SCIENTIFIC GAMES CORP
Form 10-Q
November 09, 2009
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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 September 30, 2009

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 o 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 November 6, 2009:

Class A Common Stock: **92,785,148**

Class B Common Stock: **None**

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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, 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 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 in our markets; recent changes to certain contracts; 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; ability to enhance and develop successful gaming concepts; influence of certain stockholders; dependence on suppliers and manufacturers; liability for product defects; 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 under the heading Risk Factors 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.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

As of September 30, 2009 and December 31, 2008

(Unaudited, in thousands, except per share amounts)

	September 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 213,078	$ 140,639
Accounts receivable, net of allowance for doubtful accounts of $6,072 and $6,465 as of September 30, 2009 and December 31, 2008, respectively	212,410	212,487
Inventories	75,758	75,371
Deferred income taxes, current portion	14,684	14,360
Prepaid expenses, deposits and other current assets	67,190	68,921
Total current assets	583,120	511,778
Property and equipment, at cost	1,072,057	1,016,767
Less accumulated depreciation	(506,869)	(441,288)
Property and equipment, net	565,188	575,479
Goodwill, net	777,540	657,211
Intangible assets, net	113,760	120,946
Other assets and investments	297,057	317,039
Total assets	$ 2,336,665	$ 2,182,453
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Debt payments due within one year	$ 138,767	$ 43,384
Accounts payable	55,561	64,635
Accrued liabilities	162,552	152,665
Total current liabilities	356,880	260,684
Deferred income taxes	34,576	33,809
Other long-term liabilities	87,991	96,048
Long-term debt, excluding current installments	1,189,449	1,196,083
Total liabilities	1,668,896	1,586,624
Commitments and contingencies		
Stockholders equity:		
Class A common stock, par value $0.01 per share, 199,300 shares authorized, and 92,765 and 92,601 shares outstanding as of September 30, 2009 and December 31, 2008, respectively	928	926
Additional paid-in capital	649,771	628,356

Accumulated earnings		68,321		58,059
Treasury stock, at cost, 3,130 and 2,608 shares held as of September 30, 2009 and December 31, 2008, respectively		(48,126)		(42,586)
Accumulated other comprehensive income		(3,125)		(48,926)
Total stockholders equity		667,769		595,829
Total liabilities and stockholders equity	$	2,336,665	$	2,182,453

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, 2009 and 2008

(Unaudited, in thousands, except per share amounts)

	Three Months Ended September 30, 2009	2008
Operating revenues:		
Services	$ 222,023	$ 265,430
Sales	17,123	26,505
	239,146	291,935
Operating expenses:		
Cost of services (exclusive of depreciation and amortization)	127,773	157,480
Cost of sales (exclusive of depreciation and amortization)	10,513	17,257
Selling, general and administrative expenses	38,861	41,937
Depreciation and amortization	32,049	36,487
Operating income	29,950	38,774
Other (income) expense:		
Interest expense	22,736	20,920
Equity in earnings of joint ventures	(14,180)	(13,356)
Early extinguishment of debt	(550)	
Other income, net	(27)	(818)
	7,979	6,746
Income before income taxes	21,971	32,028
Income tax expense	6,865	9,862
Net income	$ 15,106	$ 22,166
Basic and diluted net income per share:		
Basic net income per share	$ 0.16	$ 0.24
Diluted net income per share	$ 0.16	$ 0.23
Weighted-average number of shares used in per share calculations:		
Basic shares	92,727	92,841
Diluted shares	94,028	94,626

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, 2009 and 2008

(Unaudited, in thousands, except per share amounts)

	Nine Months Ended September 30, 2009	2008
Operating revenues:		
Services	$ 650,615	$ 764,044
Sales	44,249	90,867
	694,864	854,911
Operating expenses:		
Cost of services (exclusive of depreciation and amortization)	377,678	440,394
Cost of sales (exclusive of depreciation and amortization)	30,898	63,808
Selling, general and administrative expenses	119,479	138,003
Employee termination costs	3,920	2,772
Depreciation and amortization	93,453	106,099
Operating income	69,436	103,835
Other (income) expense:		
Interest expense	62,940	55,745
Equity in earnings of joint ventures	(44,758)	(48,612)
(Gain) loss on early extinguishment of debt	(4,594)	2,960
Other income, net	(1,013)	(1,513)
	12,575	8,580
Income before income taxes	56,861	95,255
Income tax expense	46,599	30,672
Net income	$ 10,262	$ 64,583
Basic and diluted net income per share:		
Basic net income per share	$ 0.11	$ 0.69
Diluted net income per share	$ 0.11	$ 0.68
Weighted-average number of shares used in per share calculations:		
Basic shares	92,577	92,933
Diluted shares	93,859	94,588

See accompanying notes to consolidated financial statements.

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine Months Ended September 30, 2009 and 2008

(Unaudited, in thousands, except per share amounts)

	Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 10,262	$ 64,583
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	93,453	106,099
Change in deferred income taxes	34,350	1,489
Stock-based compensation	25,903	24,348
Non-cash interest expense	11,234	13,184
Undistributed equity in earnings of joint ventures	(13,778)	(24,248)
(Gain) loss on early extinguishment of debt	(4,594)	2,960
Changes in current assets and liabilities, net of effects of acquisitions		
Accounts receivable	4,144	(41,319)
Inventories	2,070	(5,211)
Accounts payable	(8,701)	553
Accrued liabilities	(23,743)	(16,368)
Other current assets and liabilities	45,432	11,078
Other	(38)	4,297
Net cash provided by operating activities	175,994	141,445
Cash flows from investing activities:		
Capital expenditures	(9,135)	(10,886)
Wagering systems expenditures	(44,870)	(119,327)
Other intangible assets and software expenditures	(26,040)	(33,711)
Change in other assets and liabilities, net	3,611	(1,826)
Business acquisitions, net of cash acquired	(89,453)	(3,174)
Net cash used in investing activities	(165,887)	(168,924)
Cash flows from financing activities:		
Net repayments under revolving credit facility		(158,000)
Proceeds from issuance of long-term debt	259,658	797,243
Payment on long-term debt	(183,632)	(447,069)
Payment of financing fees	(11,535)	(15,085)
Purchases of treasury stock	(5,539)	(18,017)
Net proceeds from issuance of common stock	2,191	3,020
Net cash provided by financing activities	61,143	162,092
Effect of exchange rate changes on cash and cash equivalents	1,189	(2,246)
Increase in cash and cash equivalents	72,439	132,367
Cash and cash equivalents, beginning of period	140,639	29,403
Cash and cash equivalents, end of period	$ 213,078	$ 161,770

See accompanying notes to consolidated financial statements.

