SCIENTIFIC GAMES CORP
Form 10-Q
May 10, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

{Mark One}

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from to

Commission file number: 0-13063

SCIENTIFIC GAMES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**81-0422894**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

750 Lexington Avenue, New York, New York 10022

(Address of principal executive offices)

(Zip Code)

(212) 754-2233

(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The registrant has the following number of shares outstanding of each of the registrant s classes of common stock as of May 4, 2011:

Class A Common Stock: **92,065,347**

Class B Common Stock: **None**

Table of Contents

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

INDEX TO FINANCIAL INFORMATION

AND OTHER INFORMATION

THREE MONTHS ENDED MARCH 31, 2011

Table of Contents

Forward-Looking Statements

Throughout this Quarterly Report on Form 10-Q we make forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements describe future expectations, plans, results or strategies and can often be identified by the use of terminology such as may, will, estimate, intend, continue, believe, expect, anticipate, could, potential, opportu terminology. The forward-looking statements contained in this Quarterly Report on Form 10-Q are generally located in the material set forth under the headings Management s Discussion and Analysis of Financial Condition and Results of Operations but may be found in other locations as well. These statements are based upon management s current expectations, assumptions and estimates and are not guarantees of future results or performance. Actual results may differ materially from those projected in these statements due to a variety of risks and uncertainties and other factors, including, among other things: competition; material adverse changes in economic and industry conditions; technological change; retention and renewal of existing contracts and entry into new or revised contracts; availability and adequacy of cash flows to satisfy obligations and indebtedness or future needs; protection of intellectual property; security and integrity of software and systems; laws and government regulation, including those relating to gaming licenses, permits and operations; inability to identify, complete and integrate future acquisitions; inability to complete the proposed acquisition of Barcrest Group Limited and Cyberview Technology CZ s.r.o.; inability to benefit from, and risks associated with, joint ventures and strategic investments and relationships; seasonality; pending legal challenges that may affect our joint venture s Illinois lottery private management agreement or the failure of our joint venture to meet the net income targets or otherwise realize the anticipated benefits under such agreement; inability to identify and capitalize on trends and changes in the lottery and gaming industries; inability to enhance and develop successful gaming concepts; dependence on suppliers and manufacturers; liability for product defects; fluctuations in foreign currency exchange rates and other factors associated with foreign operations; influence of certain stockholders; dependence on key personnel; failure to perform on contracts; resolution of pending or future litigation; labor matters; and stock price volatility. Additional information regarding risks and uncertainties and other factors that could cause actual results to differ materially from those contemplated in forward-looking statements is included from time to time in our filings with the Securities and Exchange Commission (SEC), including under the heading Risk Factors in our most recent Annual Report on Form 10-K and in this Quarterly Report on Form 10-Q. Forward-looking statements speak only as of the date they are made and, except for our ongoing obligations under the U.S. federal securities laws, we undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise.

You should also note that this Quarterly Report on Form 10-Q may contain various references to industry market data and certain industry forecasts. Industry market data and industry forecasts are obtained from publicly available information and industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of that information is not guaranteed. Similarly, industry forecasts, while we believe them to be accurate, are not independently verified by us and we do not make any representation as to the accuracy of that information. In general, there is less publicly available information concerning the international lottery industry than the lottery industry in the U.S.

Table of Contents

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

As of March 31, 2011 and December 31, 2010

(Unaudited, in thousands, except per share amounts)

		March 31, 2011		December 31, 2010
ASSETS				
Current assets:				
Cash and cash equivalents	$	118,591	$	124,281
Accounts receivable, net of allowance for doubtful accounts of $2,155 and $2,175 as of March 31, 2011 and December 31, 2010, respectively		158,996		178,179
Inventories		67,754		68,744
Deferred income taxes, current portion		2,490		2,448
Prepaid expenses, deposits and other current assets		49,776		40,013
Total current assets		397,607		413,665
Property and equipment, at cost		783,619		776,367
Less accumulated depreciation		(338,802)		(325,786)
Net Property and equipment		444,817		450,581
Goodwill, net		777,704		763,915
Intangible assets, net		81,673		70,613
Other assets and investments		504,060		452,764
Total assets	$	2,205,861	$	2,151,538
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Debt payments due within one year	$	10,427	$	8,431
Accounts payable		49,570		50,642
Accrued liabilities		153,484		136,925
Total current liabilities		213,481		195,998
Deferred income taxes		62,744		60,858
Other long-term liabilities		63,444		53,765
Long-term debt, excluding current installments		1,382,077		1,388,259
Total liabilities		1,721,746		1,698,880
Commitments and contingencies				
Stockholders equity:				
Class A common stock, par value $0.01 per share, 199,300 shares authorized, 97,798 and 97,474 shares issued and 92,049 and 91,725 shares outstanding as of March 31, 2011 and December 31, 2010, respectively		978		975
Additional paid-in capital		678,007		674,691
Accumulated earnings		(137,953)		(131,021)

