SCIENTIFIC GAMES CORP
Form 10-Q
August 09, 2007

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 June 30, 2007

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 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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o	Non-accelerated filer 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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of August 7, 2007:

Class A Common Stock:	**92,708,518**
Class B Common Stock:	**None**

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
INDEX TO FINANCIAL INFORMATION
AND OTHER INFORMATION
THREE MONTHS ENDED JUNE 30, 2007

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 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 outcomes 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 in our markets; technological change; retention and renewal of existing contracts and entry into new contracts; availability and adequacy of cash flow 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; seasonality; dependence on suppliers and manufacturers; factors associated with foreign operations; 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 set forth from time to time in our filings with the SEC, including our most recent Annual Report on Form 10-K. 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.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
As of December 31, 2006 and June 30, 2007
(Unaudited, in thousands, except per share amounts)

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

	December 31, 2006	June 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,791	$ 27,811
Accounts receivable, net of allowance for doubtful accounts of $5,703 and $7,168 as of December 31, 2006 and June 30, 2007, respectively	178,445	203,411
Inventories	59,464	82,591
Deferred income taxes, current portion	8,960	10,852
Prepaid expenses, deposits and other current assets	70,042	56,565
Total current assets	344,702	381,230
Property and equipment, at cost	803,089	884,226
Less accumulated depreciation	(352,429)	(360,578)
Net property and equipment	450,660	523,648
Goodwill, net	633,730	708,522
Intangible assets, net	157,251	152,580
Other assets and investments	173,267	216,994
Total assets	$ 1,759,610	$ 1,982,974
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current installments of long-term debt	$ 3,148	$ 4,977
Accounts payable	60,566	59,156
Accrued liabilities	130,309	152,806
Total current liabilities	194,023	216,939
Deferred income taxes	43,143	45,744
Other long-term liabilities	81,113	80,270
Long-term debt, excluding current installments	913,253	1,028,295
Total liabilities	1,231,532	1,371,248
Commitments and contingencies		
Stockholders equity:		
Class A common stock, par value $0.01 per share, 199,300 shares authorized, and 91,628 and 92,764 shares issued and outstanding as of December 31, 2006 and June 30, 2007, respectively	916	927
Class B non-voting common stock, par value $0.01 per share, 700 shares authorized, none outstanding		
Additional paid-in capital	477,261	498,144
Accumulated earnings	33,452	83,822
Treasury stock, at cost, 1,140 shares held as of December 31, 2006 and June 30, 2007	(19,442)	(19,442)
Accumulated other comprehensive income	35,891	48,275
Total stockholders equity	528,078	611,726
Total liabilities and stockholders equity	$ 1,759,610	$ 1,982,974

See accompanying notes to consolidated financial statements.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Three Months Ended June 30, 2006 and 2007
(Unaudited, in thousands, except per share amounts)

	Three Months Ended June 30, 2006	2007
Operating revenues:		
Services	$ 206,809	$ 234,661
Sales	32,828	34,916
	239,637	269,577
Operating expenses:		
Cost of services (exclusive of depreciation and amortization)	113,461	129,698
Cost of sales (exclusive of depreciation and amortization)	24,382	26,456
Selling, general and administrative expenses	35,346	40,495
Depreciation and amortization	23,525	32,256
Operating income	42,923	40,672
Other (income) expense:		
Interest expense	11,115	14,274
Equity in earnings of joint ventures	(3,157)	(11,401)
Other (income) expense, net	(226)	347
	7,732	3,220
Income before income tax expense	35,191	37,452
Income tax expense	10,214	10,345
Net income	$ 24,977	$ 27,107
Basic and diluted net income per share:		
Basic net income per share	$ 0.27	$ 0.29
Diluted net income per share	$ 0.26	$ 0.28
Weighted-average number of shares used in per share calculations:		
Basic shares	91,202	92,581
Diluted shares	95,989	96,280

See accompanying notes to consolidated financial statements.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Six Months Ended June 30, 2006 and 2007
(Unaudited, in thousands, except per share amounts)

