SCIENTIFIC GAMES CORP
Form 10-Q
May 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

{Mark One}

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

For the quarterly period ended March 31, 2012

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

For the transition period from to

Commission file number: 0-13063

SCIENTIFIC GAMES CORPORATION
(Exact name of registrant as specified in its charter)

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

750 Lexington Avenue, New York, New York 10022
(Address of principal executive offices)
(Zip Code)

(212) 754-2233
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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

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

The registrant has the following number of shares outstanding of each of the registrant's classes of common stock as of May 7, 2012:

Class A Common Stock: 92,777,775
Class B Common Stock: None

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
INDEX TO FINANCIAL INFORMATION
AND OTHER INFORMATION
THREE MONTHS ENDED MARCH 31, 2012

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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,” “continu “believe,” “expect,” “anticipate,” “could,” “potential,” “opportunity,” or similar terminology. The forward-looking statements contained in this Quarterly Report on Form 10-Q are generally located 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 contemplated in these statements due to a variety of risks and uncertainties and other factors, including, among other things: competition; material adverse changes in economic and industry conditions; technological change; retention and renewal of existing contracts and entry into new or revised contracts; availability and adequacy of cash flows to satisfy obligations and indebtedness or future needs; protection of intellectual property; security and integrity of software and systems; laws and government regulation, including those relating to gaming licenses, permits and operations; inability to identify, complete and integrate future acquisitions; inability to benefit from, and risks associated with, strategic equity investments and relationships; failure of Northstar to meet the net income targets or otherwise realize the anticipated benefits under its private management agreement with the Illinois Lottery; seasonality; inability to identify and capitalize on trends and changes in the lottery and gaming industries, including the potential expansion of regulated gaming via the internet; inability to enhance and develop successful gaming concepts; dependence on suppliers and manufacturers; liability for product defects; fluctuations in foreign currency exchange rates and other factors associated with international operations; influence of certain stockholders; dependence on key personnel; failure to perform on contracts; resolution of pending or future litigation; labor matters; and stock price volatility. Additional information regarding risks and uncertainties and other factors that could cause actual results to differ materially from those contemplated in forward-looking statements is included from time to time in our filings with the Securities and Exchange Commission (“SEC”), including under the heading “Risk Factors” in our most recent Annual Report on Form 10-K. Forward-looking statements speak only as of the date they are made and, except for our ongoing obligations under the U.S. federal securities laws, we undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise.

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

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

	March 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$100,403	$104,402
Accounts receivable, net of allowance for doubtful accounts of $5,100 and $4,782 as of March 31, 2012 and December 31, 2011, respectively	177,398	182,467
Inventories	79,825	79,742
Deferred income taxes, current portion	4,799	4,697
Prepaid expenses, deposits and other current assets	36,972	35,805
Total current assets	399,397	407,113
Property and equipment, at cost	803,782	788,529
Less: accumulated depreciation	(384,266)	(362,041)
Net property and equipment	419,516	426,488
Goodwill, net	779,567	768,318
Intangible assets, net	85,351	86,859
Equity investments	356,292	340,494
Other assets	136,020	132,629
Total assets	$2,176,143	$2,161,901
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Debt payments due within one year	$33,819	$26,191
Accounts payable	52,055	66,221
Accrued liabilities	138,902	144,671
Total current liabilities	224,776	237,083
Deferred income taxes	57,248	56,264
Other long-term liabilities	62,969	60,364
Long-term debt, excluding current installments	1,353,566	1,364,476
Total liabilities	1,698,559	1,718,187
Commitments and contingencies		
Stockholders’ equity:		
Class A common stock, par value $0.01 per share, 199,300 shares authorized, 98,505 and 98,181 shares issued and 92,756 and 92,433 shares outstanding as of March 31, 2012 and December 31, 2011, respectively	985	982
Additional paid-in capital	700,226	693,600
Accumulated loss	(141,772)	(143,591)
Treasury stock, at cost, 5,749 shares held as of March 31, 2012 and December 31, 2011	(74,460)	(74,460)
Accumulated other comprehensive loss	(7,395)	(32,817)
Total stockholders’ equity	477,584	443,714
Total liabilities and stockholders’ equity	$2,176,143	$2,161,901

See accompanying notes to consolidated financial statements

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited, in thousands, except per share amounts)

