

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**
SEC Accession No. **0000950116-96-001310**

([HTML Version](#) on secdatabase.com)

FILER

CAPITAL GAMING INTERNATIONAL INC /NJ/

CIK: **867443** | IRS No.: **223061189** | State of Incorporation: **NJ** | Fiscal Year End: **0630**
Type: **10-Q** | Act: **34** | File No.: **000-19128** | Film No.: **96664524**
SIC: **7900** Amusement & recreation services

Mailing Address
*BAYPORT 1 8025 BLACK
HORSE PIKE
W. ATLANTIC NJ 08232*

Business Address
*BAYPORT ONE STE 250
8025 BLACK HORSE PIKE
WEST ATLANTIC CITY NJ
08232
6093833333*

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 1996

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 0-19128

CAPITAL GAMING INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

New Jersey 22-3061189
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

Bayport One, Suite 250 08232
8025 Black Horse Pike (Zip Code)
W. Atlantic City, New Jersey
(Address of principal executive offices)

Registrant's telephone number, including area code: (609) 383-3333

Not applicable

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate the number of shares outstanding of each of the issuer's class of common stock as of November 1, 1996: 19,329,574

CAPITAL GAMING INTERNATIONAL, INC.

INDEX

<TABLE>
<CAPTION>

<S> Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

<C>

Consolidated Balance Sheets as of September 30, 1996 and June 30, 1996 [Unaudited]	1 - 2
Consolidated Statements of Operations for the three months ended September 30, 1996 and 1995 [Unaudited]	3
Consolidated Statement of Changes in Stockholders' Deficit for the three months ended September 30, 1996 [Unaudited]	4
Consolidated Statements of Cash Flows for the three months ended September 30, 1996 and 1995 [Unaudited]	5 - 7
Notes to Consolidated Financial Statements	8 - 13
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Part II. OTHER INFORMATION	
Item 1. Legal Proceedings	22
Item 3. Default Upon Senior Securities	27
Item 6. Exhibits and Reports on Form 8-K	28
Signature Page	29

</TABLE>

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
ASSETS
(In thousands)

<TABLE>
<CAPTION>

	September 30, 1996	June 30, 1996
	-----	-----
	[Unaudited]	
	<C>	<C>
<S>		
CURRENT ASSETS:		
Cash and Cash Equivalents	\$ 3,145	\$ 2,102
Cash Held in Escrow	1,437	500
Interest Receivable	42	616
Native American Management Fees and Expenses Receivable	794	667
Current Portion - Native American Loan Receivable	3,748	3,696
Notes Receivable	--	35,000
Prepaid Expenses and Other Current Assets	189	206
	-----	-----
TOTAL CURRENT ASSETS	9,355	42,787
	-----	-----
FURNITURE, FIXTURES AND EQUIPMENT, net	118	127
OTHER ASSETS:		
Native American Loan Receivable	6,474	7,630
Investments in Native American Management Agreements, net	2,461	2,677
Deferred Financing Costs, net	4,573	6,213
Deposits and Other Assets	188	188
Goodwill, net	416	426
	-----	-----
TOTAL OTHER ASSETS	14,112	17,134
	-----	-----
TOTAL ASSETS	\$23,585	\$60,048
	=====	=====

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

1

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND STOCKHOLDERS' DEFICIT

<TABLE>

<CAPTION>

	September 30, 1996	June 30, 1996
	----- [Unaudited] <C>	----- <C>
CURRENT LIABILITIES:		
Accounts Payable and Accrued Expenses	\$ 3,011	\$ 9,943
Accrued Professional Fees	1,932	1,917
Accrued Interest	27,130	23,277
Equipment Notes Payable - Current Maturity	892	1,290
Bondholder Consent Fee Note	1,350	1,350
Bank Line of Credit	2,000	2,000
11.5% Senior Secured Notes Payable - [net of Original Issue Discount of \$2,196 and \$2,980]	124,804	124,020
Funds held/paid by Trustee for/to Senior Secured Noteholders	(49,986)	(22,489)
Unsecured 11.5% Term Note Payable	19,000	19,000
	-----	-----
TOTAL CURRENT LIABILITIES	\$ 130,133	\$ 160,308
LONG-TERM DEBT:	--	--
STOCKHOLDERS' DEFICIT		
Preferred Stock, No Par Value, Authorized 5,000,000 Shares;	--	--
Common Stock, No Par Value, Authorized 75,000,000 Shares;		
Issued and Outstanding 19,329,574 Shares	37,617	37,617
Additional Paid In Capital	7,877	7,877
Accumulated Deficit	(152,042)	(145,754)
	-----	-----
TOTAL STOCKHOLDERS' DEFICIT	(106,548)	(100,260)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 23,585	\$ 60,048
	=====	=====

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

2

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
[UNAUDITED]
(In thousands)

<TABLE>

<CAPTION>

	Three months ended September 30,	
	1996	1995
<S>	<C>	<C>
REVENUE		
Native American Casino Management Fees	\$ 2,137	\$ 2,718
COSTS AND EXPENSES		
Salaries, Wages and Related Costs	473	756
Gaming Development Costs	296	650
Professional Fees	439	693
General and Administrative	488	469
Depreciation and Amortization	235	175
Write-off of Deferred Charges	--	64
Reorganization Costs	243	--
Total Costs and Expenses	2,174	2,807
Loss From Continuing Operations before Other Income/[Expense]	(37)	(89)
Other Income [Expense]:		
Interest Income	168	515
Interest Expense	(4,306)	(4,775)
Gain From Sale of Development Agreement	--	221
Sale of Management Contract	--	3,000
Total Other Income [Expense], net	(4,138)	(1,039)
Loss From Continuing Operations Before Income Tax	(4,175)	(1,128)
Provision for State Income Taxes	(115)	--
Loss From Continuing Operations	(4,290)	(1,128)
Discontinued Operations:		
Loss from Operations of Discontinued Business and Other Reorganization Items	--	(1,600)
Net Loss Before Extraordinary Item	\$ (4,290)	\$ (2,728)
Extraordinary Item - Loss From Early Extinguishment of Debt	(1,998)	--
Net Loss	(6,288)	(2,728)
Earnings Per Share:		
Loss From Continuing Operations	\$ (.22)	\$ (.06)
Loss From Operations of Discontinued Business	(.00)	(.08)
Extraordinary Item	(.11)	(.00)
Net Loss	\$ (.33)	\$ (.14)
Weighted Average Number of Shares Outstanding (in thousands)	19,330	19,330

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

3

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIT
[UNAUDITED]
(In thousands)

<TABLE>

<CAPTION>

	Common Stock		Additional	Accumulated
	Shares	Amount	Capital	[Deficit]
<S>	<C>	<C>	<C>	<C>
	-----	-----	-----	-----
	-----	-----	-----	-----

Balance - June 30, 1996	19,330	\$ 37,617	\$ 7,877	\$ (145,754)
Net loss for the three months ended September 30, 1996	-	-	-	(6,288)
	-----	-----	-----	-----
Balance - September 30, 1996	19,330	\$ 37,617	\$ 7,877	\$ (152,042)
	=====	=====	=====	=====

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

4

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
[UNAUDITED]
(In thousands)