Treasury stock, at cost, 5,749 shares held as of March 31, 2011 and December 31, 2010		(74,460)		(74,460)
Accumulated other comprehensive income (loss)		17,543		(17,527)
Total stockholders equity		484,115		452,658
Total liabilities and stockholders equity	$	2,205,861	$	2,151,538

See accompanying notes to consolidated financial statements

Table of Contents

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months Ended March 31, 2011 and 2010

(Unaudited, in thousands, except per share amounts)

	Three Months Ended March 31, 2011	2010
Revenue:		
Instant tickets	$ 113,860	$ 109,099
Services	73,747	93,704
Sales	9,049	13,536
Total revenue	196,656	216,339
Operating expenses:		
Cost of instant tickets (1)	67,233	63,917
Cost of services (1)	38,922	54,442
Cost of sales (1)	5,690	10,266
Selling, general and administrative expenses	39,554	38,556
Depreciation and amortization	30,904	27,655
Operating income	14,353	21,503
Other (income) expense:		
Interest expense	26,455	24,714
Equity in earnings of joint ventures	(9,350)	(15,812)
Other (income) expense, net	(994)	5,982
	16,111	14,884
Net (loss) income before income taxes	(1,758)	6,619
Income tax expense	5,174	1,732
Net (loss) income	$ (6,932)	$ 4,887
Net (loss) income per share:		
Basic net (loss) income per share	$ (0.08)	$ 0.05
Diluted net (loss) income per share	$ (0.08)	$ 0.05
Weighted-average number of shares used in per share calculations:		
Basic shares	91,886	93,993
Diluted shares	91,886	94,662

(1) Exclusive of depreciation and amortization.

See accompanying notes to consolidated financial statements

Table of Contents

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended March 31, 2011 and 2010

(Unaudited, in thousands, except per share amounts)

	Three Months Ended March 31, 2011	2010
Cash flows from operating activities:		
Net (loss) income	$ (6,932)	$ 4,887
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	30,904	27,655
Change in deferred income taxes	621	70
Stock-based compensation	4,602	7,090
Non-cash interest expense	1,956	1,655
Undistributed equity in earnings of joint ventures	(7,505)	(10,697)
Changes in current assets and liabilities, net of effects of acquisitions		
Accounts receivable	20,930	17,119
Inventories	1,536	2,432
Accounts payable	(6,047)	(13,124)
Accrued liabilities	12,175	5,034
Other current assets and liabilities	(2,858)	(1,121)
Other	(772)	(212)
Net cash provided by operating activities	48,610	40,788
Cash flows from investing activities:		
Capital expenditures	(1,658)	(1,706)
Wagering systems expenditures	(8,788)	(12,411)
Other intangible assets and software expenditures	(11,368)	(7,787)
Proceeds from asset disposals	780	399
Investment in Joint Ventures	(27,687)	
Change in other assets and liabilities, net	(960)	289
Business acquisitions, net of cash acquired		(106)
Net cash used in investing activities	(49,681)	(21,322)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt		28,325
Payment on long-term debt	(2,121)	(38,896)
Payment of financing fees	(2,623)	(3,776)
Net proceeds from issuance of common stock	(1,521)	(242)
Net cash used in financing activities	(6,265)	(14,589)
Effect of exchange rate changes on cash and cash equivalents	1,646	(5,170)
Decrease in cash and cash equivalents	(5,690)	(293)
Cash and cash equivalents, beginning of period	124,281	260,131
Cash and cash equivalents of held for sale operations		1,075
Cash and cash equivalents, end of period	$ 118,591	$ 260,913

See accompanying notes to consolidated financial statements

6

Table of Contents

Non-cash investing and financing activities

For the three months ended March 31, 2011 and 2010

On March 28, 2011 we contributed fixed assets totaling approximately $11,600 to International Terminal Leasing (ITL) which is described in Note 3 of the Notes to Consolidated Financial Statements herein, resulting in a non-cash investment of $11,600 out of our total investment in ITL of approximately $28,000 as of March 31, 2011. There were no significant non-cash investing and financing activities for the three months ended March 31, 2010.