	Six Months Ended June 30, 2006	2007
Operating revenues:		
Services	$ 383,769	$ 445,654
Sales	63,997	66,189
	447,766	511,843
Operating expenses:		
Cost of services (exclusive of depreciation and amortization)	208,409	246,445
Cost of sales (exclusive of depreciation and amortization)	48,926	48,941
Selling, general and administrative expenses	67,738	79,640
Depreciation and amortization	42,817	61,335
Operating income	79,876	75,482
Other (income) expense:		
Interest expense	18,317	27,166
Equity in earnings of joint ventures	(4,733)	(23,279)
Other income, net	(869)	(44)
	12,715	3,843
Income before income tax expense	67,161	71,639
Income tax expense	19,814	19,773
Net income	$ 47,347	$ 51,866
Basic and diluted net income per share:		
Basic net income per share	$ 0.52	$ 0.56
Diluted net income per share	$ 0.50	$ 0.54
Weighted-average number of shares used in per share calculations:		
Basic shares	90,687	92,289
Diluted shares	94,992	95,605

See accompanying notes to consolidated financial statements.

6

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Months Ended June 30, 2006 and 2007
(Unaudited, in thousands, except per share amounts)

	Six Months Ended June 30, 2006	2007
Net cash provided by operating activities	$ 90,199	$ 93,411
Cash flows from investing activities:		
Capital expenditures	(8,516)	(18,320)
Wagering system expenditures	(71,954)	(62,572)
Other intangible assets and software expenditures	(24,502)	(18,613)
Change in other assets and liabilities, net	(9,696)	(20,083)
Business acquisitions, net of cash acquired	(267,010)	(101,893)
Net cash used in investing activities	(381,678)	(221,481)
Cash flows from financing activities:		
Net borrowings (repayments) under revolving credit facility	182,500	110,500
Net proceeds (repayments) of long-term debt	94,680	6,361
Excess tax benefit from equity-based compensation plan	4,082	
Net proceeds from issuance of common stock	11,540	10,814
Net cash provided by financing activities	292,802	127,675
Effect of exchange rate changes on cash and cash equivalents	(6,110)	415
Increase (decrease) in cash and cash equivalents	(4,787)	20
Cash and cash equivalents, beginning of period	38,942	27,791
Cash and cash equivalents, end of period	$ 34,155	$ 27,811

See accompanying notes to consolidated financial statements.

7

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 June 30, 2007, the consolidated statements of income for the three and six months ended June 30, 2006 and 2007, and the condensed consolidated statements of cash flows for the six months ended June 30, 2006 and 2007, have been prepared by Scientific Games Corporation (together with its consolidated subsidiaries, the Company) without audit. In the opinion of management, all adjustments necessary to present fairly the consolidated financial position of the Company as of June 30, 2007 and the results of its operations for the three and six months ended June 30, 2006 and 2007 and its cash flows for the six months ended June 30, 2006 and 2007 have been made.

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 the Company s 2006 Annual Report on Form 10-K. The results of operations for the period ended June 30, 2007 are not necessarily indicative of the operating results for a full year.

Basic and Diluted Net Income Per Share

The following represents a reconciliation of the numerator and denominator used in computing basic and diluted net income per share available to common stockholders for the three and six months ended June 30, 2006 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2007	2006	2007
Income (numerator)				
Net income	$ 24,977	$ 27,107	$ 47,347	$ 51,866
Shares (denominator)				
Basic weighted-average common shares outstanding	91,202	92,581	90,687	92,289
Effect of dilutive securities-stock rights	2,793	2,142	2,889	2,193
Effect of dilutive shares related to convertible debentures	1,994	1,557	1,416	1,123
Diluted weighted-average common shares outstanding	95,989	96,280	94,992	95,605
Basic and diluted per share amounts				
Basic net income per share	$ 0.27	$ 0.29	$ 0.52	$ 0.56
Diluted net income per share	$ 0.26	$ 0.28	$ 0.50	$ 0.54

The weighted-average diluted shares outstanding for the three and six month periods ended June 30, 2007 excludes the effect of approximately 1,368 and 2,494 out-of-the-money options, respectively, as their

(1) Consolidated Financial Statements (Continued)

effect would be anti-dilutive. The weighted-average diluted shares outstanding for the three and six month periods ended June 30, 2006 excludes the effect of approximately 185 and 130 out-of-the-money options, respectively, as their effect would be anti-dilutive.

The aggregate number of shares that the Company could be obligated to issue upon conversion of its $275,000, 0.75% convertible senior subordinated debentures due 2024 (the Convertible Debentures), which the Company sold in December 2004, is approximately 9,450. The Convertible Debentures provide for net share settlement upon exercise and the Company has purchased a bond hedge to mitigate the potential economic dilution from conversion.