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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, 2009, the Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and 2008, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008, have been prepared by Scientific Games Corporation and are unaudited. When used in these notes, the terms we, us, our and 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, 2009, the results of our operations for the three and nine months ended September 30, 2009 and 2008 and our cash flows for the nine months ended September 30, 2009 and 2008 have been made. Management has evaluated subsequent events through the date of financial statement issuance on November 9, 2009.

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 Current Report on Form 8-K filed on May 18, 2009 (which retrospectively adjusted portions of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 to reflect a change in accounting principle to reflect our adoption, effective January 1, 2009, of new Financial Accounting Standards Board (FASB) guidance on accounting for convertible debt instruments that may be settled in cash upon conversion). The results of operations for the period ended September 30, 2009 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 nine months ended September 30, 2009 and 2008:

	Three Months Ended September 30,	**Nine Months Ended September 30,**

	2009	2008	2009	2008
Income (numerator)				
Net income	$ 15,106	$ 22,166	$ 10,262	$ 64,583
Shares (denominator)				
Weighted-average basic common shares outstanding	92,727	92,841	92,577	92,933
Effect of dilutive securities-stock rights	1,301	1,785	1,282	1,649
Effect of dilutive shares related to convertible debentures				6
Weighted-average diluted common shares outstanding	94,028	94,626	93,859	94,588
Basic and diluted per share amounts				
Basic net income per share	$ 0.16	$ 0.24	$ 0.11	$ 0.69
Diluted net income per share	$ 0.16	$ 0.23	$ 0.11	$ 0.68

The weighted-average diluted common shares outstanding for the three and nine months ended September 30, 2009 excludes the effect of approximately 5,774 and 6,470 weighted-average stock rights outstanding, respectively, because their effect would be anti-dilutive. The weighted-average diluted common shares outstanding for the three and nine months ended September 30, 2008 excludes the effect of approximately 3,744 and 3,563 weighted-average stock rights outstanding, respectively, because their effect would be anti-dilutive.

The aggregate number of shares that we could be obligated to issue upon conversion of the remaining $99,191 in aggregate principal amount of our 0.75% convertible senior subordinated notes due 2024 (the Convertible Debentures), is approximately 3,409. The Convertible Debentures provide for net share settlement upon conversion. In December 2004, we purchased a bond hedge to mitigate the potential dilution from conversion of the Convertible Debentures during the term of the bond hedge.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

(1) Consolidated Financial Statements (continued)

During each of the first, second and third quarters of 2009, the average price of our common stock was lower than the conversion price of the Convertible Debentures. Therefore, no shares related to the Convertible Debentures were included in our weighted-average diluted common shares outstanding for the three and nine months ended September 30, 2009. During the third quarter of 2008, the average price of our common stock was lower than the conversion price of the Convertible Debentures. Therefore, no shares related to the Convertible Debentures were included in our weighted-average diluted common shares outstanding for the three months ended September 30, 2008. During the second quarter of 2008, the average price of the Company s common stock exceeded the conversion price of the Convertible Debentures; therefore, we have included approximately 6 shares related to our Convertible Debentures in our weighted-average diluted common shares outstanding for the nine-month period ended September 30, 2008.

(2) Operating Segment Information

We operate in three segments. Our Printed Products Group provides lotteries with instant tickets and related services that include 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 access to a licensed property portfolio and manufactures prepaid phone cards for cellular phone service providers. Our Lottery Systems Group offers online, instant and video lottery products and online and instant ticket validation systems. This division also provides 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. Our 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 of the Diversified Gaming Group include server-based gaming machines, video lottery terminals (VLTs), monitor games, wagering systems for the pari-mutuel racing industry, sports betting systems and services, and Great Britain regulated Category C Amusement With Prize (AWP) and Skill With Prize (SWP) terminals. This division also includes our pari-mutuel gaming operations in Connecticut, Maine and the Netherlands.

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

(2) Operating Segment Information (continued)

The following tables represent revenues, profits, depreciation, amortization and selling, general and administrative expenses for the three and nine month periods ended September 30, 2009 and 2008, by reportable segments. Corporate expenses, including interest expense, other income, and depreciation and amortization, are not allocated to the reportable segments.

	Three Months Ended September 30, 2009			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 117,744	$ 52,343	$ 51,936	$ 222,023
Sales revenues	3,035	13,144	944	17,123
Total revenues	$ 120,779	$ 65,487	$ 52,880	$ 239,146
Cost of services (exclusive of depreciation and amortization)	$ 69,897	$ 26,741	$ 31,135	$ 127,773
Cost of sales (exclusive of depreciation and amortization)	2,199	7,733	581	10,513
Selling, general and administrative expenses	11,768	8,169	5,614	25,551
Depreciation and amortization	8,216	11,452	12,209	31,877
Segment operating income	$ 28,699	$ 11,392	$ 3,341	$ 43,432
Unallocated corporate costs				13,482
Consolidated operating income				$ 29,950

	Three Months Ended September 30, 2008			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 147,142	$ 62,354	$ 55,934	$ 265,430
Sales revenues	7,431	15,072	4,002	26,505
Total revenues	$ 154,573	$ 77,426	$ 59,936	$ 291,935
Cost of services (exclusive of depreciation and amortization)	$ 91,459	$ 32,597	$ 33,424	$ 157,480
Cost of sales (exclusive of depreciation and amortization)	4,423	11,581	1,253	17,257
Selling, general and administrative expenses	14,330	6,860	5,449	26,639
Depreciation and amortization	9,276	15,409	11,519	36,204

Segment operating income	$	35,085	$	10,979	$	8,291	$	54,355
Unallocated corporate costs								15,581
Consolidated operating income							$	38,774

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

(2) Operating Segment Information (continued)

