hansen & Sons, Inc., a privately owned holding company, a position he has held since December 1996. From May 1995 to November 1996, he was self-employed as a financial consultant to businesses. From April 1988 until April 1996, he was a Vice-President and the Chief Financial Officer of Suvar Corporation, a manufacturer of specialty chemicals for the printing and coatings markets. From June 1970 until April 1988, Mr. Parente was employed by KPMG LLP and was a partner with that firm from April 1979 until April 1988. Mr. Parente is a certified public accountant.

Lambert C. Thom joined eGames as a Director in December 1997. He has served as Vice President and Managing Director of Bangert, Dawes, Reade, Davis & Thom, Incorporated, a private investment firm, since 1975. From 1989 to 1995, Mr. Thom served as Vice President of John Hancock Capital Growth Management, Inc., an investment management firm.

Audit Committee:

The Board of Directors of eGames has an Audit Committee comprised of Eugene H. Mauro, Lambert C. Thom, and Thomas D. Parente. Mr. Parente is the Chairman of the Audit Committee.

Code of Ethics:

We have adopted a Code of Ethics that applies to all of our directors and employees, including our Chief Executive Officer, Chief Financial Officer and senior financial and accounting officers. In addition to other matters, the Code of Ethics establishes policies to deter wrongdoing and to promote honest and ethical conduct, including ethical handling of actual or apparent conflicts of interest, compliance with applicable laws, rules and regulations, full, fair, accurate, timely and understandable disclosure in public communications and prompt internal reporting of violations of the Code of Ethics. A copy of the eGames Code of Ethics is available on our website at http://www.egamesonline.com/egames/investors/ethics.asp. Shareholders may request a printed copy of the Code of Ethics, free of charge, by contacting our Vice President and Chief Financial Officer at:

eGames, Inc.
Attention: Vice President and Chief Financial Officer
2000 Cabot Boulevard, Suite 110
Langhorne, PA 19047

Executive Compensation:

Summary Compensation Table

The following table sets forth certain information concerning the compensation paid during the fiscal years ended June 30, 2009, 2008, and 2007 to our Chief Executive Officer and other executive officers whose salary and bonus exceeded $100,000 during the 2009 fiscal year.

		Annual Compensation		Long-Term Compensation	
Name & Principal Position	Fiscal Year	Salary ($)	Bonus (2) ($)	Securities Underlying Options (#)	All Other Compensation (1) ($)
Gerald W. Klein	2009	200,000	1,500	-0-	9,101
President and Chief Executive	2008	200,000	1,500	100,000	9,498
Officer	2007	200,000	1,170	-0-	9,516
Thomas W. Murphy	2009	145,000	1,500	-0-	4,317
Vice President - Finance and	2008	145,000	1,500	100,000	7,943
Chief Financial Officer	2007	141,500	1,170	-0-	8,481
Richard H. Siporin	2009	170,000	1,500	-0-	5,979
Vice President - Sales and Marketing	2008	170,000	1,500	100,000	8,104
	2007	170,000	1,170	-0-	7,854

(1) Represents: (a) amounts contributed by eGames to each named executive officer's 401(k) Plan, and (b) life insurance premiums paid by eGames.
(2) Represents Christmas bonus paid to all employees.

Stock Option Grants During 2009 Fiscal Year

None.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-end Option Values

The following table provides information related to employee stock options exercised by the named executive officers during fiscal 2009 and the value of such stock options at year-end.

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options at FY End (#) Exercisable/Un-exercisable	Value* of Unexercised In-The-Money Options at FY-End ($) Exercisable/Un Exercisable
Gerald W. Klein	- 0 -	- 0 -	65,000 / 145,000	- 0 - / - 0 -
Thomas W. Murphy	- 0 -	- 0 -	47,500 / 127,500	- 0 - / - 0 -
Richard H. Siporin	- 0 -	- 0 -	47,500 / 127,500	- 0 - / - 0 -

* Value of stock options based upon a share price of $0.18, the closing price of our Common Stock on June 30, 2009.

Long-Term incentive Plans

We do not have any long-term incentive plans.

Compensation of Directors

The non-employee members of the Board of Directors, who are also members of our Audit Committee and Compensation Committee, receive a per-meeting fee of $500 each. From July 1, 2008 through June 30, 2009, the non-employee directors were paid for participating in five meetings. All directors are entitled to reimbursement for reasonable expenses incurred in the performance of their duties as Board members.

Change of Control Severance Arrangements

In June 2004, we adopted a Change of Control Severance Plan for Level One Employees (the "Severance Plan"). The Chief Executive Officer, the President, any Vice President of eGames, and each other person designated by the Board in writing are eligible to participate in the Severance Plan. The Severance Plan provides for benefits in the event that eGames or its successor terminates an eligible individual's employment within 90 days prior to or 365 days after a change of control for any reason other than for "cause," as defined in the Severance Plan, or any eligible employee terminates his or her employment for "good reason," as defined in the Severance Plan. The eligible employees under the Severance Plan may be eligible to receive (A) a lump sum payment of two times the sum of their annual base salary and the greater of (1) the annual cash bonus, if any, actually paid or declared for the year immediately preceding the year in which the employee's employment terminates or (2) the annual bonus for the year immediately preceding the year the change of control giving rise to the termination of employment and (B) continuation of health benefits for up to 24 months.

Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth information as supplied to us regarding the number and percentage of shares of the Company's Common Stock beneficially owned as of September 29, 2009 (unless otherwise noted) by: (i) those persons or entities known by management to beneficially own more than five percent of the Common Stock; (ii) each of our directors; (iii) each of our executive officers named in the Summary Compensation Table; and (iv) all of our directors and executive officers as a group.

Name and address of Beneficial Owner (1)	Amount and Nature Of Beneficial Ownership (2)	Percent of Class Beneficially Owned
Gerald W. Klein	687,200 (3)	5.5%
Eugene H. Mauro	60,000 (4)	*
Thomas W. Murphy	138,642 (5)	1.1%
Thomas D. Parente	162,000 (6)	1.3%
Richard H. Siporin	141,667 (7)	1.1%
Lambert C. Thom	216,124 (8)	1.7%
All executive officers and directors as a group (7 persons)	1,405,633 (9)	11%

*Less than 1%

(1) Unless otherwise indicated, the address of each named holder is c/o eGames, Inc., 2000 Cabot Boulevard West, Suite 110, Langhorne, PA 19047.

(2) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission (the "SEC") and generally includes voting or investment power with respect to securities. In accordance with SEC rules, the shares in this column include shares that may be acquired upon

exercise of stock options within sixty days of September 29, 2009. Except as indicated by footnote, and subject to community property laws where applicable, the persons or entities named in the table above have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them.

(3) Includes 76,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date. Also includes 1,200 shares held by Mr. Klein's immediate family members.

(4) Includes 60,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date.

(5) Includes 55,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date. Also includes 788 shares held by Mr. Murphy's immediate family members.

(6) Includes 80,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date.

(7) Includes 55,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date.

(8) Includes 80,000 shares of Common Stock that may be acquired through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date.

(9) Includes 406,000 shares of Common Stock that may be acquired by such persons through the exercise of options that were exercisable as of September 29, 2009 or became exercisable within 60 days of that date.

Equity Compensation Plan Information:

The following table summarizes, as of June 30, 2009, outstanding common stock warrants and common stock options to acquire shares of our Common Stock that have been issued under our 1995 Amended and Restated Stock Option Plan, which expired June 30, 2005, or that were issued outside this plan.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders.	540,000	$0.78	- 0 -
Equity compensation plans not approved by security holders. (1)	900,000	$0.57	- 0 -
Warrants issued to Cinemaware, Inc. (2)	300,000	$0.63	- 0 -
Warrants issued to First Global Securities. (3)	62,000	$1.10	- 0 -
Total	**1,802,000**	**$0.66**	**- 0 -**

(1) In December 2005, we granted common stock options to our outside Directors to purchase 150,000 shares of our Common Stock at an exercise price of $0.31, the market price on the date of grant. These common stock options

have ten year terms, and vested over three years after the date of grant in equal annual installments. These common stock options were not part of any formal stock option plan.
On June 19, 2007, we granted a common stock option to one employee to purchase 50,000 shares of our common stock, with an exercise price of $0.73 (the closing price of our common stock on date of grant) and a life of six years. This common stock option was not part of any formal stock option plan.
On June 5, 2008, we granted common stock options to our Board of Directors and members of management to purchase 800,000 shares of our common stock, with an exercise price of $0.62 (the closing price of our common stock on date of grant), vesting over ten years and having a life of eleven years. Due to one of these optionees leaving the Company, an option to purchase 100,000 shares from this grant was subsequently cancelled. These common stock options were not part of any formal stock option plan.

(2) In partial consideration for the acquisition of assets of Cinemaware, Inc. in October 2005, we issued to Cinemaware a common stock warrant to purchase 150,000 shares of our Common Stock at an exercise price of $0.50 per share, and a common stock warrant to purchase 150,000 shares of our Common Stock at an exercise price of $0.75 per share (collectively, the "Warrants"). The Warrants each have a term of five years.

(3) On May 8, 2008, in consideration for placement agency services rendered during our private offering of Preferred Stock, we issued to First Global Securities a five year common stock warrant to purchase 62,000 shares of our Common Stock at an exercise price of $1.10 per share.

Certain Relationships and Related Transactions

None.

Availability of Financial Information

Shareholders can access our financial and other information by going to the Investor Relations page of our website at www.egames.com, where our annual financial statements, as well as press releases containing quarterly financial information, can be accessed. Information can also be found on the Pink Sheets website at www.pinksheets.com and typing in our symbol "EGAM". Shareholders and other interested parties may also request a paper copy of financial information by contacting us by mail at eGames, Inc. 2000 Cabot Boulevard, Suite 110, Langhorne, Pennsylvania 19047 to the attention of the Chief Financial Officer. Additionally, shareholders can be placed on a list to receive press releases, as they are issued, via email by going to the following link on the eGames investor relations webpage: http://www.egamesonline.com/egames/investors/alert.asp.

PART IV

Independent Auditors' Fees and Services

The following table sets forth the fees that we incurred or expect to incur with our independent auditors for services provided to us during the last two fiscal years. Fiscal 2008 amounts are actual costs incurred and fiscal 2009 amounts are per our engagement letter with Stockton Bates, LLP.

	FY-2009	FY-2008
Audit Fees (1)	$ 38,000	$ 34,000
Audit-Related Fees (2)	$ - 0 -	$ - 0 -
Tax Fees (3)	$ 10,000	$ 4,300
All Other Fees (4)	$ - 0 -	$ - 0 -

(1) Audit Fees consist of fees billed for professional services rendered for the audit of our annual financial statements.
(2) Audit-Related Fees consist of services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under "Audit Fees."

(3) Tax Fees consist of professional services rendered by the independent auditors for tax compliance, tax advice, and tax planning. The services for the fees disclosed under this category include tax return preparation and tax advice.
(4) Other fees consist of services such as: review of distribution agreements; research on dividend reporting and tax withholding on international royalty payments; and annual meeting preparation**.**

The Audit Committee has considered whether the provision of services other than audit services is compatible with maintaining the independent public accountant’s independence.

During fiscal 2009, the Audit Committee approved all audit, non-audit, tax and all other services which Stockton Bates, LLP was to perform during the year and the range of fees for each of these categories. The Audit Committee's current policy is to consider for pre-approval annually all categories of audit, non-audit, tax and other services proposed to be provided by our independent auditors for the fiscal year, which categories and services are reviewed as needed throughout the year. The Audit Committee must separately pre-approve any service that is not included in the approved list of services or any proposed services exceeding pre-approved cost levels.

Exhibits Incorporated by Reference

The following is a list of exhibits incorporated by reference into this annual report from reports that eGames previously filed with the Securities and Exchange Commission or posted on www.pinksheets.com.

Exhibit Cross-Reference	Description of Exhibit
(1)	By-Laws of eGames, Inc.
(2)	Articles of Incorporation of eGames, Inc.
(3)	Warrant for the Purchase of 150,000 shares of Common Stock of eGames, Inc. exercisable at $0.75 per share
(3)	Warrant for the Purchase of 150,000 shares of Common Stock of eGames, Inc. exercisable at $0.50 per share
(4) *	Amended and Restated 1995 Stock Option Plan.
(5) *	Form of Incentive Stock Option Agreement.
(5) *	Form of Non-Employee Director Stock Option Agreement.
(6) *	Change of Control Severance Plan for Level One Employees.
(6) *	Change of Control Severance Plan for Level Two Employees.
(7)	Code of Ethics for Employees and Board Members

*	Management contracts.
(1)	Incorporated herein by reference from our Form 10-QSB for the quarter ended September 30, 1998 as filed with the Securities and Exchange Commission on November 16, 1998.
(2)	Incorporated herein by reference from our Annual Report for Fiscal 2008 as posted on www.pinksheets.com and www.egames.com on October 27, 2008.
(3)	Incorporated herein by reference from our Form 8-K as filed with the Securities and Exchange Commission on October 19, 2005.
(4)	Incorporated by reference herein from our Form 10-KSB for the year ended June 30, 1998 as filed with the Securities and Exchange Commission on September 10, 1998.
(5)	Incorporated by reference herein from our Form 10-KSB for the year ended June 30, 2004 as filed with the Securities and Exchange Commission on September 27, 2004
(6)	Incorporated herein by reference from our Form 8-K as filed with the Securities and Exchange Commission on June 28, 2004.
(7)	Incorporated herein by reference from our Form 10-KSB as filed with the Securities and Exchange Commission on September 27, 2005.

Description of Material Contracts Not Incorporated into Annual Report

Development agreement: We have entered into a master work-for-hire development agreement with our primary independent contractor for the development of our proprietary game titles for the PC, Internet and various game console platforms. Pursuant to the master agreement, for each title developed, we enter into an addendum that sets forth the progress payments to the independent contractor based on agreed upon development milestones for such game title. At June 30, 2009, we had $126,500 in outstanding commitments for future game development which are all scheduled to be paid during fiscal 2010.