<TABLE>
<CAPTION>

	Three months ended September 30,	
	1996	1995
	-----	-----
	<C>	<C>
<S>		
OPERATING ACTIVITIES:		
Net Loss from Continuing Operations	\$ (4,290)	\$ (1,128)
Adjustments to Reconcile Net Loss to Net Cash Provided by Continuing Operations:		
Depreciation and Amortization	235	174
Write-off of Deferred Charges	--	64
Amortization of Deferred Finance Charges and Original Issue Discount and Extraordinary Loss From Early Extinguishment of Debt	426	519
Gain From Sale of Development Agreement	--	(221)
Changes in Assets and Liabilities - [Increase] Decrease in:		
Interest Receivable	140	399
Prepaid Expenses and Other Current Assets	18	--
Management Fees and Expenses Receivable	(128)	976
Deposits and Other Assets	--	8
Increase [Decrease] in:		
Accounts Payable and Accrued Expenses	83	(358)
Accrued Interest Expense	3,852	4,175
	-----	-----
Total Adjustments	4,626	5,736
	-----	-----
Net Cash - Continuing Operations	\$ 336	\$ 4,608
Loss From Discontinued Operations	--	(1,600)
Adjustments to Reconcile Loss to Net Cash Used in Discontinued Operations:		
Equity in Losses of River City Joint Venture	--	831

Change in Net Assets of Discontinued Operations	--	(192)
	-----	-----
Net Cash - Discontinued Operations	--	(961)
	-----	-----
Net Cash - Operating Activities	\$ 336	\$ 3,647

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

5

Part I, Item 1

CAPITAL GAMING INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
[UNAUDITED]
(In thousands)

<TABLE>
<CAPTION>

	Three months ended	
	September 30,	
	1996	1995
	-----	-----
<S>	<C>	<C>
INVESTING ACTIVITIES:		
Investment in Property, Vessel and Equipment	\$ --	\$ (453)
Advances to Joint Venture	--	(630)
Net Transfers from Restricted Cash	--	4,064
Investments in Management Agreements	--	(149)
Native American Casino Development Advances	--	(1,070)
Repayment of Native American Notes Receivable	1,104	9,660
	-----	-----
Net Cash - Investing Activities	\$ 1,104	\$ 11,422
FINANCING ACTIVITIES:		
Funds Held by Trustee	--	(14,386)
Reduction in Equipment Notes	(397)	(428)
Proceeds From Sale of Development Agreement	--	292
	-----	-----
Net Cash - Financing Activities	\$ (397)	\$ (14,522)
	-----	-----
NET DECREASE IN CASH	\$ 1,043	\$ 547
Cash and Cash Equivalents - Beginning of Periods	\$ 2,102	\$ 1,187
	-----	-----
Cash and Cash Equivalents - End of Periods	\$ 3,145	\$ 1,734
	=====	=====

</TABLE>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

6

CAPITAL GAMING INTERNATIONAL, INC.
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 [UNAUDITED]

Supplemental Disclosures of Cash Flow Information:

	Three months ended September 30,	
	1996	1995
	----	----
Cash paid during the periods for:		
Interest	\$ 27	\$ --
Income Taxes	\$ --	\$ --

Supplemental Disclosure of Non-Cash Investing and Financing Activities:

On July 29, 1996, the Indenture Trustee for the Company's Senior Secured Noteholders distributed an aggregate of \$49,986,000 in cash and Purchaser's Notes to the Senior Secured Noteholders on account of principal and accrued interest ("Noteholder Distribution"). The Noteholder Distribution included \$28 million in Purchaser's Notes, as well as cash from the sale of CCCD to CMC, proceeds from the early payment of the development loan to the Muckleshoot Tribe, proceeds from the buyout of the Cow Creek contract, \$3.2 million in unused restricted cash and other sources. Subsequently, in August 1996 the Purchaser's Notes were redeemed by CMC at 100% of the principal amount plus accrued interest. The remainder is held by the trustee of the Company's Senior Secured Noteholders, including cash escrow balances of \$413,030 and \$524,017 to secure current and future fees for services of the trustee.

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements.

CAPITAL GAMING INTERNATIONAL, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 [UNAUDITED]

[A] BASIS OF PRESENTATION

Capital Gaming International, Inc. (the "Company"), together with its subsidiaries, is a multi-jurisdictional gaming company with gaming management interests with Native American Tribes in several states. The management of Native American gaming facilities is conducted through Capital Gaming Management, Inc. ("CGMI"), a wholly-owned subsidiary of the Company. The development of the Narragansett Casino project is conducted through Capital Development Gaming Corp., ("CDGC"), a wholly-owned subsidiary of the Company.

The Company's CGMI subsidiary currently manages and operates three Native American gaming facilities, which CGMI has developed or expanded into Class III facilities:

- o Muckleshoot Tribe - Auburn, Washington (Class III facility became operational in April 1995)
- o Tonto Apache Tribe - Payson, Arizona (Class III facility became operational in April 1995)
- o Umatilla Tribes - Pendleton, Oregon (Class III facility became operational in March 1995)

CGMI also has a management contract to develop a Class III facility for the Jena Band of Choctaws Tribe in Louisiana.

The Company's CDGC subsidiary has a management and development contract with the Narragansett Tribe for the development of a Class III gaming facility in Charlestown, Rhode Island.

The Company previously had an interest in Crescent City Capital Development Corp. ("CCCD"), a wholly owned subsidiary which had a 50% interest in a joint venture riverboat gaming facility in New Orleans, Louisiana (the

"River City Joint Venture"). Due primarily to unforeseen failure of projected market conditions which have been widely reported to have severely and negatively impacted the entire New Orleans riverboat and land-based gaming industry, the gaming facility voluntarily ceased operations in June of 1995 and the River City Joint Venture was terminated in July of 1995. On July 28, 1995, CCCD consented to the entry of an order for relief under Chapter 11 of the U.S. Bankruptcy Code. Since such order, CCCD continued to manage its business and properties as a debtor-in-possession. On May 13, 1996, the Company sold the assets and its remaining interest in CCCD to a wholly owned subsidiary of Casino Magic Corporation (CMC) for an aggregate consideration of \$50 million in cash and notes and the assumption of up to \$6.5 million in certain equipment liabilities.

As a result of CCCD's reorganization and sale, the Company is now focusing all of its efforts on (i) restructuring the Company's debt, (ii) maintaining its remaining gaming management contracts with Native American Tribes, (iii) developing the Narragansett Casino, and (iv) seeking new gaming opportunities. In order to restructure its debt, the Company intends to file a consensual, pre-negotiated Plan of Reorganization under Chapter 11 of the Bankruptcy Code which will have the approval of the Steering Committee for its Senior Secured Noteholders (the "Restructuring Case"). The Company believes that a pre-negotiated plan of reorganization has many benefits including an expedited time frame for confirmation of approximately 120 days or less. See "Going Concern and Planned Restructuring".

The accompanying unaudited financial statements have been prepared in accordance with generally

8

Capital Gaming International, Inc.
Notes to Consolidated Financial Statements (Continued)
[Unaudited]

accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, such statements include all adjustments [consisting only of normal recurring items] which are considered necessary for a fair presentation of the financial position of the Company at September 30, 1996, and the results of its operations and cash flows for the periods then ended. Results of operations for interim periods are not necessarily indicative of a full year of operations. The expenses incurred by CCCD to maintain the physical assets and maintain certain administrative requirements are reflected as part of Discontinued Operations in the Statement of Operations for all periods presented. It is suggested that these financial statements be read in conjunction with the financial statements and notes included in the Capital Gaming International, Inc. Form 10-K for the fiscal year ended June 30, 1996 and as filed with the Securities and Exchange Commission ("SEC").

Certain reclassifications have been made to the prior period financial statements to conform to classifications used in the current period.

[B] CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and all of its wholly owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

[C] SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Company are set forth in the Company's Form 10-K, as amended, for the year ended June 30, 1996, as filed with the Securities and Exchange Commission.

[D] GOING CONCERN AND PLANNED RESTRUCTURING

As shown in the accompanying financial statements, the Company has a stockholders' deficit of approximately \$107 million. At September 30, 1996 the Company's current liabilities exceeded its current assets by approximately \$121 million. Additionally, the Company is a party to various legal and other actions as a result of the cessation of certain operations and defaults on debt. Those factors create uncertainty about the Company's ability to continue as a going concern. The ultimate liability resulting from those matters cannot presently be determined.