	Nine Months Ended September 30, 2009			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 340,616	$ 159,414	$ 150,585	$ 650,615
Sales revenues	9,776	31,088	3,385	44,249
Total revenues	$ 350,392	$ 190,502	$ 153,970	$ 694,864
Cost of services (exclusive of depreciation and amortization)	$ 202,608	$ 83,511	$ 91,559	$ 377,678
Cost of sales (exclusive of depreciation and amortization)	6,728	22,027	2,143	30,898
Selling, general and administrative expenses	34,141	23,042	17,283	74,466
Employee termination costs	2,016	125	433	2,574
Depreciation and amortization	24,095	32,882	35,959	92,936
Segment operating income	$ 80,804	$ 28,915	$ 6,593	$ 116,312
Unallocated corporate costs				45,530
Corporate employee termination costs				1,346
Consolidated operating income				$ 69,436

	Nine Months Ended September 30, 2008			
	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Service revenues	$ 421,153	$ 178,332	$ 164,559	$ 764,044
Sales revenues	24,648	47,335	18,884	90,867
Total revenues	$ 445,801	$ 225,667	$ 183,443	$ 854,911
Cost of services (exclusive of depreciation and amortization)	$ 249,650	$ 92,429	$ 98,315	$ 440,394
Cost of sales (exclusive of depreciation and amortization)	16,309	38,352	9,147	63,808
Selling, general and administrative expenses	45,088	25,742	19,493	90,323
Employee termination costs	2,772			2,772
Depreciation and amortization	28,728	45,765	30,774	105,267
Segment operating income	$ 103,254	$ 23,379	$ 25,714	$ 152,347
Unallocated corporate costs				48,512

Consolidated operating income	$	103,835

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

(2) Operating Segment Information (continued)

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

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Reported segment operating income	$ 43,432	$ 54,355	$ 116,312	$ 152,347
Unallocated corporate costs	(13,482)	(15,581)	(45,530)	(48,512)
Corporate employee termination costs			(1,346)	
Consolidated operating income	29,950	38,774	69,436	103,835
Interest expense	(22,736)	(20,920)	(62,940)	(55,745)
Equity in income of joint ventures	14,180	13,356	44,758	48,612
Gain (loss) on early extinguishment of debt	550		4,594	(2,960)
Other income, net	27	818	1,013	1,513
Income before income taxes	$ 21,971	$ 32,028	$ 56,861	$ 95,255

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 our Notes to Consolidated Financial Statements in our Current Report on Form 8-K, filed on May 18, 2009).

(3) Equity Investments in Joint Ventures

We are a member of Consorzio Lotterie Nazionali (CLN), a consortium consisting principally of us, Lottomatica S.p.A, and Arianna 2001, a company owned by the Federation of Italian Tobacconists. The consortium holds a concession from the Italian Monopoli di Stato to be the exclusive operator of the Italian Gratta e Vinci instant lottery. The concession commenced in mid-2004 and has an initial term of six years with a six-year extension option at the option of the Monopoli di Stato. Under our contract with CLN, we supply instant lottery tickets, game development services, marketing support, the instant ticket management system and systems support. We also participate in the profits or losses of CLN as a 20% equity owner, and assist Lottomatica S.p.A in the lottery operations. We account for this investment using the equity method of accounting. For the three and nine months ended September 30, 2009, we recorded income of $11,235 and $37,812, respectively, representing our share of the earnings of CLN in each period. For the three and nine months ended September 30, 2008, we recorded income of $12,015 and $42,977, respectively, representing our share of the earnings of CLN for the indicated periods. During the second quarter of 2009, we received a cash distribution of approximately $28.0 million from CLN.

On October 12, 2009, the members of CLN tendered for a new concession to operate the Gratta e Vinci instant ticket lottery upon the termination of CLN s current concession. Although a maximum of four concessions can be granted by the terms of the tender, we understand that our bidding group was the only group to submit a bid. The concession, anticipated to begin in June 2010, will have an initial term of nine years (subject to a performance evaluation during the fifth year) and may be extended by the Monopoli di Stato for an additional nine years. Pricing for the new concession is set at 11.9% of retail sales, inclusive of retailer commissions of 8.0%, compared to the current tiered pricing structure, which averaged 12.1% of retail sales in the second quarter of 2009 inclusive of retailer commissions of 8.0% and a value-added tax (VAT). The new rate is exclusive of VAT; however VAT will be charged on the operating expenses of the concessionaire.

A non-bidding third party filed a request with the TAR Lazio (Rome Administrative Court) seeking the suspension and annulment of the tender. We understand that the request claims that the tender is discriminatory and that it unlawfully limits competition. The request to suspend the tender was denied in hearings on October 14 and October 28, 2009. Another hearing has been scheduled for November 11, 2009 to address the request for annulment. We currently expect the results of the tender to be published in mid-November 2009. In the event that the request for annulment is granted, we cannot predict what actions, if any, the Italian government or Monopoli di Stato will take, including potentially passing new legislation, amending the tender procedures, issuing new tender procedures or exercising its option to extend CLN s current concession.

In the event that our bidding group is the sole bidding group to be awarded a concession, our bidding group would be obligated to make upfront payments of 520,000 and 280,000 on or about November 30, 2009 and November 30, 2010, respectively. We would be responsible for our pro rata share of these payments (which would be 104,000 and 56,000, respectively, assuming our ownership interest in the entity that holds the concession remains at 20%). In conjunction with the submission of its bid, our bidding group provided bank guarantees to support a 40,000 bid guarantee and a 75,000 performance guarantee. We guaranteed our pro rata share of these guarantees through the issuance of 23,000 of letters of credit under our revolving credit facilities.

There can be no assurance that our bidding group will be awarded a concession to continue to operate the instant ticket lottery following the termination of CLN s current concession or whether other operators will also be awarded a concession. In addition, there can be no assurance that we will continue to supply instant lottery tickets and/or other services under any future arrangements. In the event that our bidding group is awarded a concession, we anticipate that our bidding group will form and capitalize a new vehicle to hold the concession consistent with the tender requirements. We have entered into a memorandum of understanding with our current CLN partners with respect to the formation and governance of any new concession vehicle on terms substantially similar to the terms governing CLN. However, we cannot guarantee that we will be able to enter into definitive governing agreements, nor can we predict the final terms of any such definitive agreements (including terms relating to the structure of the vehicle and governance rights).