	Three Months Ended March 31, 2012	2011
Revenue:		
Instant tickets	$123,324	$113,860
Services	90,286	73,747
Sales	20,965	9,049
Total revenue	234,575	196,656
Operating expenses:		
Cost of instant tickets (1)	69,963	67,233
Cost of services (1)	45,859	38,922
Cost of sales (1)	16,927	5,690
Selling, general and administrative expenses	46,172	39,554
Employee termination and restructuring costs	2,875	—
Depreciation and amortization	30,518	30,904
Operating income	22,261	14,353
Other (income) expense:		
Interest expense	24,898	26,455
Earnings from equity investments	(8,845)	(9,350)
Other	(478)	(994)
	15,575	16,111
Net income (loss) before income taxes	6,686	(1,758)
Income tax expense	4,867	5,174
Net income (loss)	$1,819	$(6,932)
Other comprehensive income:		
Foreign currency translation gain	26,016	35,079
Pension and post-retirement benefits, net of tax	(371)	(459)
Gain on derivative financial instruments, net of tax	120	450
Loss on foreign currency forward contracts	(343)	—
Other comprehensive income	25,422	35,070
Comprehensive income	$27,241	$28,138
Basic and diluted net income (loss) per share:		
Basic	$0.02	$(0.08)
Diluted	$0.02	$(0.08)
Weighted average number of shares used in per share calculations:		
Basic shares	92,484	91,886
Diluted shares	94,224	91,886

(1) Exclusive of depreciation and amortization.

See accompanying notes to consolidated financial statements

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands, except per share amounts)

	Three Months Ended March 31, 2012	2011
Cash flows from operating activities:		
Net income (loss)	$1,819	$(6,932)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	30,518	30,904
Change in deferred income taxes	263	621
Stock-based compensation	5,771	4,602
Non-cash interest expense	1,996	1,956
Earnings from equity investments	(8,845)	(9,350)
Distributed earnings from equity investments	—	1,845
Changes in current assets and liabilities, net of effects of acquisitions		
Accounts receivable	7,240	20,930
Inventories	919	1,536
Accounts payable	(11,428)	(6,047)
Accrued liabilities	(5,968)	12,175
Other current assets and liabilities	(706)	(2,858)
Other	345	(772)
Net cash provided by operating activities	21,924	48,610
Cash flows from investing activities:		
Capital expenditures	(1,958)	(1,658)
Lottery and gaming systems expenditures	(7,393)	(8,788)
Other intangible assets and software expenditures	(12,446)	(11,368)
Proceeds from asset disposals	84	780
Equity method investments	—	(27,687)
Distributions of capital on equity investments	2,407	—
Business acquisitions, net of cash acquired	(344)	—
Change in other assets and liabilities, net	(152)	(960)
Net cash used in investing activities	(19,802)	(49,681)
Cash flows from financing activities:		
Payments on long-term debt	(3,551)	(2,121)
Payments of financing fees	(57)	(2,623)
Net redemptions of common stock under stock-based compensation plans	(3,555)	(1,521)
Net cash used in financing activities	(7,163)	(6,265)
Effect of exchange rate changes on cash and cash equivalents	1,042	1,646
Decrease in cash and cash equivalents	(3,999)	(5,690)
Cash and cash equivalents, beginning of period	104,402	124,281
Cash and cash equivalents, end of period	$100,403	$118,591

See accompanying notes to consolidated financial statements

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands, except per share amounts)

Non-cash investing and financing activities

For the three months ended March 31, 2012 and 2011

There were no significant non-cash investing or financing activities for the three months ended March 31, 2012.

On March 28, 2011, we contributed fixed assets totaling approximately $11,600 to International Terminal Leasing ("ITL") resulting in a non-cash investment of $11,600 out of our total investment in ITL of approximately $28,000 as of March 31, 2011. Our equity method investment in ITL is described in Note 16 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K.

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 Sheets as of March 31, 2012 and December 31, 2011, the Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2012 and 2011, and the Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011, have been prepared by Scientific Games Corporation and are unaudited. When used in these notes, the terms “we,” “us,” “our” and the “Company” refer to Scientific Games Corporation and all entities included in our consolidated financial statements unless otherwise specified or the context otherwise indicates. In the opinion of management, all adjustments necessary to present fairly our consolidated financial position as of March 31, 2012, our results of operations and comprehensive income for the three months ended March 31, 2012 and 2011, and our cash flows for the three months ended March 31, 2012 and 2011 have been made. Such adjustments are of a normal, recurring nature.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2011 Annual Report on Form 10-K. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results of operations for the full year.

