

SCIENTIFIC GAMES CORP  
Form 10-Q  
May 10, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-Q**

{Mark One}

**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

**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**

(State or other jurisdiction of  
incorporation or organization)

**81-0422894**

(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  No

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

Indicate by check mark 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

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

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

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

Class B Common Stock: **None**

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**SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES**

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**AND OTHER INFORMATION**

**THREE MONTHS ENDED MARCH 31, 2011**

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**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, opportunity, or other similar 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
<b>ASSETS</b>		
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
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
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)

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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

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## 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

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(1) Exclusive of depreciation and amortization.

See accompanying notes to consolidated financial statements



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## 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



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**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.

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**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

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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	2010
<b>Income (numerator)</b>		
Net (loss) income	\$ (6,932)	\$ 4,887
<b>Shares (denominator)</b>		
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
<b>Basic and diluted per share amounts</b>		
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.

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	<b>Three Months Ended March 31, 2011</b>			
<b>Printed Products Group</b>	<b>Lottery Systems Group</b>	<b>Diversified Gaming Group</b>		<b>Totals</b>