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, in thousands, except per share amounts)

(4) Comprehensive Income

The following presents a reconciliation of net income to comprehensive income for the three and nine month periods ended September 30, 2009 and 2008:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net income	$ 15,106	$ 22,166	$ 10,262	$ 64,583
Other comprehensive income (loss):				
Foreign currency translation gain (loss)	5,343	(40,808)	43,651	(22,180)
Gain on derivative financial instruments	1,349		2,150	
Unrealized loss on investments				(181)
Other comprehensive income	6,692	(40,808)	45,801	(22,361)
Comprehensive income	$ 21,798	$ (18,642)	$ 56,063	$ 42,222

(5) Inventories

Inventories consist of the following:

	September 30, 2009	December 31, 2008
Parts and work-in-process	$ 29,351	$ 36,449
Finished goods	46,407	38,922
	$ 75,758	$ 75,371

Point of sale terminals we manufacture 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.

(6) Long-Term Debt

On May 21, 2009, Scientific Games International, Inc. (SGI) issued $225,000 in aggregate principal amount of its 9.25% Senior Subordinated Notes due 2019 (the 2009 Notes) at an issue price of 96.823% of the principal amount. The 2009 Notes were issued pursuant to an indenture dated as of May 21, 2009 (the 2009 Notes Indenture) among SGI, as issuer, the Company, as a guarantor, the Company s subsidiary guarantors party thereto and The Bank of Nova Scotia Trust Company of New York, as trustee.

The 2009 Notes bear interest at the rate of 9.25% per annum, which accrues from May 21, 2009 and is payable semiannually in arrears on June 15 and December 15 of each year, commencing on December 15, 2009. The 2009 Notes mature on June 15, 2019, unless earlier redeemed or repurchased, and are subject to the terms and conditions set forth in the 2009 Notes Indenture.

SGI may redeem some or all of the 2009 Notes at any time prior to June 15, 2014 at a price equal to 100% of the principal amount of the 2009 Notes plus accrued and unpaid interest, if any, to the date of redemption plus a make whole premium. SGI may redeem some or all of the 2009 Notes for cash at any time on or after June 15, 2014 at the prices specified in the 2009 Notes Indenture. In addition, at any time on or prior to June 15, 2012, SGI may redeem up to 35% of the initially outstanding aggregate principal amount of the 2009 Notes at a redemption price of 109.25% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of redemption, with the net cash proceeds contributed to the capital of SGI from one or more equity offerings of the Company. Additionally, if a holder of the 2009 Notes is required to be licensed, qualified or found suitable under any applicable gaming laws or regulations and that holder does not become so licensed or qualified or is not found to be suitable, then SGI will have the right to, subject to certain notice provisions set forth in the 2009 Notes Indenture, (1) require that holder to dispose of all or a portion of those Notes or (2) redeem the 2009 Notes of that holder at a redemption price calculated as set forth in the 2009 Notes

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(6) Long-Term Debt (continued)

Indenture. If the Company or SGI experiences specific kinds of changes in control or the Company or any of its restricted subsidiaries sells certain of its assets, then SGI must offer to repurchase the 2009 Notes on the terms set forth in the 2009 Notes Indenture.

The 2009 Notes are unsecured senior subordinated obligations of SGI and are subordinated to all of SGI s existing and future senior debt, rank equally with all of SGI s existing and future senior subordinated debt and rank senior to all of SGI s future debt that is expressly subordinated to the 2009 Notes. The 2009 Notes are structurally subordinated to all of the liabilities of the Company s non-guarantor subsidiaries.

The 2009 Notes are guaranteed on an unsecured senior subordinated basis by the Company and all of its 100%-owned domestic subsidiaries (other than SGI). The guarantees of the 2009 Notes are subordinated to all of the guarantors existing and future senior debt, rank equally with all of their existing and future senior subordinated debt, and rank senior to all of their future debt that is expressly subordinated to the guarantees of the 2009 Notes. The 2009 Notes are structurally subordinated to all of the liabilities of the Company s non-guarantor subsidiaries.

The 2009 Notes Indenture contains certain covenants that, among other things, limit the Company s ability, and the ability of certain of its subsidiaries, to incur additional indebtedness, pay dividends or make distributions or certain other restricted payments, purchase or redeem capital stock, make investments or extend credit, engage in certain transactions with affiliates, engage in sale-leaseback transactions, consummate certain assets sales, effect a consolidation or merger, or sell, transfer, lease or otherwise dispose of all or substantially all assets, or create certain liens and other encumbrances on assets.

The 2009 Notes Indenture contains events of default customary for agreements of its type (with customary grace periods, as applicable) and provides that, upon the occurrence of an event of default arising from certain events of bankruptcy or insolvency with respect to the Company or SGI, all outstanding Notes will become due and payable immediately without further action or notice. If any other type of event of default occurs and is continuing, then the trustee or the holders of at least 25% in principal amount of the then outstanding Notes may declare all the 2009 Notes to be due and payable immediately.

The 2009 Notes were issued in a private offering to qualified institutional buyers in accordance with Rule 144A under the Securities Act of 1933, as amended, (the Securities Act) and to persons outside the United States under Regulation S under the Securities Act. In connection with the issuance of the 2009 Notes, SGI, the Company, the Company s subsidiary guarantors party thereto, and J.P. Morgan Securities Inc., Banc of America Securities LLC, Credit Suisse Securities (USA) LLC and Goldman, Sachs & Co., as representatives for the initial purchasers listed therein, entered into a registration rights agreement, dated May 21, 2009 (the Registration Rights Agreement). Under the Registration Rights Agreement, SGI and the guarantors agreed, for the benefit of the holders of the 2009 Notes, that they will file with the Securities and Exchange Commission (the SEC) within 90 days after the date the 2009 Notes were issued, and use their commercially reasonable efforts to cause to become effective, a registration statement relating to an offer to exchange the 2009 Notes for an issue of SEC-registered notes (the 2009 Exchange Notes) with terms identical to the 2009 Notes (except that the 2009 Exchange Notes will not be subject to restrictions on transfer or to any increase in annual interest rate as described below).