Table of Contents

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

Notes to Consolidated Financial Statements

(1) Consolidated Financial Statements

Basis of Presentation

The Consolidated Balance Sheet as of March 31, 2011, the Consolidated Statements of Operations for the three months ended March 31, 2011 and 2010, and the Consolidated Statements of Cash Flows for the three months ended March 31, 2011 and 2010, have been prepared by Scientific Games Corporation and are unaudited. When used in these notes, the terms we, us, our and the Company refer to Scientific Games Corporation and all entities included in our consolidated financial statements unless otherwise specified or the context otherwise indicates. In the opinion of management, all adjustments necessary to present fairly our consolidated financial position as of March 31, 2011 and the results of our operations and our cash flows for the three months ended March 31, 2011 and 2010 have been made. Such adjustments are of a normal, recurring nature.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2010 Annual Report on Form 10-K. The results of operations for the period ended March 31, 2011 are not necessarily indicative of the operating results for the full year.

Significant Accounting Policies

We describe our significant accounting policies in Note 1 of the Notes to Consolidated Financial Statements in our 2010 Annual Report on Form 10-K. There have been no changes to our significant accounting policies during the period ended March 31, 2011 except as discussed below.

In September 2009, the Financial Accounting Standards Board (FASB) amended the Accounting Standards Codification (ASC) as summarized in Accounting Standards Update (ASU) 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements*, and ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. As summarized in ASU 2009-14, ASC Topic 985 has been amended to remove from the scope of industry-specific revenue accounting guidance for software and software related transactions tangible products containing software components and non-software components that function together to deliver the product s essential functionality. As summarized in ASU 2009-13, ASC Topic 605 has been amended: (1) to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) to require an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price; and (3) to eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. The accounting changes summarized in ASU 2009-14 and ASU 2009-13 are both effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application.

We adopted these amendments to the ASC on January 1, 2011 on a prospective basis as applicable to our revenue generated from licensing branded properties that are coupled with a service component, where we also purchase and distribute prizes on behalf of lottery authorities. The impact of these accounting changes was not material to our consolidated financial statements for the three months ended March 31, 2011.

Table of Contents

Basic and Diluted Net (Loss) Income Per Share

The following represents a reconciliation of the numerator and denominator used in computing basic and diluted net (loss) income per share available to common stockholders for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Income (numerator)		
Net (loss) income	$ (6,932)	$ 4,887
Shares (denominator)		
Weighted-average basic common shares outstanding	91,886	93,993
Effect of dilutive securities-stock rights		669
Weighted-average diluted common shares outstanding	91,886	94,662
Basic and diluted per share amounts		
Basic net (loss) income per share	$ (0.08)	$ 0.05
Diluted net (loss) income per share	$ (0.08)	$ 0.05

The weighted-average diluted common shares outstanding for the three months ended March 31, 2011 and 2010 excludes the effect of approximately 7,409 and 5,835 weighted-average stock rights outstanding, respectively, because their effect would be anti-dilutive. During the first quarter of 2011, there were no dilutive stock rights due to the net loss reported for the period.

(2) Operating Segment Information

We operate in three segments: Printed Products Group; Lottery Systems Group; and Diversified Gaming Group. We recently reviewed the allocation of overhead expenses to our reportable segments in light of the realignment of our management structure. Based on this review, we determined to no longer allocate certain overhead expenses to our reportable segments. This change, which was effective January 1, 2011, had no impact on the Company s consolidated balance sheets or its statements of operations, cash flows or changes in stockholders equity for any periods. Prior period segment information has been adjusted to reflect the change in segment reporting.

The following tables represent revenue, cost of revenue, depreciation, amortization, selling, general and administrative expenses and operating income for the three months ended March 31, 2011 and 2010, by reportable segments. Corporate expenses, including interest expense, other (income) expense and corporate depreciation and amortization, are not allocated to the reportable segments.

Table of Contents

	Three Months Ended March 31, 2011			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Revenue:				
Instant tickets	$ 113,860	$	$	$ 113,860
Services		49,216	24,531	73,747
Sales	1,770	7,173	106	9,049
Total revenue	115,630	56,389	24,637	196,656
Cost of instant tickets (1)	67,233			67,233
Cost of services (1)		25,968	12,954	38,922
Cost of sales (1)	1,006	4,649	35	5,690
Selling, general and administrative expenses	10,380	4,272	2,926	17,578
Depreciation and amortization	8,360	11,367	11,048	30,775
Segment operating income (loss)	$ 28,651	$ 10,133	$ (2,326)	36,458
Unallocated corporate costs				$ 22,105
Consolidated operating income				$ 14,353

(1) Exclusive of depreciation and amortization.