During the first and second quarters of 2007, the average price of the Company s common stock exceeded the specified conversion price. For the three and six months ended June 30, 2007, the Company has included 1,557 and 1,123 shares, respectively, related to its Convertible Debentures in its diluted weighted-average common shares outstanding. For the three and six months ended June 30, 2006, the Company has included 1,994 and 1,416 shares, respectively, related to its Convertible Debentures in its diluted weighted-average common shares outstanding. The Company has not included the offset from the bond hedge as it would be anti-dilutive; however, when the Convertible Debentures mature, the diluted share amount will decrease because the bond hedge will offset the economic dilution from conversion.

(2) Acquisitions

On May 1, 2007, the Company acquired Oberthur Gaming Technologies and related companies (OGT). OGT is a manufacturer of instant lottery tickets and operates three instant ticket plants located in Montreal, Canada; Sydney, Australia and San Antonio, Texas. The purchase price was approximately $102,000 (approximately one-third of which is attributable to U.S. assets), subject to certain adjustments. The Company expects its acquisition of OGT will allow it to strengthen its international presence in Canada, Europe and Australia and offer its customers an expanded array of products and services. The Company financed the acquisition through borrowings under its revolving credit facility. Approximately $20,000 of the preliminary goodwill of approximately $59,000 resulting from the acquisition of OGT will be deductible for tax purposes. The operating results of OGT have been included in the Company s Printed Products segment and have been consolidated in the Company s statement of operations since the date of acquisition.

In conjunction with the purchase of substantially all of the online lottery assets of EssNet AB (EssNet) in March of 2006, the Company recorded approximately $26,717 in liabilities, primarily related to involuntary employee terminations, termination of leases and termination of service contracts that will result from the integration. The table below summarizes the payments made to date, adjustments and the balance of the accrued integration costs from December 31, 2006 to June 30, 2007:

	Severance Pay and Benefits	Lease Terminations	Contractual Obligations	Total Liability
Accrued costs as of December 31, 2006	$ 3,250	916	5,382	9,548
Payments	(1,107)	(191)	(398)	(1,696)
Adjustments to goodwill	234	39	4,075	4,348
Accrued costs as of March 31, 2007	$ 2,377	764	9,059	12,200
Payments	(1,149)	(193)	(518)	(1,860)
Accrued costs as of June 30, 2007	$ 1,228	571	8,541	10,340

(3) Operating Segment Information

Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), defines operating segments to be those components of a business for which separate financial information is available that is regularly evaluated by management in making operating decisions and in assessing performance. SFAS 131 further requires that segment information be presented consistently with the basis and manner in which management internally disaggregates financial information for the purposes of assisting in making internal operating decisions.

The Printed Products Group provides lotteries with instant ticket and related services that includes ticket design and manufacturing as well as value-added services, including game design, sales and marketing support, inventory management and warehousing and fulfillment services. Additionally, this division provides lotteries with licensed brand products and manufactures prepaid phone cards for cellular phone service providers. In addition, as a result of the acquisition of 80% of the common stock of International Lotto Corp., SRL (ILC) in December 2006, Printed Products now has an agreement with certain charities in Peru under which the Company participates in the operation of a lottery in Peru. The Lottery Systems Group offers online, instant and video lottery products and online and instant ticket validation systems. Its business includes the supply of transaction processing software for the accounting and validation of both instant and online lottery games, point-of-sale terminal hardware sales, central site computers and communication hardware sales and ongoing support and maintenance for these products. The Diversified Gaming Group provides services and systems to private and public operators in the wide area gaming markets and the pari-mutuel wagering industry. The product offerings include fixed odds betting terminals (FOBTs), video lottery terminals (VLTs), monitor games, wagering systems for the pari-mutuel racing industry, sports betting systems and services, Amusement With Prize (AWP) and Skill With Prize (SWP) terminals and pari-mutuel gaming operations in Connecticut, Maine and the Netherlands.

Subsequent to the issuance of the 2006 financial statements management determined that certain EssNet sales revenues of approximately $7,400 and EssNet cost of sales of approximately $5,100 were classified as service revenues and cost of services in the Lottery Systems Group during the three and six months ended June 30, 2006 periods. Accordingly the amounts have been revised in the following presentation.