On September 17, 2009, the Company filed a Registration Statement with the SEC under Form S-4 pursuant to which SGI, offered to exchange all outstanding 2009 Notes that are validly tendered and not validly withdrawn for an equal principal amount of 2009 Exchange Notes that are, subject to specified conditions, freely transferable. The exchange offer was launched on September 15, 2009 and expired at 5:00 p.m., New York City time, on October 26, 2009.

On May 7, 2009, the Company entered into an agreement with the principal selling shareholder and key management of Global Draw Limited (Global Draw) related to the earn-out and contingent bonuses that were payable to them in connection with the Company s 2006 acquisition. Based on the performance of the business, the total amount payable was determined to be approximately £60,600 of which approximately £30,500 was paid in May 2009. Approximately £28,100 of the total amount payable

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(6) Long-Term Debt (continued)

was deferred under the terms of two-year, senior unsecured promissory notes issued by certain of the Company s foreign subsidiaries (and guaranteed by the Company and certain of its U.S. subsidiaries). The earn-out balance of approximately £2,000 was paid in September 2009.

The promissory note issued to the principal selling shareholder, which was executed on May 7, 2009 by Scientific Games Luxembourg Finance S.a.r.l. (SGLF), an indirect 100%-owned subsidiary of the Company, has a principal amount of approximately £26,000 and bears simple interest at the rate of 6.90% per annum, which interest is payable quarterly in arrears on the last day of March, June, September and December of each year, commencing on June 30, 2009. The note matures on May 7, 2011. Although not required to do so (except in connection with an event of default as described below), SGLF may repay all or a portion of the principal amount of the note at any time prior to maturity without premium or penalty. The note is a senior unsecured obligation of SGLF and is guaranteed on a joint and several basis by the Company and certain of its 100%-owned domestic subsidiaries (including SGI). Such guaranty represents senior debt as that term is defined in the indentures governing the Company s 6.25% Senior Subordinated Notes due 2012 (the 2004 Notes), the Convertible Debentures, SGI s 7.875% Senior Subordinated Notes due 2016 (the 2008 Notes) and the 2009 Notes.

If an event of default under the note shall occur and be continuing, the holder of the note may declare the principal amount of, and accrued interest on, the note to be immediately due and payable. An event of default under the note shall occur if (1) SGLF shall fail to pay the then unpaid principal amount under the note within 15 days after the maturity date or any interest payment that is due and payable within 15 days after the applicable interest payment date, or (2) an event of default (as defined in the Credit Agreement (as defined below)) shall occur and be continuing and, as a result thereof, the amounts owing under the Credit Agreement immediately become due and payable.

The terms of the promissory notes issued to key management of Global Draw and the related guaranties are substantially identical to the note and guaranties described above, except that one of the notes was issued by a different foreign subsidiary of the Company.

On March 27, 2009, we and our 100%-owned subsidiary, SGI, entered into an amendment (the First Amendment) to the credit agreement, dated as of June 9, 2008 (the Credit Agreement), among SGI, as borrower, the Company, as guarantor, the several lenders from time to time parties thereto and JPMorgan Chase Bank, N.A. (JPMorgan), as administrative agent The purpose of the First Amendment was to provide the Company with additional operating and financing flexibility.

Under the First Amendment, (i) up to approximately $18,800 in certain charges incurred and reserves created in the fourth quarter of 2008, (ii) up to $15,000 of certain charges that may be incurred during the 12-month period commencing on March 1, 2009, including charges in connection with cost-reduction initiatives, and (iii) certain costs and fees incurred in connection with the First Amendment, will be added back to Consolidated EBITDA for purposes of calculating the Consolidated Leverage Ratio and the Consolidated Senior Debt Ratio (as such terms are defined under the Credit Agreement). In addition, for purposes of determining the Consolidated Leverage Ratio and the Consolidated Senior Debt Ratio as of any date prior to the earliest date on which any of the holders of Convertible Debentures may require the Company to repurchase their Convertible Debentures (currently June 1, 2010) (the Convertible Debentures Repurchase Date) neither (i) the earn-out payable with respect to the Company s acquisition of Global Draw nor (ii) the principal amount of any unsecured promissory notes that may be issued in order to defer payment of up to the equivalent of $60,000 of such earn-out (provided that, among other terms of such promissory notes, no principal payment thereon is required prior to September 30, 2010), will be included as Indebtedness in the calculation of Consolidated Total Debt (as such terms are defined in the Credit Agreement). Accordingly, the promissory notes described above that were issued to the principal selling shareholder and key management of Global Draw will not be included as Indebtedness in the calculation of Consolidated Total Debt for purposes of determining the Consolidated Leverage Ratio and the Consolidated Senior Debt Ratio prior to the Convertible Debenture Repurchase Date.

In conjunction with the promissory notes issued to defer payment of a portion of the Global Draw earn-out, the revolving credit facility and the term loan facility under the Credit Agreement will mature (if earlier than the date that would otherwise apply under the terms of the Credit Agreement) on February 7, 2011 unless on such date no such promissory notes remain outstanding or the sum of the aggregate available revolving commitments under the Credit Agreement plus unrestricted cash and cash equivalents of SGI and the guarantors under the Credit Agreement is not less than $50,000 in excess of the amount required to repay in full such outstanding promissory notes.

Under the First Amendment, for purposes of determining the Consolidated Leverage Ratio as of any date of determination prior to the earlier of the Convertible Debentures Repurchase Date and the date the Convertible Debentures are redeemed in full, unrestricted cash and cash equivalents of SGI and the guarantors up to the Debenture Reserve Amount at such determination date will be netted against the then outstanding principal amount of the Convertible Debentures (and Consolidated Total Debt will be thereby reduced to the extent of such netting). The Debenture Reserve Amount is an amount equal to the net cash proceeds received by SGI or the guarantors after the date of the First Amendment and prior to the Convertible Debentures Repurchase Date from (i) the issuance by the

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(6) Long-Term Debt (continued)

Company of shares of its capital stock (other than disqualified stock), or the issuance of Permitted Additional Senior Indebtedness or Permitted Additional Subordinated Debt, or Indebtedness under the Incremental Facilities (as such terms are defined in the Credit Agreement), and (ii) any Asset Sales (as defined in the Credit Agreement) (up to an aggregate of $125,000 of net cash proceeds) with respect to which a reinvestment notice is timely given (provided that the Debenture Reserve Amount will (A) not exceed the outstanding principal amount of the Convertible Debentures, (B) be reduced to zero on the Convertible Debentures Repurchase Date and (C) to the extent the Debenture Reserve Amount is increased as a result of Assets Sales, will be decreased if and to the extent that term loans under the Credit Agreement are prepaid in lieu of reinvesting the net cash proceeds there from pursuant to a reinvestment notice). The 2009 Notes constitute Permitted Additional Subordinated Debt and, as such, the net cash proceeds from the issuance of such notes will be included in the Debenture Reserve Amount to the extent permitted under the First Amendment.