	Three Months Ended March 31, 2010			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Revenue:				
Instant tickets	$ 109,099	$	$	$ 109,099
Services		48,187	45,517	93,704
Sales	2,870	9,711	955	13,536
Total revenue	111,969	57,898	46,472	216,339
Cost of instant tickets (1)	63,917			63,917
Cost of sevices (1)		26,673	27,769	54,442
Cost of sales (1)	2,008	7,459	799	10,266
Selling, general and administrative expenses	10,240	5,381	6,373	21,994
Depreciation and amortization	8,537	10,814	8,181	27,532
Segment operating income	$ 27,267	$ 7,571	$ 3,350	38,188
Unallocated corporate costs				$ 16,685
Consolidated operating income				$ 21,503

(1) Exclusive of depreciation and amortization.

The following table provides a reconciliation of segment operating income to consolidated (loss) income before income taxes for each period:

	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
Reported segment operating income	$	36,458	$	38,188
Unallocated corporate costs		(22,105)		(16,685)
Consolidated operating income		14,353		21,503
Interest expense		(26,455)		(24,714)
Equity in earnings of joint ventures		9,350		15,812
Other income (expense), net		994		(5,982)
(Loss) income before income taxes	$	(1,758)	$	6,619

Table of Contents

In evaluating financial performance, we focus on operating income as a segment s measure of profit or loss. Operating income is income before interest income, interest expense, equity in earnings of joint ventures, corporate expenses and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies (see Note 1 of the Notes to Consolidated Financial Statements in our 2010 Annual Report on Form 10-K).

(3) Equity Investments in Joint Ventures

Lotterie Nazionali S.r.l. / Consorzio Lotterie Nazionali

We are a 20% equity owner in Lotterie Nazionali S.r.l. (LNS), a joint venture comprised principally of us, Lottomatica Group S.p.A. (Lottomatica) and Arianna 2001, a company owned by the Federation of Italian Tobacconists, that was awarded the concession from the Italian Monopoli di Stato to be the exclusive operator of the Italian Gratta e Vinci instant ticket lottery beginning on October 1, 2010. The new concession has an initial term of nine years (subject to a performance evaluation during the fifth year) and could be extended by the Monopoli di Stato for an additional nine years. LNS succeeded Consorzio Lotterie Nazionali (CLN), a consortium comprised of essentially the same group that owns LNS, as holder of the concession. Under the new concession, we are the primary supplier of instant lottery tickets for the joint venture, as we were under the prior concession. CLN, which had held the concession since 2004, is being wound up and the bulk of its assets have been transferred to LNS. LNS paid 800,000 in upfront fees under the terms of the new concession. We paid our pro rata share of these fees in 2010 (160,000). The upfront fees associated with the new concession are amortized by LNS (anticipated to be approximately 89,000 each year of the new concession on a pre-tax basis), which reduces our equity in earnings of LNS. Our share of the amortization is expected to be approximately 18,000 each year on a pre-tax basis. In light of the corporate structure of LNS, we record our equity in earnings of LNS on an after-tax basis under applicable accounting rules, which impacts the comparability of our results of operations associated with LNS with our results of operations associated with CLN, since we recorded our equity in earnings of CLN on a pre-tax basis. Subject to applicable limitations, we are entitled to receive from LNS annual cash dividends as well as periodic return of capital payments over the life of the concession.

Northstar Lottery Group, LLC

We are a 20% equity owner in Northstar Lottery Group, LLC (Northstar), a joint venture with GTECH Corporation, a subsidiary of Lottomatica, that was formed to bid for the agreement to be the private manager for the Illinois lottery for a ten-year term. Northstar was selected as the private manager following a competitive procurement and entered into the private management agreement with the State of Illinois on January 18, 2011 (the PMA). As the private manager, Northstar will, subject to the oversight of the Illinois lottery, manage the day-to-day operations of the lottery including lottery game development and portfolio management, retailer recruitment and training, supply of goods and services and overall marketing strategy. Under the terms of the PMA, Northstar is entitled to receive annual incentive compensation payments to the extent it is successful in increasing the lottery s net income above specified target levels, subject to a cap of 5% of the applicable year s net income. Northstar will be responsible for payments to the State to the extent such targets are not achieved, subject to a similar cap. Northstar is expected to be reimbursed on a monthly basis for most of its operating expenses under the PMA. Under our agreement with Northstar, the Company will be responsible for the design, development, manufacturing, warehousing and distribution of instant lottery tickets and will be compensated based on a percentage of retail sales.