Management is taking the following steps to revise its operating and financial requirements, which it believes are sufficient to provide the Company

with the ability to continue in existence: (1) restructure substantially all of the Company's indebtedness, (2) continue to provide management services under the Company's Native American gaming operations, (3) develop the Narragansett Casino, and (4) seek new gaming opportunities. The ability of the Company to continue as a going concern is dependent on the success of those plans. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

9

Capital Gaming International, Inc.
Notes to Consolidated Financial Statements (Continued)
[Unaudited]

In connection with the restructuring of the Company's outstanding debt, the Company anticipates that it will file a consensual, pre-negotiated Plan of Reorganization (the "Pre-negotiated Plan") under Chapter 11 of the U.S. Bankruptcy Code which will have the approval of the Steering Committee for its Senior Secured Noteholders which is comprised of greater than two-thirds of the Senior Secured Noteholders (the "Restructuring Case"). The Company believes that the filing of a Pre-negotiated Plan has many benefits including an expedited time frame for confirmation of approximately 120 days or less. At this time the Company cannot project the terms of the Pre-negotiated Plan or any other plan of reorganization and there is no assurance that any plan of reorganization filed by the Company will be consummated. The consummation of a plan of reorganization will be dependent upon the satisfaction of numerous conditions, including, among others, the acceptance of such plan by at least one class of impaired claims and confirmation by the Bankruptcy Court. Acceptance by a class of creditors requires the approval of holders of two-thirds in principal amount and more than one-half in number of those voting in such class. There is no assurance that the required conditions of any plan of reorganization filed by the Company will be met. If the Company does file a voluntary petition for relief under Chapter 11, it is not possible to predict the length of time the Company will be able to operate under the protection of Chapter 11, the outcome of the Chapter 11 proceedings in general, or the effect of such proceedings on the remaining business of the Company.

While the Company cannot predict the terms of its restructuring, the Restructuring Case is most likely to take the form of an exchange of all or a substantial portion of the Company's debt for equity. Given the secured position of the Company's Senior Secured Noteholders and the substantial amount by which the Company's liabilities exceeds its assets, it is likely that the consummation of any plan of reorganization proposed with respect to the Company will result in substantial dilution of the Company's shareholders which could result in their retaining little, if any, equity interest in the Company.

The Company believes that any plan of reorganization consummated by the Company will not require a restructuring of the operations of CGMI or CDGC. Furthermore, the Company does not believe it will be necessary and does not intend to file any Restructuring Case for CGMI or CDGC. The Company does not believe that the Restructuring Case will adversely affect the existing management and development contracts of CGMI and CDGC and does not constitute a default under any such agreements. However, there can be no assurance that the Company's Native American casino management contracts will not be adversely affected by the Restructuring Case.

The management contract with the Muckleshoot Indian Tribe provides that any decree or judgment of insolvency against "Capital" (defined collectively as the Company and CGMI) is an event of default allowing the tribe to terminate the contract. The management contracts with the Tonto Apache Tribe and the Umatilla Tribe generally provide that the tribe may terminate the agreement if CGMI files or consents to the filing of an involuntary petition in bankruptcy under Chapter 7. The Company does not believe that the Restructuring Case will constitute an event of default under any of these provisions.

Section 382 of the Internal Revenue Code of 1986 provides that in the event of an "Ownership Change" within the meaning of such Section, the Company's use of its tax net operating loss carryforwards could be severely limited. Although there can be no assurance, the Company believes that an "Ownership Change" within the meaning of such Section will not occur. Additionally, it is possible that the Company's net operating loss carryforwards will be substantially reduced or eliminated by cancellation of debt income in connection with the contemplated planned restructuring.

10

The issuance of common stock in the restructuring to any holder of debt resulting in such holder becoming a substantial stockholder of the Company (greater than 5%) may require such stockholder to obtain certain licensing and other consents.

[E] FUNDS HELD (PAID) BY TRUSTEE FOR (TO) SENIOR SECURED NOTEHOLDERS

On July 29, 1996, the trustee for the Senior Secured Noteholders distributed a total of \$49,986,000 to the Senior Secured Noteholders as follows: (i) \$21,986,000 in funds previously held by the trustee, and (ii) \$28,000,000 in Casino Magic notes from the sale of the Company's CCCD subsidiary. Due to the Company's previous default on the Senior Secured Note obligation, the specific application of these repayments is not known at this time. The balance sheet as of September 30, 1996 therefore reflects a \$49,986,000 contra-liability related to Senior Secured Noteholder indebtedness. Interest expense for the period subsequent to July 29, 1996 has been recorded based on an estimated liability after the repayment of approximately \$99,000,000. The cash balances remaining with the trustee after the Senior Secured Note repayment have been reclassified as current assets as of September 30, 1996.

[F] RHODE ISLAND DEVELOPMENT PROJECT

Native American Casino [Rhode Island] - In August 1994, a Tribal-State Compact was entered into between the Narragansett Indian Tribe and Governor Bruce Sundlun of Rhode Island. In October and November of 1994, two lawsuits were filed (including one by Rhode Island Attorney General Pine) seeking to void the Tribal-State Compact on the grounds that the Governor lacked the authority to bind the State absent legislative approval. In 1995, the State's new governor, Governor Almond, joined in the Pine Case.

In February of 1996, the United States District Court for the District of Rhode Island held that the Compact was void. The State has subsequently refused to negotiate with the Tribe.

In addition, in September of 1996, federal legislation was entered as an amendment (introduced by U.S. Senator John Chaffee of Rhode Island) to the Omnibus Appropriations Bill which has the effect of excluding the Narragansett Tribe's reservation (where the gaming facility is currently planned to be built) from the benefits of IGRA.

Although there can be no assurance, the Company believes that there is a chance that the Chaffee amendment may be overturned in the next Congressional session. In addition, the Secretary of the Interior has requested comments as to whether the Secretary can enact Secretarial procedures to permit gaming under IGRA for Tribes in States (such as Rhode Island) that refuse to negotiate Tribal-State Compacts in good faith. If the Secretary concludes that he has such authority, the Company believes that the Secretary may adopt such procedures sometime in 1997. On April 16, 1996, the Narragansett Tribe filed a petition with the Secretary requesting that the Secretary adopt procedures applicable to gaming by the Tribe. Unless the Chaffee amendment is overturned, however, there can be no assurance that the Secretary will have the authority to impose a compact on the State of Rhode Island. In spite of the set-back caused by the Chaffee amendment, the Company intends to pursue the Narragansett development project.

CDGC has entered into a management contract with the Narragansett Tribe (the "Narragansett Contract"). As amended, the Agreement provides for CDGC to receive an annual management fee of 30% of net revenues (as defined) of the facility for the first five years and 20% for the remaining two years. As part of the amended management contract, the Company will advance a construction loan to be repaid over a seven year period. The amended Narragansett Contract was submitted to the NIGC for approval in June of 1995 and until approved is not legally binding, or enforceable against the Tribe. No assurance can be given that, or when, such approval will be obtained. It is possible, as a condition of obtaining such approval, that the NIGC will require modifications to be made to the contract, some of which may be material.

In August 1996, the NIGC submitted comments on the Narragansett Contract. In light of the decision by the United States District Court invalidating the Tribal-State Compact, the NIGC has informed the Company and the Tribe that they will only consider at this time a contract relating solely to Class II gaming. In light of this, the Company currently intends to bifurcate the Narragansett Contract and submit only the portions relating to Class II gaming and return the Class III contract as a development contract until such time as a compact for Class III gaming is signed. Unless the Chaffee amendment is overturned, however, there can be no assurance that the Chairman of the NIGC will have the authority to approve the Narragansett contract.

The Company has continued funding the on-going development costs of the Rhode Island Development Project, which for the three months ended September 30, 1996 have amounted to approximately \$296,000. Such costs primarily consist of legal costs, environmental engineering and assessment and design costs.