The First Amendment increased each of the interest rates set forth in the pricing grid in the Credit Agreement by 0.25% such that, depending upon the Consolidated Leverage Ratio, the interest rate will vary from 2.00% to 3.00% above LIBOR for eurocurrency loans, and 1.00% to 2.00% above the higher of (i) the prime rate or (ii) the Federal Funds Effective Rate plus 0.50% for base rate loans. Notwithstanding the foregoing, from the Effective Date (as defined in the Credit Agreement) until September 30, 2009, the applicable margin for eurocurrency loans was deemed to be 3.00% and the applicable margin for base rate loans was deemed to be 2.00%.

In connection with the First Amendment, SGI agreed to pay an aggregate of approximately $2,800 in fees to consenting lenders and the administrative agent.

On September 30, 2009, the Company and SGI entered into a second amendment (the Second Amendment) to the Credit Agreement. The primary purpose of the Second Amendment was to facilitate our ability to participate in the recently announced competitive tender process for a license to sell instant lottery tickets under the Gratta e Vinci lottery in Italy.

The Second Amendment provides that certain payments, costs and obligations made or incurred by any of the Company or its subsidiaries, whether directly or indirectly, in connection with any award of a license to operate the instant ticket lottery (the Italian Concession), including any up-front fee required under the tender process (collectively, Italian Concession Obligations), will be permitted, subject to certain limitations, under the Credit Agreement covenant restricting Investments (as defined in the Credit Agreement) (to the extent such Italian Concession Obligations are deemed to be Investments under the Credit Agreement). Certain Guarantee Obligations (as defined in the Credit Agreement) incurred by any of the Company or its subsidiaries in respect of certain Italian Concession Obligations will be permitted under the Credit Agreement covenant restricting Indebtedness. In addition, the Second Amendment provides that certain Italian Concession Obligations paid or incurred in an applicable period will be added back to the definition of Consolidated EBITDA to the extent such Italian Concession Obligations are treated as an expense in the period paid or incurred.

The Second Amendment provides further that, in lieu of any required prepayment of term loans under the Credit Agreement, the net cash proceeds from any Asset Sale or Recovery Event (as defined in the Credit Agreement) may, during the 12-month reinvestment period, be applied to make or incur any Investment to fund or satisfy any Italian Concession Obligations not yet made or satisfied (or, under certain circumstances, may be deemed to apply to any Investment that is made or incurred to fund or satisfy Italian Concession Obligations already funded or satisfied).

In addition, pursuant to the Second Amendment, we will be required to maintain the following revised financial ratios during the following relevant periods:

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- a Consolidated Leverage Ratio as at the last day of each fiscal quarter no more than the ratio set forth below with respect to such fiscal quarter or with respect to the period during which such fiscal quarter ends:

- 4.25 to 1.00 (fiscal quarter ended June 30, 2008 through September 30, 2009);

- 4.75 to 1.00 (fiscal quarter ended December 31, 2009 through December 31, 2010);

- 4.50 to 1.00 (fiscal quarter ended March 31, 2011 through December 31, 2011);

- 4.25 to 1.00 (fiscal quarter ended March 31, 2012 through September 30, 2012); and

- 4.00 to 1.00 (fiscal quarter ending December 31, 2012 and thereafter);

- a Consolidated Senior Debt Ratio as at the last day of each fiscal quarter no more than the ratio set forth below with respect to such fiscal quarter or with respect to the period during which such fiscal quarter ends:

- 2.50 to 1.00 (fiscal quarter ended June 30, 2008 through September 30, 2009);

- 2.75 to 1.00 (fiscal quarter ended December 31, 2009 through December 31, 2010); and

- 2.50 to 1.00 (fiscal quarter ended March 31, 2011 and thereafter);

- a Consolidated Interest Coverage Ratio (as defined in the Credit Agreement) for any period of four consecutive fiscal quarters of not less than the ratio set forth below with respect to such period or with respect to the period during which such four consecutive fiscal quarters ends:

- 3.50 to 1.00 (four consecutive fiscal quarters ending on or prior to September 30, 2009); and

- 3.00 to 1.00 (four consecutive fiscal quarters ending December 31, 2009 and thereafter).

Pursuant to the Second Amendment, certain additional dispositions will be permitted under the Credit Agreement covenant restricting Dispositions, including, subject to certain limitations, dispositions pursuant to certain permitted investments such as permitted investments in Non-Guarantor Subsidiaries, joint ventures and Permitted Acquisitions (as such terms are defined in the Credit Agreement).

The interest rates set forth in the pricing grid in the Credit Agreement will be unchanged, except that, pursuant to the Second Amendment, an interest rate level will be added to the top of the grid such that, if the Consolidated Leverage Ratio as of the most recent determination date is equal to or greater than 4.25 to 1 (and, in any event, for the six-month period beginning on September 30, 2009), the interest rate will be 3.25% above LIBOR for eurocurrency loans, and 2.25% above the higher of (i) the prime rate or (ii) the Federal Funds Effective Rate plus 0.50% for base rate loans.

The Second Amendment also provides that the commitment fee rate payable in respect of the available revolving credit facility commitments under the Credit Agreement will be (i) 0.50% per annum if the Consolidated Leverage Ratio as of the most recent determination date is less than 4.25 to 1.00 or (ii) 0.75% per annum if the Consolidated Leverage Ratio as of the most recent determination date is greater than or equal to 4.25 to 1.00 (and, in any event, for the six-month period beginning on September 30, 2009).

In connection with the Second Amendment, SGI agreed to pay an aggregate of approximately $2,800 in fees to consenting lenders and the administrative agent.

On September 30, 2009, we had $201,408 of availability under our revolving credit facility. There were no borrowings and $48,592 in outstanding letters of credit under our revolving credit facility as of September 30, 2009.