The following tables represent revenues, profits, depreciation, amortization and selling, general and administrative expenses for the three and six month periods ended June 30, 2006 and 2007, by current reportable segments. Corporate expenses, including interest expense, other income, and corporate depreciation and amortization are not allocated to the reportable segments.

	Three Months Ended June 30, 2006			
	Printed Products Group	**Lottery Systems Group**	**Diversified Gaming Group**	**Totals**
Service revenues	$ 100,615	49,236	56,958	206,809
Sales revenues	11,818	19,832	1,178	32,828
Total revenues	112,433	69,068	58,136	239,637
Cost of services (exclusive of depreciation and amortization)	52,695	28,560	32,206	113,461
Cost of sales (exclusive of depreciation and amortization)	9,206	13,995	1,181	24,382
Selling, general and administrative expenses	10,849	8,079	4,534	23,462
Depreciation and amortization	6,141	11,041	6,099	23,281
Segment operating income	$ 33,542	7,393	14,116	55,051
Unallocated corporate costs				$ 12,128
Consolidated operating income				$ 42,923

(3) Operating Segment Information (Continued)

	Three Months Ended June 30, 2007 Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 126,951	52,812	54,898	234,661
Sales revenues	10,094	10,466	14,356	34,916
Total revenues	137,045	63,278	69,254	269,577
Cost of services (exclusive of depreciation and amortization)	70,868	28,077	30,753	129,698
Cost of sales (exclusive of depreciation and amortization)	8,380	5,888	12,188	26,456
Selling, general and administrative expenses	15,724	7,338	5,214	28,276
Depreciation and amortization	10,123	15,225	6,679	32,027
Segment operating income	$ 31,950	6,750	14,420	53,120
Unallocated corporate costs				$ 12,448
Consolidated operating income				$ 40,672

	Six Months Ended June 30, 2006 Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 194,194	101,953	87,622	383,769
Sales revenues	25,939	34,531	3,527	63,997
Total revenues	220,133	136,484	91,149	447,766
Cost of services (exclusive of depreciation and amortization)	98,986	56,233	53,190	208,409
Cost of sales (exclusive of depreciation and amortization)	19,979	25,587	3,360	48,926
Selling, general and administrative expenses	22,205	15,528	6,975	44,708
Depreciation and amortization	11,326	21,534	9,495	42,355
Segment operating income	$ 67,637	17,602	18,129	103,368
Unallocated corporate costs				$ 23,492
Consolidated operating income				$ 79,876

(3) Operating Segment Information (Continued)

	Six Months Ended June 30, 2007 Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 231,582	107,143	106,929	445,654
Sales revenues	19,356	21,515	25,318	66,189
Total revenues	250,938	128,658	132,247	511,843
Cost of services (exclusive of depreciation and amortization)	126,530	57,468	62,447	246,445
Cost of sales (exclusive of depreciation and amortization)	16,004	12,126	20,811	48,941
Selling, general and administrative expenses	27,205	15,335	10,562	53,102
Depreciation and amortization	18,523	29,356	13,001	60,880
Segment operating income	$ 62,676	14,373	25,426	102,475
Unallocated corporate costs				$ 26,993
Consolidated operating income				$ 75,482

The following table provides a reconciliation of segment operating income to the consolidated income before income tax expense for each period:

	Three Months Ended June 30, 2006	2007	Six Months Ended June 30, 2006	2007
Reported segment operating income	$ 55,051	$ 53,120	$ 103,368	$ 102,475
Unallocated corporate costs	(12,128)	(12,448)	(23,492)	(26,993)
Consolidated operating income	42,923	40,672	79,876	75,482
Interest expense	(11,115)	(14,274)	(18,317)	(27,166)
Equity in earnings of joint ventures	3,157	11,401	4,733	23,279
Other income	226	(347)	869	44
Income before income tax expense	$ 35,191	$ 37,452	$ 67,161	$ 71,639

In evaluating financial performance, the Company focuses on operating profit as a segment s measure of profit or loss. Operating income is 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 except for accounting for income tax contingencies (see Critical Accounting Policies in this Form 10-Q for the three months ended June 30, 2007 and Note 1 of the Company s Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2006).