[G] INCOME TAXES

Effective July 1, 1993, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 109 "Accounting for Income Taxes." The Statement requires that deferred income taxes reflect the tax consequences on future years of differences between the tax bases of assets and liabilities and their financial reporting amounts. The effect of the adoption is not material to the financial statements.

As of September 30, 1996, the Company has a net operating loss carryforward in excess of approximately \$72 million which begins to expire in 2009. As a result the Company has recorded a deferred tax asset of approximately \$24.5 million which has been offset by an allowance of \$24.5 million as realization cannot be assured at this time. Additionally, it is possible that the Company's net operating loss carryforwards will be substantially reduced or eliminated by cancellation of debt income in connection with the contemplated planned restructuring.

Capital Gaming International, Inc.
Notes to Consolidated Financial Statements (Continued)
[Unaudited]

[H] SALE OF CRESCENT CITY CAPITAL DEVELOPMENT

On May 13, 1996, the Company sold substantially all of its remaining assets in the CCCD subsidiary to a wholly owned subsidiary of Casino Magic Inc. ("CMC") for \$56,500,000 as follows:

Notes	\$35,000,000
Cash	15,000,000
Assumption of Equipment Liability	6,500,000

	\$56,500,000

During the quarter ending September 30, 1996, the trustee for the Senior Secured Noteholders transferred \$28,000,000 of the CMC notes to the Senior Secured Noteholders. In addition, the remaining \$7,000,000 of notes were transferred to the CCCD bankruptcy trustee in settlement of previously recorded liabilities. In August 1996 the CMC notes were redeemed by CMC at 100% of the principal amount plus accrued interest.

[I] EXTRAORDINARY LOSS FROM EARLY EXTINGUISHMENT OF DEBT

The payment to the Senior Secured Noteholders resulted in a loss from early extinguishment of debt of approximately \$1,998,000. The loss is primarily a result of the write-off of unamortized original issue discount and unamortized deferred finance costs related to the principal amount of the notes retired (See Note E.)

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Selected Consolidated Financial Data and the Company's Consolidated Financial Statements and the related notes thereto appearing elsewhere in this Report.

As a result of the sale of the Company's former unrelated business and disposal of certain gaming operations, the comparability and informative value of year-to-year comparisons may not be meaningful or precise.

Liquidity and Capital Resources

General

The Company is experiencing serious liquidity difficulties as a result of the failure of the New Orleans project and sale of Crescent City Capital Development Corp. ("CCCD"). From July 28, 1995 through April 29, 1996, when its Amended Plan of Reorganization was confirmed, CCCD was operating as a debtor-in-possession. Pursuant to CCCD's Amended Plan of Reorganization, substantially all of the assets of CCCD were sold to Casino Magic Corp. on May 13, 1996. The Company has defaulted on the Company's 11-1/2% Senior Secured Notes ("Senior Secured Notes") and the FNBC bank note due to failure to make required interest payments. In addition, the Company did not make the required October 26, 1995 interest payment on the \$19 million unsecured term note. The Company's working capital position at September 30, 1996 was negative approximately \$121 million which includes the outstanding balance of the Senior Secured Notes which are in default and classified as a current liability. Stockholders' equity is in a deficit position of approximately \$107 million as of September 30, 1996. The Company continues to operate based upon the funds received from its wholly owned subsidiary, Capital Gaming Management, Inc., the subsidiary which manages three Native American gaming facilities. The Company's cash flows are dependent upon the management fees earned from three management contracts.

The Company believes it must restructure its remaining debt in order to continue its operations and pursue new management and development opportunities. As a result, the Company is focusing all of its efforts on (i) restructuring the Company's remaining debt, (ii) maintaining its gaming management contracts with Native American Tribes, (iii) developing the Narragansett Casino, and (iv) seeking new gaming opportunities. The Company has and continues to actively negotiate with the Senior Secured Noteholders' Steering Committee regarding the restructuring of the Senior Secured Notes. The Company's total liabilities as of September 30, 1996 aggregate approximately \$130 million. Although the Company believes it will successfully restructure its debt to a level that is adequately serviceable by the cash flow of the Company and allows the Company the ability to build sufficient cash to pursue new development opportunities, there can be no assurances that the Company will reach any agreement with the holders of its Senior Secured Notes or with any other secured or unsecured creditors regarding the restructuring of the Company's liabilities.

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Planned Restructuring

In connection with such a restructuring, the Company anticipates that it will file a consensual, pre-negotiated Plan of Reorganization (the "Pre-negotiated Plan") under Chapter 11 of the U.S. Bankruptcy Code which will have the approval of the Steering Committee for its Senior Secured Noteholders

(the "Restructuring Case"). The Company believes that the filing of a Prenegotiated Plan has many benefits including an expedited timeframe for confirmation of approximately 120 days or less. At this time the Company cannot project the terms of the Prenegotiated Plan or any other plan of reorganization and there is no assurance that any plan of reorganization filed by the Company will be consummated. The consummation of a plan of reorganization will be dependent upon the satisfaction of numerous conditions, including, among others, the acceptance of such plan by at least one class of impaired claims and confirmation by the Bankruptcy Court. Acceptance by a class of creditors requires the approval of holders of two-thirds in principal amount and more than one-half in number of those voting in such class. There is no assurance that the required conditions of any plan of reorganization filed by the Company will be met. If the Company does file a voluntary petition for relief under Chapter 11, it is not possible to predict the length of time the Company will be able to operate under the protection of Chapter 11, the outcome of the Chapter 11 proceedings in general, or the effect of such proceedings on the remaining business of the Company.

While the Company cannot predict the terms of its restructuring, the Restructuring Case is most likely to take the form of an exchange of all or a substantial portion of the Company's debt for equity. Given the secured position of the Company's Senior Secured Noteholders and the substantial amount by which the Company's liabilities exceeds its assets, it is likely that the consummation of any plan of reorganization proposed with respect to the Company will result in substantial dilution to the Company's shareholders which could result in their retaining little, if any, equity interest in the Company. The Company believes that any plan of reorganization consummated by the Company will not require a restructuring of the operations of CGMI or CDGC. Furthermore, the Company does not believe it will be necessary and does not intend to file any reorganization proceedings for CGMI or CDGC. The Company does not believe that the Restructuring Case will adversely affect the existing management and development contracts of CGMI and CDGC. However, there can be no assurance that the Company's Native American casino management contracts will not be adversely affected by the Restructuring Case. The management contract with the Muckleshoot Indian Tribe provides that any decree or judgment of insolvency against "Capital" (defined collectively as the Company and CGMI) is an event of default allowing the tribe to terminate the contract. The management contracts with the Tonto Apache Tribe and the Umatilla Tribe generally provide that the tribe may terminate the agreement if CGMI files or consents to the filing of an involuntary petition in bankruptcy under Chapter 7. The Company does not believe that the Restructuring Case will constitute an event of default under any of these provisions.

Sources and Uses of Cash

During the three months ended September 30, 1996 cash of approximately \$336,000 was generated from operating activities. Cash flow was primarily attributable to CGMI's net income from operations of approximately \$1,275,000. Significant non-cash items during the three month period include interest expense accruals of approximately \$3,577,000 and depreciation and amortization of \$2,659,000. These cash sources are

15

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

offset by expenses of Capital Gaming International, Inc., development costs incurred related to the Rhode Island project and the extraordinary loss from the early retirement of debt. If the Company held the liquid resources necessary to meet its interest expense obligations as they came due, net cash from operating activities would be negative.

The net cash from investment activities for the quarter ended September 30, 1996 was \$1,104,000 generated from collection of Native American loan repayments. Net financing activities required \$397,000, primarily for the reduction of equipment notes payable.

The Company's source of internal funds for the next twelve months is expected to be derived only from excess cash generated by CGMI's operations and Native American loan repayments. In the event conditions arise, for whatever reasons, that cause a reduction or elimination in such sources of funds, the Company may not be able to continue operations.