We were in compliance with our debt covenants as of September 30, 2009.

The Company may, from time to time, seek to retire or purchase its outstanding debt in open market purchases, in privately negotiated transactions, or otherwise. Any such retirement or purchase of debt may be funded by cash flows from operations, borrowings or other sources and will depend upon prevailing market conditions, liquidity requirements, contractual restrictions and other factors, and the amounts involved may be material. During the three and nine months ended September 30, 2009, we repurchased approximately $43,188 and $174,591, respectively, in aggregate principal amount of our Convertible Debentures for approximately $42,369 and $166,372, respectively, in cash under our previously announced Convertible Debenture repurchase program. During the three and nine months ended September 30, 2009, we recognized a gain on early extinguishment of debt of approximately $550 and $4,239, respectively, from the Convertible Debenture repurchase program. During the nine months ended September 30, 2009, we repurchased approximately $12,925 in aggregate principal amount of our 2004 Notes for approximately $12,396 in cash under our previously announced 2004 Notes repurchase program. During the nine months ended September 30, 2009, we recognized a gain on early extinguishment of debt of approximately $355 from the 2004 Notes repurchase program.

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(Unaudited, in thousands, except per share amounts)

(6) Long-Term Debt (continued)

During the second and third quarters of 2009, in connection with repurchases made under our Convertible Debenture repurchase program, we unwound a corresponding portion of the convertible bond hedge and warrant option transactions that we entered into in December 2004 in connection with the original issuance of the Convertible Debentures such that the number of call options held by us under the bond hedge was reduced from 275 to approximately 99 and the number of warrants held by the warrant counterparties was reduced from approximately 9,450 to approximately 3,409. We received a net cash settlement of approximately $130 and $1,334, respectively, during the three and nine months ended September 30, 2009 as a result of this unwinding of a portion of the convertible bond hedge and warrant option transactions. For additional information on the bond hedge and warrants, refer to Note 8 of the Notes to Consolidated Financial Statements included in our Current Report on Form 8-K filed on May 18, 2009.

On January 1, 2009, we adopted new FASB guidance on accounting for convertible debt instruments that may be settled in cash upon conversion (the New Convertible Debt Guidance). The New Convertible Debt Guidance clarifies that convertible debt instruments that may be settled in cash upon conversion are not addressed by previous convertible debt accounting guidance and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The New Convertible Debt Guidance was effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and was required to be applied retrospectively to all periods presented. The impact of adoption was an adjustment to accumulated earnings of approximately $22,600 representing the cumulative effect of a change in accounting principle as of January 1, 2007.

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(6) Long-Term Debt (continued)

The adoption of the New Convertible Debt Guidance had the following effect on our Consolidated Statements of Operations for the three and nine months ended September 30, 2008:

	Three Months Ended September 30, 2008			Nine Months Ended September 30, 2008		
	Previously Reported	As Adjusted	Effect of Change	Previously Reported	As Adjusted	Effect of Change
Interest expense	$ 17,659	$ 20,920	$ 3,261	$ 45,962	$ 55,745	$ 9,783
Income tax expense	9,879	9,862	(17)	30,725	30,672	(53)
Net income	25,410	22,166	(3,244)	74,313	64,583	(9,730)
Basic net income per share	$ 0.27	$ 0.24	$ (0.03)	$ 0.80	$ 0.69	$ (0.11)
Diluted net income per share	$ 0.27	$ 0.23	$ (0.04)	$ 0.79	$ 0.68	$ (0.11)

The adoption of the New Convertible Debt Guidance had the following effect on our Consolidated Balance Sheet as of December 31, 2008:

	December 31, 2008		
	Previously Reported	As Adjusted	Effect of Change
Other assets and investments	$ 317,818	$ 317,039	$ (779)
Long-term debt, excluding current installments	1,216,264	1,196,083	(20,181)
Additional paid-in capital	561,202	628,356	67,154
Accumulated earnings	105,811	58,059	(47,752)

As of January 1, 2008, the cumulative effect of the change in accounting principle on accumulated earnings and additional paid-in capital was approximately $34,800 and $67,200, respectively.

The adoption of the New Convertible Debt Guidance had the following effect on our Consolidated Statement of Cash Flows for the nine months ended September 30, 2008:

	Nine Months Ended September 30, 2008		
	Previously Reported	As Adjusted	Effect of Change
Cash flows from operating activities:			
Net income	$ 74,313	$ 64,583	$ (9,730)
Change in deferred income taxes	1,542	1,489	(53)
Non-cash interest expense	3,401	13,184	9,783

As of September 30, 2009 and December 31, 2008, the equity component of the Convertible Debentures under the New Convertible Debt Guidance was approximately $62,234 and $68,592, respectively. The following represents the principal amount of the liability component, the unamortized discount, and the net carrying amount of our convertible debt instruments as of September 30, 2009 and December 31, 2008, respectively:

	September 30, 2009	December 31, 2008
Principal	$ 99,191	$ 273,782
Unamortized discount	(3,439)	(20,181)
Net carrying amount	$ 95,752	$ 253,601

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(6) Long-Term Debt (continued)

As of September 30, 2009, the remaining discount will be amortized over a period of approximately eight months. The conversion price of the remaining $99,191 in aggregate principal amount of the Convertible Debentures is $29.10 and the aggregate number of shares that we could be obligated to issue upon conversion is approximately 3,409.

The effective interest rate on the liability component of the Convertible Debentures is approximately 6.25% for the three and nine months ended September 30, 2009 and 2008. The amount of interest cost recognized for the contractual interest coupon during the three and nine months ended September 30, 2009 was approximately $213 and $1,109, respectively. The amount of interest cost recognized for the contractual interest coupon during the three and nine months ended September 30, 2008 was approximately $513 and $1,540, respectively. The amount of interest cost recognized for the amortization of the discount on the liability component of the Convertible Debentures during the three and nine months ended September 30, 2009 was approximately $1,514 and $7,598, respectively. The amount of interest cost recognized for the amortization of the discount on the liability component of the Convertible Debentures during the three and nine months ended September 30, 2008 was approximately $3,362 and $9,783, respectively.

(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 September 30, 2009, the Hedge was measured at a fair value of $4,490 using Level 2 valuation techniques of the fair value hierarchy and included in other long-term liabilities on the Consolidated Balance Sheet.