(4) Equity Investments in Joint Ventures

The Company is a member of Consorzio Lotterie Nazionali, a consortium consisting principally of the Company, Lottomatica S.p.A, and Arianna 2001, a company owned by the Federation of Italian Tobacconists. The consortium has a signed contract with the Italian Monopoli di Stato to be the exclusive operator of the Italian Gratta e Vinci instant lottery. The contract, which commenced in mid-2004, has an initial term of six years with a six year-extension option. Under our contract with the consortium, the Company is a supplier of instant lottery tickets, will participate in the profits or losses of the consortium as a 20% equity owner, and will assist Lottomatica S.p.A in the lottery operations. The Company accounts for this investment using the equity method of accounting. For the three months ended June 30, 2006 and

(4) Equity Investments in Joint Ventures (Continued)

2007, the Company recorded income of $3,381 and $10,407, respectively, representing its share of the earnings of the consortium for the indicated periods. For the six months ended June 30, 2006 and 2007, the Company recorded income of $5,055 and $21,970, respectively, representing its share of the earnings of the consortium for the indicated periods.

Effective February 28, 2007, the Company sold its racing communications business and its 70% interest in NASRIN, its data communications business, to Roberts Communications Network, LLC (RCN) in exchange for a 29.4% interest in the RCN consolidated business. RCN provides communications services to racing and non-racing customers using both satellite and terrestrial services. Since the date of acquisition, the Company s share of the earnings of RCN is reflected in the caption Equity in earnings of joint ventures in the Consolidated Statements of Income. The Company s carrying value in RCN, is reflected in the caption Other assets and investments in the Consolidated Balance Sheets. The interest in RCN is not material to the Company s operations.

(5) Comprehensive Income

The following presents a reconciliation of net income to comprehensive income for the three and six month periods ended June 30, 2006 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2007	2006	2007
Net income	$ 24,977	$ 27,107	$ 47,347	$ 51,866
Other comprehensive income (loss)				
Foreign currency translation gain	17,976	10,297	18,716	12,018
Unrealized gain (loss) on investments	264	252	(511)	366
Other comprehensive income (loss)	18,240	10,549	18,205	12,384
Comprehensive income	$ 43,217	$ 37,656	$ 65,552	$ 64,250

(6) Inventories

Inventories consist of the following:

	December 31, 2006	June 30, 2007
Parts and work-in-process	$ 23,517	$ 39,408
Finished goods	35,947	43,183
	$ 59,464	$ 82,591

Point of sale terminals manufactured by the Company may be sold to customers or included as part of long-term wagering system contracts. 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.

(7) Long-Term Debt

On June 30, 2007, the Company had approximately $146,183 available for additional borrowing or letter of credit issuance under its revolving credit facility due 2009 (the Revolver) under its existing credit agreement dated as of December 23, 2004, as amended and restated as of January 24, 2007, (the January 2007 Amended and Restated Credit Agreement). There were $110,500 of outstanding loans and $43,317 in outstanding letters of credit under the Revolver as of June 30, 2007.

The January 2007 Amended and Restated Credit Agreement is secured by a first priority, perfected lien on: (i) substantially all the property and assets (real and personal, tangible and intangible) of the Company and 100%-owned domestic subsidiaries; (ii) 100% of the capital stock of all of the direct and indirect 100%-owned domestic subsidiaries and 65% of the Company s interest in the capital stock of its 100%-owned first-tier foreign subsidiaries; and (iii) all inter-company indebtedness owing amongst the Company and its 100%-owned domestic subsidiaries. The January 2007 Amended and Restated Credit Agreement is supported by guarantees provided by all of the Company s direct and indirect 100%-owned domestic subsidiaries.

The Company was in compliance with the covenants as of June 30, 2007.

The terms of the indenture governing the Convertible Debentures give holders the right to convert the Convertible Debentures at any time between July 1, 2007 and September 30, 2007. Upon conversion, the terms of such indenture require the Company to pay cash for the face amount of the Convertible Debentures which have been presented for conversion, with the value of the difference between the stated conversion price and the prevailing market price payable by the issuance of additional shares of its Class A common stock.

(8) Goodwill and Intangible Assets

The following disclosure presents certain information regarding the Company s acquired intangible assets as of December 31, 2006 and June 30, 2007. Amortizable intangible assets are amortized over their estimated useful lives, as indicated below, with no estimated residual values.

Intangible Assets	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Balance
Balance as of December 31, 2006				
Amortizable intangible assets:				
Patents	13	$ 8,839	(1,207)	7,632
Customer lists	11	28,705	(12,179)	16,526
Customer service contracts	15	3,691	(1,889)	1,802
Licenses	10	49,751	(12,611)	37,140
Intellectual property	4	21,622	(4,115)	17,507
Lottery contracts	5	34,747	(19,889)	14,858
	9	147,355	(51,890)	95,465
Non-amortizable intangible assets:				
Trade name		38,115	(2,118)	35,997
Connecticut off-track betting system operating right		34,108	(8,319)	25,789
		72,223	(10,437)	61,786
Total intangible assets		$ 219,578	(62,327)	157,251
Balance as of June 30, 2007				
Amortizable intangible assets:				
Patents	14	$ 8,892	(1,508)	7,384
Customer lists	11	29,045	(14,325)	14,720
Customer service contracts	15	3,782	(2,061)	1,721
Licenses	10	53,138	(17,869)	35,269
Intellectual property	4	22,102	(6,894)	15,208
Lottery contracts	5	39,825	(24,025)	15,800
	9	156,784	(66,682)	90,102
Non-amortizable intangible assets:				
Trade name		38,257	(2,118)	36,139
Connecticut off-track betting system operating right		34,658	(8,319)	26,339
		72,915	(10,437)	62,478
Total intangible assets		$ 229,699	(77,119)	152,580

The aggregate intangible amortization expense for the three month periods ended June 30, 2006 and 2007 was approximately $5,400 and $8,400, respectively. The aggregate intangible amortization expense for the six month periods ended June 30, 2006 and 2007 was approximately $8,200 and $15,700, respectively.

The table below reconciles the change in the carrying amount of goodwill, by reporting segment, for the period from December 31, 2006 to June 30, 2007. In 2007, the Company recorded (a) a $58,667 increase in goodwill associated with the acquisition of OGT, (b) a $1,338 increase in goodwill associated with the purchase price valuation and allocation adjustments associated with the acquisition of Games Media Limited (Games Media), (c) a $1,178 increase in goodwill associated with the final purchase price valuation and allocation adjustments associated with the acquisition of the Global Draw Limited (Global Draw), (d) a $4,218 increase in goodwill associated with the final purchase price valuation and allocation

(8) Goodwill and Intangible Assets (Continued)

adjustments associated with the acquisition of substantially all of the online lottery assets of EssNet, (e) a $624 increase in goodwill associated with the purchase price valuation and allocation adjustments associated with the acquisition of 80% of the common stock of ILC, (f) a $213 increase in goodwill associated with the purchase price valuation and allocation adjustments associated with the acquisition of Printpool Honsel GmbH (Honsel), (g) a $5 increase in goodwill associated with the purchase price valuation and allocation adjustments associated with certain other acquisitions and (h) an increase in goodwill of $8,549 as a result of foreign currency translation.

Goodwill	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Balance as of December 31, 2006	$ 259,710	184,509	189,511	633,730
Adjustments	60,974	6,469	7,349	74,792
Balance as of June 30, 2007	$ 320,684	190,978	196,860	708,522

(9) Pension and Other Post-Retirement Plans

The Company has defined benefit pension plans for its U.S. and U.K. based union employees (the U.S. Plan and the U.K. Plan) and, with the acquisition of OGT, certain Canadian based employees (the OGT Plans). Retirement benefits under the U.S. Plan are based upon the number of years of credited service up to a maximum of 30 years for the majority of the employees. 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 OGT Plans are based on the number of years of credited service for the majority of its employees. The Company s policy is to fund the minimum contribution permissible by the respective tax authorities.

The following table sets forth the combined amount of net periodic benefit cost recognized for the three and six month periods ended June 30, 2006 and 2007.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2007	2006	2007
Components of net periodic pension benefit cost:				
Service cost	$ 548	$ 697	$ 1,095	$ 1,173
Interest cost	551	1,070	1,102	1,845
Expected return on plan assets	(561)	(1,192)	(1,123)	(2,060)
Amortization of actuarial gains/losses	290	256	580	496
Amortization of transition asset		(23)		(23)
Amortization of prior service costs	6	25	11	36
Net periodic cost	$ 834	$ 833	$ 1,665	$ 1,467

The Company has a 401(k) plan covering all U.S. based employees who are not covered by a collective bargaining agreement. Under the plan, participants are eligible to receive matching contributions of 50 cents on the dollar from the Company for the first 6% of participant contributions for a match of up to 3% of eligible compensation. The Company has a 401(k) plan for all U.S. based union employees which does not provide for Company contributions. With the acquisition of OGT, the Company has a 401(k) plan covering certain U.S. based employees. Under the plan, participants are eligible to receive matching contributions of 50 cents on the dollar from the Company for the first 4% of participant contributions.

(10) Income Taxes

On January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. As a result of the implementation of FIN 48, the Company recognized an increase in the liability for unrecognized tax benefits of approximately $1,376, which was accounted for as a reduction to the Company s accumulated earnings as of January 1, 2007. The total amount of unrecognized tax benefits as of January 1, 2007 was approximately $4,113. Of this amount, approximately $3,607, if recognized, would be included in the Company s statement of operations and have an impact on the Company s effective tax rate. Also as a result of the implementation of FIN 48, the Company recognized accrued interest related to unrecognized tax benefits of $120, which was accounted for as a reduction to the Company s accumulated earnings as of January 1, 2007. The Company recognizes interest accrued for unrecognized tax benefits in interest expense and recognizes penalties in income tax expense. As of the date of adoption of FIN 48, the Company had accrued approximately $259 for the payment of interest and penalties.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001. The Company does not believe that the amount of uncertain tax positions will change by a significant amount within the next 12 months. In the event of subsequent recognition, the entire amount recognized would impact the effective tax rate.

The effective tax rate for the three and six months ended June 30, 2007 of 27.6% was determined using an estimated annual effective tax rate, which was less than the federal statutory rate of 35% due to lower tax rates applicable to the increase in the Company s earnings from operations outside the United States and the tax benefit of the 2004 debt restructuring. The effective tax rates for the three and six months ended June 30, 2006 of 29.0% and 29.5%, respectively, were determined using an estimated annual effective tax rate, which was less than the federal statutory rate of 35% due to lower tax rates applicable to the increase in the Company s earnings from operations outside the United States and the tax benefit of the 2004 debt restructuring.

(11) Stockholders Equity

As of June 30, 2007, the Company had a total of 2,000 shares of preferred stock, $1.00 par value, authorized for issuance, including 229 authorized shares of Series A Convertible Preferred Stock and 1 authorized share of Series B Preferred Stock. No shares of preferred stock are currently outstanding.

(11) Stockholders Equity (Continued)

The Company has two classes of common stock, consisting of Class A common stock and Class B non-voting common stock. All shares of Class A common stock and Class B common stock entitle holders to the same rights and privileges except that the Class B common stock is non-voting. Each share of Class B common stock is convertible into one share of Class A common stock. The following demonstrates the change in the number of Class A common shares outstanding during the fiscal year ended December 31, 2006 and during the three months ended June 30, 2007:

	Twelve Months Ended December 31, 2006	Three Months Ended June 30, 2007
Shares issued and outstanding as of beginning of period	89,869	92,510
Shares issued as part of equity-based compensation plans and the ESPP, net of RSUs surrendered for taxes	2,054	164
Other shares issued	29	
Shares repurchased into treasury stock	(324)	
Shares issued and outstanding as of end of period	91,628	92,674

On December 15, 2006, the Company entered into a licensing agreement with Hasbro, Inc. (Hasbro) for the use of certain Hasbro brands in multiple lottery platforms. Under the terms of the agreement, on February 28, 2007, the Company issued to Hasbro warrants (the Warrants) to purchase 40 shares of the Company s Class A common stock for $32.98 per share. The Warrants may be exercised at any time before February 28, 2012. The fair value of the Warrants on the date of grant was $480. Such amount is reflected in the caption Other assets and investments in the Consolidated Balance Sheets.

(12) Stock-Based Compensation

As of June 30, 2007, the Company had approximately 1,600 stock options or restricted stock units authorized to be granted under its equity-based compensation plans.

Stock Options

A summary of the changes in stock options outstanding under the Company s equity-based compensation plans during 2007 is presented below:

	Number of Options	Weighted Average Remaining Contract Term (Years)	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
Options outstanding as of December 31, 2006	6,972	6.3	$ 16.89	$ 117,732
Granted	635		33.86	
Exercised	(810)		11.54	16,509
Canceled	(14)		26.01	
Options outstanding as of March 31, 2007	6,783	6.7	$ 19.10	$ 93,156
Granted	15		32.82	
Exercised	(121)		17.10	2,324
Canceled	(19)		22.99	
Options excercisable as of June 30, 2007	6,658	6.4	$ 18.62	$ 108,863
Weighted-average per share fair value of options granted during the three months ended:				
March 31, 2007	$ 13.70			
June 30, 2007	$ 13.45			

18

(12) Stock-Based Compensation (Continued)

For the three months ended June 30, 2006 and 2007, the Company recognized equity-based compensation expense of approximately $3,500 and $2,300, respectively, related to the vesting of stock options and the related tax benefit of approximately $800 and $600, respectively. For the six months ended June 30, 2006 and 2007, the Company recognized equity-based compensation expense of approximately $7,200 and $6,200, respectively, related to the vesting of stock options and the related tax benefit of approximately $2,200 and $1,700, respectively. As of June 30, 2007, the Company had unearned compensation of approximately $28,600 relating to stock option awards that will be amortized over a weighted-average period of approximately two years.

Restricted Stock Units

A summary of the changes in restricted stock units outstanding under the Company s equity compensation plans during 2007 is presented below:

	Number of Restricted Stock	Weighted Average Grant Date Fair Value Per Share
Non-vested units as of December 31, 2006	977	$ 30.93
Granted	376	$ 33.54
Vested	(100)	$ 30.68
Canceled	(3)	$ 27.77
Non-vested units as of March 31, 2007	1,250	$ 31.74
Granted	228	$ 34.48
Vested	(31)	$ 36.16
Canceled	(1)	$ 27.68
Non-vested units as of June 30, 2007	1,446	$ 32.11

For the three months ended June 30, 2006 and 2007, the Company recognized equity-based compensation expense of approximately $1,500 and $2,600, respectively, related to the vesting of restricted stock units and the related tax benefit of approximately $600 and $700, respectively. For the six months ended June 30, 2006 and 2007, the Company recognized equity-based compensation expense of approximately $2,200 and $5,800, respectively, related to the vesting of restricted stock units and the related tax benefit of approximately $900 and $1,600, respectively. As of June 30, 2007, the Company had unearned compensation of approximately $37,000 relating to restricted stock units that will be amortized over a weighted-average period of approximately two years.

(13) Financial Information for Guarantor Subsidiaries and Non-Guarantor Subsidiaries

The Company conducts substantially all of its business through its domestic and foreign subsidiaries. The Company s 6.25% senior subordinated notes due 2012 (2004 Notes), the Convertible Debentures and the January 2007 Amended and Restated Credit Agreement are fully, unconditionally and jointly and severally guaranteed by substantially all of the Company s 100%-owned domestic subsidiaries (the Guarantor Subsidiaries).

Presented below is condensed consolidating financial information for (i) Scientific Games Corporation (the Parent Company), (ii) the 100%-owned Guarantor Subsidiaries and (iii) the 100%-owned foreign subsidiaries and the non-100%-owned domestic and foreign subsidiaries (collectively, the Non-Guarantor Subsidiaries) as of December 31, 2006 and June 30, 2007 and for the three and six months ended June 30, 2006 and 2007. The condensed consolidating financial information has been

(13) Financial Information for Guarantor Subsidiaries and Non-Guarantor Subsidiaries (Continued)

presented to show the nature of assets held, results of operations and cash flows of the Parent Company, Guarantor Subsidiaries and Non-Guarantor Subsidiaries, assuming the guarantee structure of the January 2007 Amended and Restated Credit Agreement, the Convertible Debentures and the 2004 Notes were in effect at the beginning of the periods presented. Separate financial statements for Guarantor Subsidiaries are not presented based on management s determination that they would not provide additional information that is material to investors.

The condensed consolidating financial information reflects the investments of the Parent Company in the Guarantor and Non-Guarantor Subsidiaries using the equity method of accounting. Corporate interest and administrative expenses have not been allocated to the subsidiaries.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2006
(Unaudited, in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Assets					
Cash and cash equivalents	$	4,070	23,721		27,791
Accounts receivable, net		125,598	52,847		178,445
Inventories		45,801	14,088	(425)	59,464
Other current assets	36,937	20,511	21,554		79,002
Property and equipment, net		294,952	156,308	(600)	450,660
Investment in subsidiaries	574,579	194,556	130,743	(899,878)	
Goodwill	183	302,144	331,403		633,730
Intangible assets		106,605			