Operations under the PMA are scheduled to commence in 2011. On January 26, 2011, the Appellate Court of Illinois upheld a constitutional challenge to the revenue statute that, among other things, amended the lottery law to facilitate the PMA on grounds that the statute impermissibly addressed more than one subject. The Illinois Supreme Court subsequently granted a stay of the Appellate Court s decision pending the appeal to the Illinois Supreme Court by the State of Illinois. We cannot predict what effect, if any, the court decision, if it is not reversed by the Illinois Supreme Court or addressed through new authorizing legislation, will have on the PMA. In March 2011, we contributed $10,000 to Northstar. If the PMA is ultimately invalidated, we may lose our investment in Northstar and our existing instant ticket supply agreement for the Illinois lottery may come up for re-bid.

International Terminal Leasing

As contemplated by our strategic agreements with Video B Holdings Limited (Video B), a subsidiary of Playtech Limited, relating to our license of Video B s back-end technology platform for our gaming machines, we formed ITL with Video B in the first quarter of 2011. The purpose of ITL is to acquire gaming terminals using funds contributed to the capital of ITL by each partner. The gaming terminals, which will employ Video B s software, will be leased to whichever Company subsidiary is to provide the terminals to third party gaming operator customers. We account for our interest in ITL under the equity method of accounting. The equity interest of each partner is expected to vary based on the respective capital contributions from the partners; however, each partner has joint control regarding operating decisions of ITL. Intra-entity profits and losses will be eliminated as necessary. As of March 31, 2011 our investment in ITL was $28,026, which is included in Other Assets and Investments. There was no impact of ITL on our Consolidated Statements of Operations for the three months ended March 31, 2011.

Table of Contents

Sportech Plc

Upon the closing of the sale of our racing and venue management businesses (the Racing Business) to Sportech Plc (Sportech) on October 5, 2010, we received an equity interest in Sportech of approximately 20% of the shares then outstanding. Sportech operates football pools and associated games through various distribution channels including direct mail and telephone, agent-based collection and via the Internet. Sportech also operates a portfolio of online casino, poker, bingo and fixed-odds games through its e-Gaming division. Our interest in Sportech is accounted for under the equity method of accounting. We record our equity interest in Sportech on a 90-day lag as allowed under Accounting Standards Codification 323, *Investments Equity Method and Joint Ventures*.

Shandong Inspur Scientific Games Technology, Ltd.

On April 16, 2007, we invested approximately $750 to establish Shandong Inspur Scientific Games Technology, Ltd. (SIST). On February 1, 2011, we sold our interest in SIST resulting in a gain of $397.

(4) Comprehensive Income (Loss)

The following presents a reconciliation of net (loss) income to comprehensive income (loss) for the three month periods ended March 31, 2011 and 2010:

	Three Months Ended March 31,			
		2011		2010
Net (loss) income	$	(6,932)	$	4,887
Other comprehensive income (loss)				
Foreign currency translation gain (loss)		34,620		(28,864)
Gain (loss) on derivative financial instruments		450		(34)
Other comprehensive income (loss)		35,070		(28,898)
Comprehensive income (loss)	$	28,138	$	(24,011)

(5) Inventories

Inventories consist of the following:

	March 31, 2011	December 31, 2010

Parts and work-in-process	$	22,223	$	23,224
Finished goods		45,531		45,520
	$	67,754	$	68,744

Parts and work-in-process includes costs for equipment expected to be sold. Costs incurred for equipment associated with specific wagering system contracts not yet placed in service are classified as construction in progress in property and equipment and are not depreciated.

(6) Long-Term Debt

Credit Agreement

The Company and its wholly owned subsidiary, Scientific Games International, Inc. (SGI), entered into the credit agreement, dated as of June 9, 2008 and amended and restated as of February 12, 2010 (as amended from time to time, the Credit Agreement), among SGI, the Company, the several lenders from time to time party thereto and JPMorgan Chase Bank, N.A., as administrative agent. The Credit Agreement provides for a $250,000 senior secured revolving credit facility and senior secured term

Table of Contents

loan credit facilities under which $567,622 of borrowings are outstanding as of March 31, 2011. The Credit Agreement will mature on June 9, 2013.