We believe we have matched the critical terms of the hedged variable-rate debt with the Hedge and expect the Hedge to be highly effective in offsetting changes in the expected cash flows due to fluctuation in the three-month LIBOR-based rate over the term of the forecasted interest payments related to the $100,000 notional amount of variable-rate debt. 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 Statement of Operations. During the three and nine months ended September 30, 2009, we recorded a gain of approximately $1,349 and $2,150, respectively in other comprehensive income (loss). There was no ineffective portion of the Hedge recorded in the Consolidated Statement of Operations. Amounts recorded in other comprehensive income (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.

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(8) Goodwill and Intangible Assets

The following disclosure presents certain information regarding our acquired intangible assets as of September 30, 2009 and December 31, 2008. 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 September 30, 2009			
Amortizable intangible assets:			
Patents	$ 12,117	$ (3,506)	$ 8,611
Customer lists	29,774	(17,004)	12,770
Customer service contracts	3,994	(2,770)	1,224
Licenses	63,917	(39,515)	24,402
Intellectual property	18,694	(15,924)	2,770
Lottery contracts	31,212	(30,678)	534
	159,708	(109,397)	50,311
Non-amortizable intangible assets:			
Trade name	37,827	(2,118)	35,709
Connecticut off-track betting system operating right	36,059	(8,319)	27,740
	73,886	(10,437)	63,449
Total intangible assets	$ 233,594	$ (119,834)	$ 113,760
Balance as of December 31, 2008			
Amortizable intangible assets:			
Patents	$ 11,563	$ (2,871)	$ 8,692
Customer lists	28,772	(14,044)	14,728
Customer service contracts	3,892	(2,505)	1,387
Licenses	60,237	(32,615)	27,622
Intellectual property	17,057	(11,425)	5,632
Lottery contracts	27,926	(27,498)	428
	149,447	(90,958)	58,489
Non-amortizable intangible assets:			
Trade name	37,285	(2,118)	35,167
Connecticut off-track betting system operating right	35,609	(8,319)	27,290
	72,894	(10,437)	62,457
Total intangible assets	$ 222,341	$ (101,395)	$ 120,946

The aggregate intangible amortization expense for the three and nine months ended September 30, 2009 was approximately $4,400 and $13,600, respectively. The aggregate intangible amortization expense for the three and nine months ended September 30, 2008 was approximately $6,900 and $21,800, respectively.

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(8) Goodwill and Intangible Assets (continued)

The table below reconciles the change in the carrying amount of goodwill, by reporting segment, for the period from December 31, 2008 to September 30, 2009. In 2009, we recorded (a) a $86,937 increase in goodwill associated with the final purchase price adjustment in accordance with the Global Draw earn-out, and (b) an increase in goodwill of $33,392 as a result of foreign currency translation.

Goodwill	Printed Products Group	Lottery Systems Group	Diversified Gaming Group	Totals
Balance as of December 31, 2008	$ 324,245	$ 190,341	$ 142,625	$ 657,211
Adjustments	3,999	2,554	113,776	120,329
Balance as of September 30, 2009	$ 328,244	$ 192,895	$ 256,401	$ 777,540

(9) Pension and Other Post-Retirement Plans

We have defined benefit pension plans for our U.S.-based union employees, our U.K.-based union employees, and certain Canadian-based employees (the U.S. Plan, the U.K. Plan and the Canadian Plan, respectively). 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 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.

The following table sets forth the combined amount of net periodic benefit cost recognized for the three and nine months ended September 30, 2009 and 2008.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Components of net periodic pension benefit cost:				
Service cost	$ 371	$ 713	$ 1,114	$ 1,964
Interest cost	1,052	1,366	3,156	3,079
Expected return on plan assets	(888)	(1,440)	(2,665)	(3,487)

Amortization of actuarial losses	119	280	357	758
Amortization of prior service costs	11	11	32	32
Net periodic cost	$ 665	$ 930	$ 1,994	$ 2,346

We have a 401(k) plan for U.S.-based employees who are not covered by a collective bargaining agreement. Effective February 28, 2009, we reduced the matching contributions from 50 cents to 25 cents on the dollar for the first 6% of participant contributions for a match of up to 1.5% of eligible compensation.

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(10) Income Taxes

The effective tax rates of 31.2% and 82.0%, respectively, for the three and nine months ended September 30, 2009 were determined using an estimated annual effective tax rate. The effective tax rate for the three and nine months ended September 30, 2009 includes the impact of a valuation allowance against the deferred tax asset related to foreign tax credits and the release of certain FIN 48 reserves related to tax settlements in the third quarter. The effective tax rates of 30.8% and 32.2%, respectively, for the three and nine months ended September 30, 2008 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 earnings from operations outside the United States.

At December 31, 2008, the Company had a deferred tax asset for its foreign tax credit (FTC) carry forward of approximately $40,400. The Company has and will continue to explore tax planning strategies to use all of its FTC but at March 31, 2009, the Company established a valuation allowance of approximately $33,833 against the FTC deferred tax asset to reduce the asset to the net amount management estimates is more likely than not to be realized.

Further, the Company determined it is not more likely than not that the foreign taxes generated in 2009 will be realized in full against its U.S. tax liability during the FTC carry forward period. As a result, the Company s 2009 annual effective income tax rate is greater than the federal statutory rate because of the valuation allowance established against the deferred tax asset for a portion of the FTC generated in 2009.

(11) Stockholders Equity

The following demonstrates the change in the number of shares of Class A common stock outstanding during the three months ended September 30, 2009 and during the fiscal year ended December 31, 2008:

	Three Months Ended September 30, 2009	Twelve Months Ended December 31, 2008
Shares outstanding as of beginning of period	92,642	93,414
Shares issued as part of equity-based compensation plans and the ESPP, net of restricted stock units surrendered for taxes	123	655
Shares repurchased into treasury stock		(1,468)
Shares outstanding as of end of period	92,765	92,601

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(12) Stock-Based Compensation

As of September 30, 2009, we had approximately 3,266 shares available for grants of equity awards under our equity-based compensation plans.

Stock Options

A summary of the changes in stock options outstanding under our equity-based compensation plans during 2009 is presented below: