

SCIENTIFIC GAMES CORP  
Form 10-Q  
November 02, 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 September 30, 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

Smaller reporting company

(Do not check if a 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 October 28, 2011:

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Class A Common Stock: **92,137,470**

Class B Common Stock: **None**

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**SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES**

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**AND OTHER INFORMATION**

**THREE AND NINE MONTHS ENDED SEPTEMBER 30, 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, and 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 heading 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 benefit from, and risks associated with joint ventures and strategic investments and relationships; failure of the Company's Northstar joint venture to meet the net income targets or otherwise realize the anticipated benefits under its private management agreement with the Illinois Lottery; seasonality; 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 September 30, 2011 and December 31, 2010

(Unaudited, in thousands, except per share amounts)

<b>ASSETS</b>		
<b>Current assets:</b>		
Accounts receivable, net of allowance for doubtful accounts of \$6,469 and \$2,175 as of September 30, 2011 and December 31, 2010, respectively	187,236	178,179
Deferred income taxes, current portion	2,339	2,448
<b>Total current assets</b>	<b>408,285</b>	<b>413,665</b>
Less: accumulated depreciation	(342,631)	(325,786)
Goodwill, net	766,288	763,915
Other assets and investments	494,677	452,764
<b>Current liabilities:</b>		
Accounts payable	64,640	50,642
<b>Total current liabilities</b>	<b>234,272</b>	<b>195,998</b>
Other long-term liabilities	57,517	53,765
<b>Total liabilities</b>	<b>1,735,564</b>	<b>1,698,880</b>
<b>Stockholders' equity:</b>		
Additional paid-in capital	689,861	674,691

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Treasury stock, at cost, 5,749 shares held as of September 30, 2011 and December 31, 2010	(74,460)	(74,460)
Total stockholders' equity	460,777	452,658

See accompanying notes to consolidated financial statements

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## SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months Ended September 30, 2011 and 2010

(Unaudited, in thousands, except per share amounts)

	Three Months Ended September 30,	
	2011	2010
Revenue:		
Instant tickets	\$ 126,693	\$ 115,968
Services	81,429	92,813
Sales	14,617	12,280
Total revenue	222,739	221,061
Operating expenses:		
Cost of instant tickets (1)	71,785	67,138
Cost of services (1)	42,562	57,723
Cost of sales (1)	10,332	7,977
Selling, general and administrative expenses	47,660	36,435
Write-down of assets held for sale		2,155
Employee termination and restructuring costs	1,030	602
Depreciation and amortization	27,994	27,284
Operating income	21,376	21,747
Other (income) expense:		
Interest expense	26,297	24,617
Earnings from equity investments	(8,895)	(13,031)
Loss on early extinguishment of debt	4,185	2,236
Other (income) expense, net	1,711	(3,011)
	23,298	10,811
Net (loss) income before income taxes	(1,922)	10,936
Income tax expense	2,202	2,232
Net (loss) income	\$ (4,124)	\$ 8,704
Basic and diluted net (loss) income per share:		
Basic net (loss) income per share	\$ (0.04)	\$ 0.09
Diluted net (loss) income per share	\$ (0.04)	\$ 0.09
Weighted-average number of shares used in per share calculations:		
Basic shares	92,125	91,844
Diluted shares	92,125	92,240

(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 OPERATIONS

Nine Months Ended September 30, 2011 and 2010

(Unaudited, in thousands, except per share amounts)

	Nine Months Ended September 30,	
	2011	2010
Revenue:		
Instant tickets	\$ 370,972	\$ 343,506
Services	237,272	287,527
Sales	31,399	39,400
Total revenue	639,643	670,433
Operating expenses:		
Cost of instant tickets (1)	211,151	199,282
Cost of services (1)	122,944	167,336
Cost of sales (1)	21,383	27,843
Selling, general and administrative expenses	130,640	115,543
Write-down of assets held for sale		8,029
Employee termination and restructuring costs	1,030	602
Depreciation and amortization	87,902	82,017
Operating income	64,593	69,781
Other (income) expense:		
Interest expense	79,161	74,176
Earnings from equity investments	(27,469)	(42,474)
Loss on early extinguishment of debt	4,185	2,236
Other (income) expense, net	(159)	9,555
	55,718	43,493
Net income before income taxes	8,875	26,288
Income tax expense	12,912	17,040
Net (loss) income	\$ (4,037)	\$ 9,248
Basic and diluted net (loss) income per share:		
Basic net (loss) income per share	\$ (0.04)	\$ 0.10
Diluted net (loss) income per share	\$ (0.04)	\$ 0.10
Weighted-average number of shares used in per share calculations:		
Basic shares	92,027	93,122
Diluted shares	92,027	93,648

(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

Nine Months Ended September 30, 2011 and 2010

(Unaudited, in thousands, except per share amounts)

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net (loss) income	\$ (4,037)	\$ 9,248
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	87,902	82,017
Change in deferred income taxes	2,326	11,541
Stock-based compensation	15,293	17,383
Non-cash interest expense	6,122	5,276
Undistributed earnings from equity investments	2,611	(8,062)
Write-down of assets held for sale		8,029
Loss on extinguishment of debt	4,185	2,236
Changes in current assets and liabilities, net of effects of acquisitions		
Accounts receivable	9,380	7,012
Inventories	(827)	(2,375)
Accounts payable	(2,125)	(8,970)
Accrued liabilities	14,671	(3,463)
Other current assets and liabilities	16,163	22,886
Other	963	483
Net cash provided by operating activities	152,627	143,241
Cash flows from investing activities:		
Capital expenditures	(5,863)	(6,873)
Lottery and gaming systems expenditures	(33,972)	(45,257)
Other intangible assets and software expenditures	(28,536)	(26,335)
Change in other assets and liabilities, net	(11,356)	(571)
Net equity investments	(37,878)	(127,314)
Business acquisitions, net of cash acquired	(50,177)	(12,493)
Net cash used in investing activities	(167,782)	(218,843)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt		355,541
Payments on long-term debt	(6,232)	(242,758)
Payments of financing fees	(9,186)	(12,969)
Purchases of treasury stock		(26,334)
Net proceeds from issuance of common stock	(1,426)	(2,067)
Net cash (used in) provided by financing activities	(16,844)	71,413
Effect of exchange rate changes on cash and cash equivalents	(5,403)	(8,965)
Decrease in cash and cash equivalents	(37,402)	(13,154)
Cash and cash equivalents, beginning of period	124,281	260,131
Change in cash and cash equivalents of held for sale operations at September 30, 2010		2,593
Cash and cash equivalents, end of period	\$ 86,879	\$ 249,570

See accompanying notes to consolidated financial statements

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**SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Nine Months Ended September 30, 2011 and 2010**

**(Unaudited, in thousands, except per share amounts)**

**Non-cash investing and financing activities**

*For the nine months ended September 30, 2011 and 2010*

Our total investment in International Terminal Leasing ( ITL ), which is described in Note 3 of the Notes to Consolidated Financial Statements, was \$35,961 as of September 30, 2011 which includes a non-cash investment of \$4,859 during the nine months ended September 30, 2011. There were no significant non-cash investing and financing activities for the nine months ended September 30, 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 September 30, 2011, the Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 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 September 30, 2011, the results of our operations for the three and nine months ended September 30, 2011 and 2010 and our cash flows for the nine months ended September 30, 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 three and nine months ended September 30, 2011 are not necessarily indicative of the results of operations 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 September 30, 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

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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 the 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 and nine months ended September 30, 2011.



Table of Contents*Basic and Diluted Net Income (Loss) 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 and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Income (numerator)</b>				
Net (loss) income	\$ (4,124)	\$ 8,704	\$ (4,037)	\$ 9,248
<b>Shares (denominator)</b>				
Weighted-average basic common shares outstanding	92,125	91,844	92,027	93,122
Effect of dilutive securities-stock rights		396		526
Weighted-average diluted common shares outstanding	92,125	92,240	92,027	93,648
<b>Basic and diluted per share amounts</b>				
Basic net (loss) income per share	\$ (0.04)	\$ 0.09	\$ (0.04)	\$ 0.10
Diluted net (loss) income per share	\$ (0.04)	\$ 0.09	\$ (0.04)	\$ 0.10

There were no dilutive stock rights for the three and nine months ended September 30, 2011 due to the net loss reported for the periods. The weighted-average diluted common shares outstanding for the three and nine months ended September 30, 2010 excludes the effect of approximately 6,917 and 6,496 weighted-average stock rights outstanding, respectively, because their effect would be anti-dilutive.

**(2) Reportable Segment Information**

We operate in three reportable segments: Printed Products Group, Lottery Systems Group, and Diversified Gaming Group. During the first quarter of 2011 we reviewed the allocation of overhead expenses to our reportable segments as a result 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 reportable segment information has been adjusted to reflect the change in reportable segment reporting.

The following tables set forth revenue, cost of revenue, depreciation, amortization, selling, general and administrative expenses, write-down of assets held for sale, employee termination and restructuring costs, and operating income for the three and nine months ended September 30, 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 and are presented as unallocated corporate costs.



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	Three Months Ended September 30, 2011				Totals
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group		
Revenue:					
Instant tickets	\$ 126,693	\$	\$	\$	126,693
Services		49,944		31,485	81,429
Sales	2,953	9,640		2,024	14,617
Total revenue	\$ 129,646	\$ 59,584	\$	\$ 33,509	\$ 222,739
Cost of instant tickets (1)	\$ 71,785	\$	\$	\$	71,785
Cost of services (1)		26,899		15,663	42,562
Cost of sales (1)	1,906	6,813		1,613	10,332
Selling, general and administrative expenses	13,029	6,626		4,238	23,893
Employee termination and restructuring costs				1,030	1,030
Depreciation and amortization	8,177	11,939		7,744	27,860
Segment operating income	\$ 34,749	\$ 7,307	\$	\$ 3,221	\$ 45,277
Unallocated corporate costs					23,901
Consolidated operating income					\$ 21,376

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(1) Exclusive of depreciation and amortization.

	Three Months Ended September 30, 2010		
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group