Defaults on Indebtedness

Senior Secured Notes. As described above, the Company is in default under the Indenture as a result of the CCCD Restructuring Case. The Company also failed to make interest payments on its Senior Secured Notes of \$7,302,500 each on August 1, 1995, February 1, 1996 and August 1, 1996, and a \$1,350,000 consent fee payment which was due to the holders of the Senior Secured Notes on August 1, 1995. Such consent fee was previously incurred to allow the relocation of the Company's New Orleans River City Casino. The Company's failure to make the August 1, 1995 interest and consent payments and the February 1, 1996 and August 1, 1996 interest payment are also Events of Default under the Indenture.

The Company's Indenture also contains certain covenants regarding maintenance of consolidated net worth levels, the maintenance of ratios between earnings before income taxes, depreciation and amortization and certain fixed charges of the Company. As of the date hereof, the Company does not satisfy many of these covenants.

On June 21, 1995, the New Orleans 2000 Partnership, the mortgagee of real property owned by River City, provided notice of various defaults under its first mortgage to CCCD, River City Joint Venture and Grand Palais. An event of default under this mortgage constitutes an Event of Default under the Indenture.

As a result of the various defaults under the Indenture, the holders of the Senior Secured Notes are entitled to all of the remedies contained in the Indenture, including but not limited to acceleration of the Senior Secured Notes and foreclosing on the Collateral pledged by the Company to the Trustee which includes, among other things, the management fees derived from the management agreements between CGMI and the Native American Tribes. Furthermore, the security agreements entered into by the Company provide remedies to the holders of Senior Secured Notes including a requirement to transfer any proceeds received in respect of any dispositions of Collateral from and after the occurrence of an Event of Default as defined in the Indenture.

In the event that the holders of the Senior Secured Notes exercise all of their available remedies under the Indenture and related agreements, the Company and its subsidiaries will not be able to continue their

16

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

operations. However, the Company does not believe the holders of the Senior Secured Notes will exercise their remedies where the exercise of such remedies would prevent CGMI from continuing its operations as manager of several existing Native American gaming facilities or CDGC from continuing its development of the Narragansett Casino project.

Bank Line of Credit. On March 28, 1995, CCCD entered into a loan agreement with First National Bank of Commerce ("FNBC") which was guaranteed by the Company. Pursuant to the terms of this agreement, CCCD received a \$2 million working capital Line of Credit from FNBC for a period of ninety (90) days. In April 1995, this credit facility was utilized to provide CCCD with \$2 million of working capital. Borrowings against this facility were due June 27, 1995. CCCD was not able to repay the obligation thereby causing a default under the agreement. In addition, the Line of Credit contains cross-default provisions with the Indenture. FNBC has filed suit against Capital Gaming International, Inc. as a guarantor of CCCD's obligation and there is a chance that its suit may succeed. Any guarantor liability, however, may be partially offset by amounts recovered by FNBC on this obligation in connection with the CCCD Reorganization Case.

Term Note Payable. In connection with the buy-out of the profit interest of Republic Corporate Services, Inc. ("Republic") in CCCD, the Company executed an unsecured promissory note payable to Republic for \$19,000,000. The note bears interest at 11.5% per annum and requires semi-annual interest payments in April and October until its maturity on April 26, 2002 when all principal becomes due. In October 1994 and April 1995, the Company made each of the required interest payments of this term note totalling \$2,185,000. As a result of the cessation of the Company's New Orleans operations on June 9, 1995, and the resultant Chapter 11 petition filed by CCCD, the Company did not make the required interest payments under the note. As a result, the Company is in default under the note agreement.

Hospitality Franchise Systems, Inc. Hospitality Franchise Systems, Inc. ("HSFI") purchased shares of the Company's common stock in the February 1994 private placement. The Company entered into a Marketing Services Agreement (the

"Marketing Services Agreement") with HFS Gaming Corp. ("HFSC"), a wholly-owned subsidiary of HSFI, on February 17, 1994 which was amended in June 1994. Pursuant to the amended Marketing Services Agreement HFSC agreed to employ marketing efforts for the Company's current gaming projects to HSFC's customers as well as the franchises of HSFI and their customers in return for 1% of Net Gaming Revenues (as defined) other than the Narragansett Project which is limited to 0.25% of the annual gaming revenues for such project. The Company is presently in default under the Marketing Services Agreement.

Capital Requirements

Capital Gaming International, Inc. Upon the cessation of gaming operations at the New Orleans River City Casino, the Company implemented a business strategy of not only reducing operating expenses at the Crescent City Corp. level but also reducing operating expenses at the Company as well as at the other operating subsidiaries. In connection therewith, in the fiscal year ended June 30, 1996, the Company and its subsidiaries (other than Crescent City Corp.) reduced non-Crescent City Corp. selling general and administrative expenses by \$9.5 million per year. Additionally, the Company and its subsidiaries have downsized its employees from 56 at fiscal year end June 30, 1995 to 13 employees at September 30, 1996. The capital requirements of the parent company through September 30, 1997 will approximate \$3.2 million not including estimated attorney and restructuring fees surrounding the anticipated restructuring which may total an additional \$1.5 million.

Capital Gaming Management, Inc. CGMI will continue to operate with the Muckleshoot, Tonto Apache and Umatilla management agreements. Absent new development or consideration of the Rhode Island development project, three contracts will provide the Company with its only source of revenue for the approximately four years remaining of the contracts. Additionally, the Company will receive loan repayments from the Tonto Apache and Umatilla Tribes. The capital requirements of CGMI for the next twelve months will

17

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

approximate \$3.0 million for all overhead costs, as restructured, and equipment financing repayments. The expected management fees and loan repayments are anticipated to exceed the capital requirements of CGMI as well as the Company combined. Such excess, although not assured, if realized will assist in funding capital requirements of the Rhode Island Project.

Rhode Island Development Project. The Company's Rhode Island subsidiary, Capital Development Gaming Corp. ("CDGC"), has a management contract with the Narragansett Indian Tribe of Charlestown, Rhode Island that requires CDGC to fund the development of the Class III casino facility, however, a precise estimate of the required investment can not be determined at this time. The investment will be in the form of a term loan to the Tribe with repayment to be required over no longer than the remaining duration of the Narragansett Contract. The Tribe will own all real and personal property. The Company will most likely seek to employ the issuance of debt instruments in order to obtain the initial funding for the project, although it is not known whether such financing will be obtained through public or private capital markets. There can be no assurance that such financing will be available or if available, that the terms thereof will be acceptable to the Company. The interest in the Narragansett Contract is held through a wholly-owned subsidiary which is not a guarantor of the Senior Secured Notes.

In order to fund the capital requirements for the project, it is anticipated that the Company will require significant additional capital. Depending on the content of a binding gaming compact with the State of Rhode Island, which the Tribe continues to seek, the potential inability of the Narragansett casino to offer a full scope of gaming could create a competitive disadvantage. Such a disadvantage, if it materializes, may negatively impact the Company's ability to finance the project or to finance the project on terms acceptable to the Company. There can be no assurance that such financing will be available, or if available that the terms thereof will be acceptable to the Company. Given the development phase of the project and the fact that the Tribe's petition to the Secretary of the Interior for procedures to obtain a binding compact is pending, no financing commitments for this project have been obtained as of the date of this report. Once financing is obtained, management intends to pursue the construction of the casino on an expedited basis. No assurances can be given, however, that construction delays will not prevent the Narragansett casino from being established at the earliest possible time.

The estimated timing of capital requirements can not be estimated at this time due to the pending legal issues and needed compact as well as evaluation of the recently completed environmental work. Before construction commences, the requisite financing will need to be secured.

18

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The following discussion of the results of operations includes Capital Gaming International, Inc. and its wholly owned subsidiaries, Crescent City Capital Development Corp., (CCCD), and Capital Gaming Management Inc. (CGMI). On May 13, 1996, all of the shares of capital stock were sold to a wholly-owned subsidiary of Casino Magic Corp. (CMC). The Company's other active wholly owned subsidiary, Capital Development Gaming Corp. is continuing to fund expenses of the Rhode Island project. The results of operations of CCCD for the three months ended September 30, 1995 include its 50% interest in losses of River City Joint Venture ("RCJV"), a general partnership whose other equal partner was Grand Palais Riverboat, Inc. (a wholly owned subsidiary of Hemmeter Enterprises, Inc.). The operations of CCCD have been presented in the Statement of Operations as discontinued operations. All amounts in this discussion are approximate as the format of the financial statements rounds all amounts to the nearest thousand.

Three months ended September 30, 1996 compared to September 30, 1995

Consolidated

The three months ended September 30, 1996, resulted in a net loss from continuing operations of \$4,290,000 (\$.22 per share) and an extraordinary loss of \$1,998,000 (\$.11 per share) producing for the Company a net loss of \$6,288,000, (\$.33 per share). This compares with losses from the quarterly period ended September 30, 1995 of \$1,128,000 (\$.06 per share) and \$1,600,000 (\$.08 per share), representing continuing operations and discontinued operations, respectively. The losses from continuing operations for the quarter ended September 30, 1996 are substantially attributable to interest expense related to the Company's secured and unsecured debt. This is similarly true for the quarter ended September 30, 1995. The Company accrued interest based on \$98,883,000 and \$127,000,000 of outstanding 11.5% Senior Secured Notes for the quarterly periods September 30, 1996 and 1995, respectively, and the \$19,000,000 unsecured term note. The Company estimated the outstanding balance of the Senior Secured Notes to be \$98,883,000 as of July 29, 1996, on which date the trustee disbursed approximately \$50,000,000 to the Noteholders. The Company allocated \$21,867,000 of this payment to the accrued and unpaid interest and \$28,117,000 as a reduction of principal. The actual allocation of these payments has not yet been agreed upon by the Senior Secured Noteholders.

The net increase of \$3,162,000 in the loss from continuing operations is primarily attributable to the \$3,000,000 buy-out of the management agreement by the Cow Creek Tribe in the prior periods and a \$221,000 gain from the sale of a development agreement during the quarter ended September 30, 1995. CGMI had three Class III facilities active as of September 30, 1996 as compared to four Class III facilities in 1995. Thus, management fees for the comparative quarters decreased approximately \$581,000.

The consolidated loss from continuing operations before interest and other income/expense for the quarter ended September 30, 1996 was \$37,000 as compared to the same loss for the immediately preceding June 30, 1996 fiscal quarter of \$184,000. The decrease in loss is primarily attributable to increased management fees

19

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

and a decrease in professional fees and salaries.

Interest Income and Expense - Interest income was \$168,000 for the quarter ending September 30, 1996 compared to \$515,000 for the quarter ended September 30, 1995, the difference being attributable to the decrease in the outstanding loans to the tribes to \$10,222,000 from \$13,763,000 for the quarters ended September 30, 1996 and 1995, respectively and adjustments to accrued interest of \$95,000. Interest expense for the quarter ended September 30, 1996 is comprised of the following: (i) Senior Secured Notes of \$3,307,000, (ii) amortization of original issue discount and deferred finance charges - \$427,000, (iii) Republic Note payable - \$546,000 and (iv) CGMI equipment notes - \$26,000 for a total of \$4,306,000. Total interest expense decreased from the quarter ended September 30, 1995 due to the extinguishment of \$28,116,000 in Senior Secured Notes on July 29, 1996.

Income Taxes - As the Company has continuing net operating losses (NOL), there is a substantial NOL carryforward existing. A deferred tax benefit could not be recorded as its realization can not be assured at this time and the amount can not be estimated. In the event of future forgiveness of indebtedness, the related taxability of such forgiveness could be reduced by available NOL carryforwards. Any "ownership change," as defined in the Internal Revenue Code of 1986, will severely limit the amount of any NOL carryforwards that may be utilized. CGMI has recorded provisions during fiscal year 1996 for income taxes payable to states in which it operates. Additionally, it is possible that the Company's net operating loss carryforwards will be substantially reduced or eliminated by cancellation of debt income in connection with the contemplated planned restructuring.

Extraordinary Loss - The loss of approximately \$1,998,000 is primarily a result of the write-off of unamortized original issue discount and unamortized deferred finance costs related to the principal amount of notes retired.

Capital Gaming Management, Inc. (CGMI)

Management fees from CGMI's three Native American gaming facilities under management were \$2,137,000 and decreased approximately \$581,000 from the quarter ended September 30, 1995 as a result of three Class III facilities being operational during the quarter ended September 30, 1996 as compared to four Class III facilities in operation during the quarter ended September 30, 1995.

CGMI's income from operations before interest and other income/expenses was \$1,275,000 for the quarter ended September 30, 1996 and reflects management fee income of \$2,137,000 reduced by \$862,000 in operating costs. This represents a decrease of \$536,000 from the quarter ended September 30, 1995. The costs include salaries and wages \$122,000, professional fees \$52,000, marketing \$364,000, and general and administration and other costs \$104,000. In addition, depreciation and amortization was \$220,000. This compares to income from operations before interest and other income/expense for the September 30, 1995 quarter of \$1,811,000 based on management fees of \$2,718,000 offset by \$907,000 in operating costs. Costs of the prior quarter include salaries and wages \$187,000, professional fees \$131,000, marketing \$178,000, and

20

Part I, Item 2

CAPITAL GAMING INTERNATIONAL, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

general and administrative and other costs \$188,000. Depreciation and amortization was \$223,000. As mentioned previously, revenues have decreased \$581,000 from the prior period.

CGMI earned interest income of \$248,000 for the quarter ended September 30, 1996 from outstanding loans to tribes of approximately \$10.2 million as of September 30, 1996. The same quarter last year earned \$473,000 in interest income, the difference being attributable to the outstanding loan balance of \$13.8 million as of September 30, 1995. Interest expense of \$26,000 was recognized in the September 30, 1996 quarter on outstanding equipment notes which CGMI obtained for financing slot machines installed in the Native American facilities.

Capital Gaming International, Inc. (CGI)

CGI's costs of operations before interest and other income/expenses of \$1,081,000 for the quarter ended September 30, 1996 include wages and salaries \$351,000, professional fees \$387,000, development costs \$49,000, reorganization

costs \$244,000, and general and administration costs \$35,000. Additionally, depreciation and amortization was approximately \$15,000. As compared to the quarter ended September 30, 1995, these costs in total represent a reduction of approximately \$818,000 from the prior quarter total of approximately \$1,899,000. The largest decrease is \$555,000 in development costs, as the result of transferring the Narragansett development responsibilities to CDGC. However, the entire costs of the operations of CDGC continues to be funded by CGI. The total gaming development costs of CGI and CDGC were \$296,000 for the quarter ended September 30, 1996, a decrease of \$308,000 from the quarter ended September 30, 1995. In addition, salaries and professional fees decreased \$218,000 and \$175,000, respectively. This is offset by an increase in reorganization costs of \$243,000 which represent costs in connection with the Company's proposed debt restructuring.

Part II, Item 1

CAPITAL GAMING INTERNATIONAL, INC.

LEGAL PROCEEDINGS

Reorganization of Crescent City Capital Development Corp. The Grand Palais and Crescent City Queen riverboats, operating through the River City Joint Venture, in which CCCD had a 50% interest, voluntarily ceased gaming operations on June 6, 1995 and June 9, 1995, respectively, primarily due to unforeseen failure of projected market conditions which have been widely reported to have severely and negatively impacted the entire New Orleans riverboat and land-based gaming industry. As a result, CCCD consented to the entry of an order for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Louisiana (the "CCCD Reorganization Case") on July 28, 1995 and became a debtor-in-possession. The Grand Palais riverboat and River City Joint Venture's entertainment pavilion and docking facility commenced operations on March 29, 1995 and the Company's Crescent City Queen riverboat commenced operations on April 4, 1995. From the commencement of gaming operations until termination on June 9, 1995, CCCD incurred operating losses of approximately \$10,061,000. The revenues derived during the period of operation of the River City Joint Venture were approximately 66% below the revenues projected by the Company. As a result of the failure of the River City Casino to generate sufficient revenue to cover operating costs, and a determination that the unforeseen failure of projected market conditions could not be reasonably expected to change, CCCD voluntarily ceased operations in order to stem further operating losses.

On June 13, 1995, First Trust National Association, the Trustee with respect to the issuance of the Company's 11-1/2% Senior Secured Notes due 2001 (the "Senior Secured Notes") notified the Company of the occurrence of events of default ("Events of Default") under the Company's Indenture (the "Indenture"). The Senior Secured Notes were guaranteed by the CCCD and CGMI subsidiaries. The Events of Default cited by the Trustee related to the assertion of various claims of creditors against Collateral, as defined in the Company's Indenture, which was pledged to secure repayment of the Senior Secured Notes. In addition, on June 13, 1995, the Trustee also notified First National Bank of Commerce ("FNBC") - the Company's Collateral Agent - that FNBC could not make further disbursements from cash collateral accounts established pursuant to the Indenture until directed by the Trustee.

CCCD filed a plan of reorganization under Chapter 11 of the Bankruptcy Code on October 13, 1995. On January 12, 1996 CCCD's plan of reorganization was confirmed (the "January Plan of Reorganization"). The January Plan of Reorganization was predicated upon an agreement (the "MRI Agreement") with Mirage Resorts, Inc. ("Mirage") for the sale of CCCD to Mirage for \$55 million plus the assumption of certain equipment liabilities of up to \$6.5 million. The sale to Mirage was contingent upon certain waivers and conditions being achieved on or before January 24, 1996 including, but not limited to, receiving all requisite regulatory approvals to transfer the operator's license. On January 24, 1996, Mirage announced that conditions to the closing of the purchase were not satisfied by the contractual deadline and terminated the MRI Agreement. Although the Louisiana State Police determined on January 23, 1996 that Mirage was suitable to hold an operator's license, the Louisiana Riverboat Gaming Commission deferred action on the matter indicating that it needed more time to rule on the proposed change in berth and transfer of the license from Orleans Parish to Bossier Parish, Louisiana. As a consequence of the termination of the

MRI Agreement, management believed that it was in the best interests of the Company, its Senior Secured Noteholders and shareholders, to immediately pursue other alternatives for the sale of CCCD's assets.

22

Part II, Item 1

CAPITAL GAMING INTERNATIONAL, INC.

LEGAL PROCEEDINGS

To that end, management was able to successfully enter into a new sale agreement (the "CMC Agreement") with a wholly-owned subsidiary of Casino Magic Corp. On February 21, 1996, the Company entered into a stock purchase agreement with Casino Magic Corp., two of its wholly-owned subsidiaries, and CCCD to transfer the ownership of CCCD and substantially all of its assets to a wholly-owned subsidiary of Casino Magic Corp. An Amended Plan of Reorganization (the "Amended Plan of Reorganization") predicated upon the CMC Agreement was filed by CCCD. The Amended Plan of Reorganization was confirmed by the Court and an order of confirmation was entered on April 29, 1996. On May 13, 1996, the Company completed the sale of CCCD to a wholly-owned subsidiary of Casino Magic Corp. for an aggregate purchase price of \$56.5 million, consisting of \$15 million cash, \$35 million in Purchaser's Notes and the assumption of up to \$6.5 million in certain equipment liabilities. The cash and Purchaser's Notes paid by Casino Magic Corp.'s wholly owned subsidiaries as the purchase price for CCCD were distributed in accordance with the provisions of CCCD's Amended Plan of Reorganization. In connection therewith, \$7 million in cash and \$28 million in Purchaser's 11.5% Notes were distributed to the Indenture Trustee for the Company's 11-1/2% Senior Secured Noteholders. The Amended Plan of Reorganization also provided for the distribution to CCCD's unsecured creditors of the proceeds of all of CCCD's remaining assets, those not sold to Casino Magic Corp., including, without limitation, any and all causes of action arising in favor of CCCD as a consequence of the termination of the MRI Agreement.

On July 29, 1996, the Indenture Trustee for the Company's Senior Secured Noteholders distributed \$49,986,000 in cash and Purchaser's Notes to the Senior Secured Noteholders on account of principal and accrued interest (the "Noteholder Distribution"). The Noteholder Distribution included \$28 million in Purchaser's Notes, as well as cash from the sale of CCCD to CMC, proceeds from the early payment of the development loan to the Muckleshoot Tribe, proceeds from the buyout of the Cow Creek contract, \$3.2 million in unused restricted cash and other sources. Subsequently, in August 1996 the \$28 million in Purchaser's Notes was redeemed by CMC at 100% of the principal amount plus accrued interest.

Senior Secured Notes. As described above, the Company is in default under the Indenture as a result of the CCCD Restructuring Case. The Company also failed to make interest payments on its Senior Secured Notes of \$7,302,500 each on August 1, 1995, February 1, 1996 and August 1, 1996, and a \$1,350,000 consent fee payment which was due to the holders of the Senior Secured Notes on August 1, 1995. Such consent fee was previously incurred to allow the relocation of the Company's New Orleans River City Casino. The Company's failure to make the August 1, 1995 interest and consent payments and the February 1, 1996 and August 1, 1996 interest payment are also Events of Default under the Indenture.

The Company's Indenture also contains certain covenants regarding maintenance of consolidated net worth levels, the maintenance of ratios between earnings before income taxes, depreciation and amortization and certain fixed charges of the Company. As of the date hereof, the Company does not satisfy many of these covenants.

On June 21, 1995, the New Orleans 2000 Partnership, the mortgagee of real property owned by River City, provided notice of various defaults under its first mortgage to CCCD, River City Joint Venture and Grand Palais. An event of default under this mortgage constitutes an Event of Default under the Indenture. As a result

23

Part II, Item 1

CAPITAL GAMING INTERNATIONAL, INC.

LEGAL PROCEEDINGS

of the various defaults under the Indenture, the holders of the Senior Secured Notes are entitled to all of the remedies contained in the Indenture, including but not limited to acceleration of the Senior Secured Notes and foreclosing on the Collateral pledged by the Company to the Trustee which includes, among other things, the management fees derived from the management agreements between CGMI and the Native American Tribes. Furthermore, the security agreements entered into by the Company provide remedies to the holders of Senior Secured Notes including a requirement to transfer any proceeds received in respect of any dispositions of Collateral from and after the occurrence of an Event of Default as defined in the Indenture.

In the event that the holders of the Senior Secured Notes exercise all of their available remedies under the Indenture and related agreements, the Company and its subsidiaries will not be able to continue their operations. However, the Company does not believe the holders of the Senior Secured Notes will exercise their remedies where the exercise of such remedies would prevent CGMI from continuing its operations as manager of several existing Native American gaming facilities or CDGC from continuing its development of the Narragansett Casino project.

Bank Line of Credit. On March 28, 1995, CCCD entered into a loan agreement with First National Bank of Commerce ("FNBC") which was guaranteed by the Company. Pursuant to the terms of this agreement, CCCD received a \$2 million working capital Line of Credit from FNBC for a period of ninety (90) days. In April 1995, this credit facility was utilized to provide CCCD with \$2 million of working capital. Borrowings against this facility were due June 27, 1995. CCCD was not able to repay the obligation thereby causing a default under the agreement. In addition, the Line of Credit contains cross-default provisions with the Indenture. FNBC has filed suit against Capital Gaming International, Inc. as a guarantor of CCCD's obligation and there is a chance that its suit may succeed. Any guarantor liability, however, may be partially offset by amounts recovered by FNBC on this obligation in connection with the CCCD Reorganization Case.

On November 21, 1995, FNBC filed suit against the Company in the U.S. District Court for the Eastern District of Louisiana alleging the Company's liability under the Guaranty for the debt incurred by CCCD, as well as a second promissory note in the amount of \$2,500,000 (the "RCJV Note") given by River City Joint Venture ("RCJV"), an entity in which CCCD was a general partner. FNBC sued the Company on the theory that CCCD, as a general partner of RCJV, was liable on the RCJV Note and the Company Guaranty applied to any and all liabilities of CCCD to FNBC. RCJV failed to pay all of the principal and interest due on the RCJV Note and ultimately filed bankruptcy. CCCD never repaid the principal of the CCCD Note and as described above filed the Bankruptcy Case. FNBC demanded payment of the notes from the Company under the Guaranty and the Company has refused for valid reasons to pay under the Guaranty. As a result of the CCCD bankruptcy and the Company's refusal to pay under the Guaranty, FNBC filed its Complaint.

On January 16, 1996, CCCD filed an Objection to Proof of Claim Filed by FNBC (the "Crescent City Objection" or "Objection") in CCCD's Bankruptcy Case which raised substantial questions about the liability of CCCD under the promissory notes on which FNBC sued the Company. The Company then filed its Motion for Referral to Bankruptcy Court on January 18, 1996, which motion was opposed by FNBC. Notwithstanding the fact that the Motion for Referral was pending, FNBC filed a Motion for Partial Summary Judgment with the

Part II, Item 1

CAPITAL GAMING INTERNATIONAL, INC.

LEGAL PROCEEDINGS

District Court on February 5, 1996, seeking judgment against the Company on only the CCCD Note. The District Court granted the Company's motion to refer the case to the Bankruptcy Court on February 9, 1996 as a non-core proceeding. The Order transferring this case was entered on February 13, 1996.

FNBC moved to dismiss that portion of the case involving the RCJV Note and the same was dismissed without prejudice by the Bankruptcy Court on May 31, 1996 leaving the only issues before the court as those relating to the Guaranty, the CCCD Note and the Company's and CCCD's liability thereunder.

The Company opposed the FNBC Motion for Partial Summary Judgment, asserting detrimental reliance as well as estoppel and misrepresentation as

defenses to liability under the Guaranty. On May 23, 1996, the Bankruptcy Case judge held a hearing on the FNBC Motion and orally granted the motion.

On June 3, 1996, the Bankruptcy Case judge issued his written Proposed Findings of Fact and Conclusions of Law. In accordance with the statutory procedure, the Company filed timely objections to those findings of fact and conclusions of law with the U.S. District Court on June 13, 1996, and set the objections for hearing on July 24, 1996, before the District Judge. In its objections, the Company argued, in addition to reiterating its previously asserted defenses, that the Bankruptcy Court erred in the calculation of the amounts due because of the uncertainty of and lack of evidence on the amounts paid by the Company or seized by FNBC. The Company also objected that FNBC had not proved any of its calculations of the interest due. FNBC filed a response to the Company's objections on July 16, 1996, opposing the Company's arguments. The Company filed a reply to FNBC's opposition to advise the court that FNBC's response was untimely and to clarify and amplify on certain statements made by FNBC in its opposition.

There has been no action by the court since July 24, 1996, and the matter remains pending before the Judge for action on the Company's objections to the Bankruptcy Judge's proposed Findings of Fact and Conclusions of Law.

The Company has and will continue vigorously to contest any liability under the CCCD Note on the basis of detrimental reliance, estoppel, and misrepresentation by FNBC. In the event that judgment is rendered against the Company, appropriate motions to reconsider or to modify the judgment will be filed and serious consideration will be given to an appeal.

Although valid objections have been made by the Company to the proposed findings of fact and conclusions of law it is probable that an unfavorable outcome could occur, notwithstanding the fact that the Company has meritorious defenses based upon detrimental reliance, estoppel and misrepresentation by FNBC. If the court rules against the Company's objections final judgment may be entered against the Company, but the amount of such judgment is still uncertain.

Term Note Payable. In connection with the buy-out of the profit interest of Republic Corporate Services, Inc. ("Republic") in CCCD, the Company executed an unsecured promissory note payable to Republic for \$19,000,000. The note bears interest at 11.5% per annum and requires semi-annual interest payments in April

25

Part II, Item 3

CAPITAL GAMING INTERNATIONAL, INC.

LEGAL PROCEEDINGS

and October until its maturity on April 26, 2002 when all principal becomes due. In October 1994 and April 1995, the Company made each of the required interest payments of this term note totalling \$2,185,000. As a result of the cessation of the Company's New Orleans operations on June 9, 1995, and the resultant Chapter 11 petition filed by CCCD, and other reasons, the Company did not make the required interest payments under the note. As a result, the Company is in default under the note agreement.

Other Litigation.

The Company and its subsidiaries are parties to various lawsuits that have arisen in the course of business, none of which is material.

There are a number of proceedings arising out of the River City project which name the Company as a party defendant. None of these cases are being actively pursued against the Company at this time. The Company believes that each of these claims is without merit and will vigorously defend them if they are pursued.

Part II, Item 4

CAPITAL GAMING INTERNATIONAL, INC.

DEFAULT UPON SENIOR SECURITIES

On June 13, 1995, First Trust National Association, the Trustee with respect to the issuance of the Company's 11-1/2% Senior Secured Notes notified the Company of the occurrence of events of default under the Company's Indenture. The Company and CCCD are also in default under certain other debt instruments. These default conditions were disclosed and reported in detail in the Company's Form 10-K for the year ended June 30, 1995 filed with the SEC.

Part II, Item 6

CAPITAL GAMING INTERNATIONAL, INC.

EXHIBIT AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit
Number

27 Financial Data Schedule

SIGNATURES

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

CAPITAL GAMING INTERNATIONAL, INC.

Date: November 1996 By: /s/ Edward M. Tracy

Edward M. Tracy, Chief Executive Officer,
President and Director
(Principal Executive Officer)

Date: November 1996 By: /s/ Cory Morowitz

Cory Morowitz, Acting Chief Financial Officer
(Principal Financial Officer)

<TABLE> <S> <C>

<ARTICLE> 5

<LEGEND>

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES THERETO AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS AND RELATED NOTES.

</LEGEND>

<MULTIPLIER> 1,000

<S>	<C>
<PERIOD-TYPE>	3-MOS
<FISCAL-YEAR-END>	JUN-30-1997
<PERIOD-END>	SEP-30-1996
<CASH>	4,582
<SECURITIES>	0
<RECEIVABLES>	4,584
<ALLOWANCES>	0
<INVENTORY>	0
<CURRENT-ASSETS>	9,355
<PP&E>	118
<DEPRECIATION>	0
<TOTAL-ASSETS>	23,585
<CURRENT-LIABILITIES>	130,133
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	37,316
<OTHER-SE>	(144,165)
<TOTAL-LIABILITY-AND-EQUITY>	23,585
<SALES>	2,137
<TOTAL-REVENUES>	2,137
<CGS>	2,174
<TOTAL-COSTS>	2,174
<OTHER-EXPENSES>	168
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	4,306
<INCOME-PRETAX>	(4,175)
<INCOME-TAX>	115
<INCOME-CONTINUING>	(4,280)
<DISCONTINUED>	0
<EXTRAORDINARY>	(1,998)
<CHANGES>	0
<NET-INCOME>	(6,288)
<EPS-PRIMARY>	(.33)
<EPS-DILUTED>	(.33)

</TABLE>