On March 11, 2011, the Company and SGI entered into an amendment (the Amendment) to the Credit Agreement. Under the Amendment, from and after December 31, 2010, consolidated EBITDA (as such term is defined in the Credit Agreement) will generally include the Company s share of the earnings of the Company s joint venture that holds the Italian instant ticket concession, whether or not such earnings have been distributed to the Company, before interest expense (other than interest expense in respect of debt of such joint venture if such debt exceeds $25,000), income tax expense and depreciation and amortization expense, provided that the amount of consolidated EBITDA attributable to the Company s interest in such joint venture that would not have otherwise been permitted to be included in consolidated EBITDA prior to giving effect to the Amendment will be capped at $25,000 in any period of four consecutive quarters (or $30,000 in the case of any such period ending on or prior to June 30, 2012). Prior to giving effect to the Amendment, consolidated EBITDA generally included only the Company s share of the earnings of such joint venture that was distributed to the Company. In addition, under the terms of the Amendment, any cash compensation expense incurred but not paid in a particular period will be added back for purposes of determining consolidated EBITDA so long as no cash payment in respect thereof is required prior to the scheduled maturity of the borrowings under the Credit Agreement. Consolidated EBITDA is relevant for determining whether the Company is in compliance with the financial ratios required to be maintained under the terms of the Credit Agreement.

The Amendment also provides that up to $100,000 of unrestricted cash and cash equivalents of the Company and its subsidiaries in excess of $15,000 will be netted against consolidated total debt for purposes of determining the Company s consolidated leverage ratio and consolidated senior debt ratio (as such terms are defined in the Credit Agreement) as of any date from and after December 31, 2010.

A summary of the terms of the Credit Agreement, including the financial ratios that the Company is required to maintain under the terms of the Credit Agreement (which ratios were not adjusted by the Amendment) is included in Note 8 of the Notes to Consolidated Financial Statements in our 2010 Annual Report on Form 10-K. For more information regarding the Amendment, see our Current Report on Form 8-K filed on March 14, 2011.

As of March 31, 2011, we had approximately $198,021 available for additional borrowing or letter of credit issuances under our revolving credit facility. There were no borrowings and $51,979 in outstanding letters of credit under our revolving credit facility as of March 31, 2011. Our ability to borrow under the Credit Agreement will depend on us remaining in compliance with the covenants contained in the Credit Agreement.

We were in compliance with our covenants under the Credit Agreement as of March 31, 2011.

Outstanding Debt and Capital Leases

As of March 31, 2011, we had total debt outstanding of $1,392,504 including $567,622 outstanding under our term loan facilities under the Credit Agreement, $345,287 in aggregate principal amount of the 9.25% senior subordinated notes due 2019 (the 2019 Notes), $200,000 in aggregate principal amount of the 7.875% senior subordinated notes due 2016 (the 2016 Notes), $250,000 in aggregate principal amount of 8.125% senior subordinated notes due 2018 (the 2018 Notes), £628 in aggregate principal amount of the promissory notes we issued to defer a portion of the earn-out payable in connection with our 2006 acquisition of The Global Draw Limited (Global Draw) and loans denominated in

Chinese Renminbi Yuan (RMB) totaling RMB178,500 of which RMB116,000 matures in December 2012 and RMB62,500 matures in January 2013.

(7) Derivative Financial Instruments

Effective October 17, 2008, SGI entered into a three-year interest rate swap agreement (the Hedge) with JPMorgan. Under the Hedge, which is designated as a cash flow hedge, SGI pays interest on a $100,000 notional amount of debt at a fixed rate of 3.49% and receives interest on a $100,000 notional amount of debt at the prevailing three-month LIBOR rate. The objective of the Hedge is to eliminate the variability of cash flows attributable to the LIBOR component of interest expense paid on $100,000 of our variable-rate debt. As of March 31, 2011, the Hedge was measured at a fair value of $1,738 using Level 2 valuation techniques of the fair value hierarchy and included in other long-term liabilities on the Consolidated Balance Sheet.

Hedge effectiveness is measured quarterly on a retrospective basis using the cumulative dollar-offset approach in which the cumulative changes in the cash flows of the actual swap are compared to the cumulative changes in the cash flows of the hypothetical swap. The effective portion of the Hedge is recorded in other comprehensive income (loss) and the ineffective portion of the Hedge, if any, is recorded in the Consolidated Statements of Operations. During the three months ended March 31, 2011 and 2010, we recorded a gain (loss) of approximately $450 and ($34), respectively, in other comprehensive income (loss). There was no ineffective portion of the Hedge recorded in the Consolidated Statements of Operations in either period. Amounts recorded in other comprehensive income

Table of Contents

(loss) that were deferred on the effective hedged forecasted transactions are reclassified to earnings when the interest expense related to the hedged item affects earnings.

(8) Goodwill and Intangible Assets

The following disclosure presents certain information regarding our acquired intangible assets as of March 31, 2011 and December 31, 2010. Amortizable intangible assets are amortized over their estimated useful lives with no estimated residual values.

Intangible Assets		Gross Carrying Amount		Accumulated Amortization		Net Balance
Balance as of March 31, 2011						
Amortizable intangible assets:						
Patents	$	12,285	$	4,525	$	7,760
Customer lists		30,577		19,838		10,739
Licenses		76,555		49,461		27,094
Intellectual property		18,265		18,200		65
Lottery contracts		1,500		1,119		381
		139,182		93,143		46,039
Non-amortizable intangible assets:						
Trade name		37,752		2,118		35,634
Total intangible assets	$	176,934	$	95,261	$	81,673
Balance as of December 31, 2010						
Amortizable intangible assets:						
Patents	$	12,106	$	4,321	$	7,785
Customer lists		30,083		19,009		11,074
Licenses		62,124		46,381		15,743
Intellectual property		17,833		17,719		114
Lottery contracts		1,500		1,093		407
		123,646		88,523		35,123
Non-amortizable intangible assets:						
Trade name		37,608		2,118		35,490
Total intangible assets	$	161,254	$	90,641	$	70,613

The aggregate intangible amortization expense for the three months ended March 31, 2011 and 2010 was approximately $3,800 and $4,300, respectively.

The table below reconciles the change in the carrying amount of goodwill, by reporting segment, for the period from December 31, 2010 to March 31, 2011. In the first quarter of 2011, we recorded an increase in goodwill of $13,789 as a result of foreign currency translation.

Goodwill	Printed Products Group	Lottery Systems	Diversified Gaming	Totals

		Group	Group	
Balance as of December 31, 2010	$335,481	$ 186,944	$ 241,490	$ 763,915
Adjustments	1,678	5,205	6,906	13,789
Balance as of March 31, 2011	$337,159	$ 192,149	$ 248,396	$ 777,704

(9) Pension and Other Post-Retirement Plans

We have defined benefit pension plans for our U.K.-based union employees and certain Canadian-based employees (the U.K. Plan and the Canadian Plan, respectively). Retirement benefits under the U.K. Plan are based on an employee s average compensation over the two years preceding retirement. Retirement benefits under the Canadian Plan are generally based on the number of years of credited service. Our policy is to fund the minimum contribution permissible by the respective tax authorities.

Table of Contents

The following table sets forth the combined amount of net periodic benefit cost recognized for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Components of net periodic pension benefit cost:		
Service cost	$ 462	$ 471
Interest cost	1,173	1,237
Expected return on plan assets	(1,162)	(1,226)
Amortization of actuarial gains/losses	95	140
Amortization of prior service costs	(3)	11
Net periodic cost	$ 565	$ 633

We have a 401(k) plan for U.S.-based employees who are not covered by a collective bargaining agreement. We contribute 37.5 cents on the dollar for the first 6% of participant contributions for a match of up to 2.25% of eligible compensation.

(10) Income Taxes

The effective tax rates of (294.4%) and 26.2%, respectively, for the three months ended March 31, 2011 and 2010 were determined using an estimated annual effective tax rate and after considering any discrete items for such periods. Due to a valuation allowance against our U.S. deferred tax assets, the effective tax rate for the three months ended March 31, 2011 does not include the benefit of the current year forecasted U.S. tax loss. Income tax expense for the three months ended March 31, 2011 is primarily due to income tax expense in foreign jurisdictions.

At December 31, 2010, we established a valuation allowance of $149,583 against the U.S. deferred tax assets that, in the judgment of management, are more likely than not to expire before they can be utilized. In assessing the recoverability of our deferred tax assets, we analyzed all evidence, both positive and negative. We considered, among other things, our deferred tax liabilities, our historical earnings and losses, projections of future income, and tax-planning strategies available to us, We have not changed our assessment regarding the recoverability of our U.S. deferred tax assets for the three months ended March 31, 2011.

(11) Stockholders Equity

The following demonstrates the change in the number of shares of Class A common stock outstanding during the three months ended March 31, 2011 and during the fiscal year ended December 31, 2010:

	Three Months Ended March 31,	Twelve Months Ended December 31,

	2011	2010
Shares outstanding as of beginning of period	91,725	93,883
Shares issued as part of equity-based compensation plans and the ESPP, net of RSUs surrendered	324	461
Shares repurchased into treasury stock		(2,619)
Shares outstanding as of end of period	92,049	91,725

Table of Contents

(12) Stock-Based Compensation

We offer stock-based compensation through the use of stock options and restricted stock units (RSUs). We grant stock options to employees and directors under our equity-based compensation plans at not less than the fair market value of the stock at the date of grant. The terms of the stock option and RSU awards, including the vesting schedule of such awards, are determined at our discretion subject to the terms of the applicable equity-based compensation plan. Options granted over the last several years have generally been exercisable in four or five equal installments beginning on the first anniversary of the date of grant with a maximum term of ten years. RSUs typically vest in four or five equal installments beginning on the first anniversary of the date of grant or when certain performance measures are met. There are 13,500 shares of common stock authorized for awards under our 2003 Incentive Compensation Plan plus available shares from a preexisting equity-based compensation plan, which plans were approved by our stockholders. We also have outstanding stock options granted as part of inducement stock option awards that are not approved by stockholders prior to being granted. We record compensation cost for all stock options and RSUs based on the fair value at the grant date.

The Company may grant certain awards that are contingent upon the Company achieving certain performance targets. Upon determining the performance target is probable, the fair value of the award is recognized over the service period. Certain equity awards may be settled in cash or shares. The fair value of these awards is measured each reporting period and recorded as a liability and corresponding compensation expense. As the fair value changes each reporting period, the corresponding liability and compensation expense are adjusted, such that the liability and cumulative compensation expense equal the total fair value of the obligation upon the reporting date.

In connection with Mr. Weil becoming Chief Executive Officer, the Company entered into an amendment to his employment agreement effective December 2, 2010. Pursuant to the amendment, the Company awarded to Mr. Weil sign-on equity awards consisting of: 1,000 stock options with an exercise price of $9.00 per share (representing an approximately 12% premium to the market value of the Company s stock on the date of grant) and a ten-year term and 1,000 RSUs, which awards have a four-year vesting schedule, with 25% scheduled to vest on December 31, 2011 and on each of the next three anniversaries of such date (such options and RSUs, the time-vesting equity awards). Mr. Weil was also awarded an additional performance-conditioned award consisting of 1,000 stock options with an exercise price of $8.06 per share (representing the market value of the Company s stock on the date of grant) and 1,000 RSUs, which awards have a five-year vesting schedule, with 20% of such options and RSUs scheduled to vest per year if specified performance targets are met subject to certain carryover vesting provisions as described in the employment agreement amendment (such performance-conditioned stock options and RSUs, the performance-conditioned equity awards).

The performance-conditioned stock options will expire, and the performance-conditioned RSUs will be forfeited, on March 15, 2016 to the extent that such awards remain unvested on such date. Any performance-conditioned stock options that have vested by March 15, 2016 will expire ten years from the date of grant. Delivery of shares in respect of vested performance-vesting RSUs will occur on March 15, 2016, provided that such RSUs will be forfeited to the extent that sufficient shares are not available under the Company s applicable equity-based compensation plan for such delivery. The performance-vesting stock options will not be exercisable to the extent that sufficient shares are not available under the plan for the delivery of the shares issuable upon such exercise. In addition, to the extent that sufficient shares are not available under the plan for the delivery of the shares underlying the 500 time-vesting RSUs that are scheduled to vest on December 31, 2013 and December 31, 2014 or the delivery of the shares issuable upon the exercise of 200 of the time-vesting stock options that are scheduled to become exercisable on December 31, 2014, the Company will settle such delivery in cash. See the Company s Current Report on Form 8-K filed on December 3, 2010 for additional information regarding these sign-on equity awards, including information regarding the performance targets with respect to the performance-conditioned equity awards.

In January 2011, the Company awarded an aggregate of 475 equity awards to certain officers consisting of approximately 113 performance-conditioned stock options, approximately 113 time-vesting stock options (with an exercise price of $10.02 per share and a ten-year term) and 250 time-vesting stock options (with an exercise price of $9.98 per share and a ten-year term), which options will not be exercisable to the extent that sufficient shares are not available under the Company s applicable equity-based compensation plan for the delivery of the shares issuable upon such exercise.

The equity awards that will be forfeited or not exercisable and the equity awards that will be settled in cash, as the case may be, to the extent that sufficient shares are not available under the Company s applicable equity-based compensation plan at the time of delivery of the underlying shares, are not deemed to be granted for accounting purposes as stock-based equity awards (and are not reflected as granted in 2011 or 2010, as the case may be, or outstanding as of March 31, 2011 or December 31, 2010 in the tables below). Excluding the awards described in the preceding sentence, we had approximately 932 and 2,119 shares available for grants of equity awards under our applicable equity-based compensation plans (including the shares available under our employee stock purch