Significant Accounting Policies

We describe our significant accounting policies in Note 1 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K. We summarize recently issued accounting guidance that we adopted on January 1, 2012 below:
In May 2011, the Financial Accounting Standards Board ("FASB") issued guidance to amend the accounting and disclosure requirements on fair value measurements. The new guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured at a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the new guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs.
In June 2011, the FASB issued guidance on presentation of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity is required to present net income and other comprehensive income either in one continuous statement or in two separate but consecutive statements. The new guidance also requires presentation of reclassification adjustments from other comprehensive income to net income on the face of the financial statements. However, the effective date pertaining to this requirement was deferred by an update issued by the FASB in December 2011. The Company adopted the new guidance on January 1, 2012 resulting in a change in the presentation of comprehensive income for the three months ended March 31, 2012 and 2011.
In September 2011, the FASB issued guidance on testing goodwill for impairment. The new guidance provides an entity with the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required

to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). If an entity determines the fair value of a reporting unit is less than its carrying amount, the two-step goodwill impairment test is required. We will apply the new guidance to our December 31, 2012 annual goodwill impairment evaluation.

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Basic and Diluted Net Income (Loss) Per Share

The following represents a reconciliation of the numerator and denominator used in computing basic and diluted net income (loss) per share available to common stockholders for the three months ended March 31, 2012 and 2011:

	Three Months Ended March 31,	
	2012	2011
Income (numerator)		
Net income (loss)	$1,819	$(6,932)
Shares (denominator)		
Weighted average basic common shares outstanding	92,484	91,886
Effect of dilutive securities-stock rights	1,740	—
Weighted average diluted common shares outstanding	94,224	91,886
Basic and diluted per share amounts		
Basic net income (loss) per share	$0.02	$(0.08)
Diluted net income (loss) per share	$0.02	$(0.08)

The weighted average diluted common shares outstanding for the three months ended March 31, 2012 and 2011 excludes the effect of approximately 2,703 and 7,409 weighted average stock rights outstanding, respectively, because their effect would be anti-dilutive. For the three months ended March 31, 2011, there were no dilutive stock rights due to the net loss reported for the period.

(2) Reportable Segment Information

We report our operations in three business segments: Printed Products; Lottery Systems; and Gaming.

The following tables set forth financial information for the three months ended March 31, 2012 and 2011, respectively, by reportable segments. Corporate expenses and corporate depreciation and amortization are not allocated to the reportable segments and are presented as unallocated corporate costs.

	Three Months Ended March 31, 2012			
	Printed Products	Lottery Systems	Gaming	Total
Revenue:				
Instant tickets	$123,324	$—	$—	$123,324
Services	—	53,006	37,280	90,286
Sales	2,163	11,471	7,331	20,965
Total revenue	125,487	64,477	44,611	234,575
Cost of instant tickets (1)	69,963	—	—	69,963
Cost of services (1)	—	29,359	16,500	45,859
Cost of sales (1)	1,410	7,955	7,562	16,927
Selling, general and administrative expenses	11,015	7,053	6,108	24,176
Employee termination and restructuring costs	—	—	2,875	2,875
Depreciation and amortization	8,003	11,798	10,568	30,369
Segment operating income	$35,096	$8,312	$998	$44,406
Unallocated corporate costs				(22,145)

Consolidated operating income	$22,261

(1) Exclusive of depreciation and amortization.

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

(1) Exclusive of depreciation and amortization.

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

	Three Months Ended March 31,	
	2012	2011
Reported segment operating income	$44,406	$36,458
Unallocated corporate costs	(22,145)	(22,105)
Consolidated operating income	22,261	14,353
Interest expense	24,898	26,455
Earnings from equity investments	(8,845)	(9,350)
Other	(478)	(994)
Net income (loss) before income taxes	$6,686	$(1,758)

In evaluating financial performance, we focus on operating income as a segment's measure of profit or loss. Segment operating income is income before other (income) expense, net, interest expense, earnings from equity investments, unallocated corporate expenses and income taxes. The accounting policies of the reportable segments are the same as those described in our summary of significant accounting policies (see Note 1 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K).

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(3) Equity Method Investments

There have been no changes in our equity method investments from those disclosed in Note 16 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K except as disclosed below.

Sciplay

On January 21, 2010, we entered into a joint venture with Playtech Services (Cyprus) Limited (“Playtech”), a subsidiary of Playtech Limited, in which we and Playtech each had a 50% interest in two entities, Sciplay International S.a.r.l. and Sciplay (Luxembourg) S.a.r.l. (collectively “Sciplay”). Sciplay focuses on providing end-to-end offerings of products and services that enable lotteries and certain other gaming operators to offer internet gaming solutions in a manner that is consistent with applicable regulatory regimes. On January 23, 2012, we entered into an agreement with Playtech that restructured this strategic relationship from a joint venture arrangement to a license arrangement. Under the agreement, Playtech will license its internet gaming software to us on a non-exclusive basis for use by certain categories of our current and prospective customers, including U.S. casinos and lotteries worldwide. As part of the restructuring the Sciplay-related entities became wholly owned subsidiaries of Scientific Games. The impact on our consolidated balance sheet and consolidated results of operations and comprehensive income as of and for the three months ended March 31, 2012 was not material.

(4) Inventories

Inventories consist of the following:

	March 31, 2012	December 31, 2011
Parts and work-in-process	$31,813	$35,444
Finished goods	48,012	44,298
	$79,825	$79,742

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

(5) Long-Term Debt

Credit Agreement

We are party to a credit agreement, dated as of June 9, 2008, as amended and restated as of August 25, 2011 (as so amended, the “Credit Agreement”), among Scientific Games International, Inc. ("SGI"), as borrower, the Company, as a guarantor, the several lenders from time to time parties thereto and JPMorgan Chase Bank, N.A., as administrative agent.

The Credit Agreement provides for a $250,000 senior secured revolving credit facility and senior secured term loan credit facilities under which $564,128 of term loan borrowings were outstanding as of March 31, 2012. There were no borrowings and $60,920 in outstanding letters of credit under the revolving credit facility as of March 31, 2012. As of March 31, 2012, we had approximately $189,080 available for additional borrowing or letter of credit issuances under the revolving credit facility. Amounts under the revolving credit facility may be borrowed, repaid and re-borrowed by SGI from time to time until maturity. Voluntary prepayments and commitment reductions under the Credit Agreement are permitted at any time in whole or in part, without premium or penalty (other than break-funding costs), upon proper notice and subject to a minimum dollar requirement. Pursuant to the August 2011 amendment to the Credit Agreement, the scheduled maturity date of the revolving credit facility commitments and the outstanding term loans was extended from June 9, 2013 to June 30, 2015.

The Credit Agreement contains customary covenants, including negative covenants that, among other things, limit the ability of the Company and 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 asset sales, effect a consolidation or merger, sell, transfer, lease or otherwise dispose of all or substantially all assets, prepay or modify certain indebtedness, or create certain liens and other encumbrances on assets.

Our ability to borrow under the Credit Agreement will depend on us remaining in compliance with the covenants contained in the Credit Agreement, including the maintenance of the applicable financial ratios. A summary of the terms of the Credit Agreement, including the financial ratios that the Company is required to maintain under the terms of the Credit Agreement, is included in Note 8 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K.

We were in compliance with the covenants under the Credit Agreement as of March 31, 2012.

On February 21, 2012, the Company and SGI entered into an agreement to refinance the approximately $16,400 of revolving credit facility and term loan commitments that were not extended in connection with the August 2011 Amendment and extend the maturity dates of these commitments to June 30, 2015. In connection with the agreement amendment, we paid approximately $57 of fees and expenses to the new lenders.

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Outstanding Debt

As of March 31, 2012, our total debt was comprised principally of $564,128 outstanding under our term loan facilities under the Credit Agreement, $345,623 in aggregate principal amount of SGI's 9.25% senior subordinated notes due 2019 (the “2019 Notes”), $200,000 in aggregate principal amount of SGI's 7.875% senior subordinated notes due 2016 (the “2016 Notes”), $250,000 in aggregate principal amount of the Company's 8.125% senior subordinated notes due 2018 (the “2018 Notes”) and loans denominated in Chinese Renminbi Yuan (“RMB”) totaling RMB 166,000 (the "China loans").

On January 17, 2012, we repaid with cash on hand RMB 12,500 in aggregate principal amount of the China loans. On January 31, 2012, the Chinese bank reduced by $1,000 a letter of credit previously issued to support this debt. On April 25, 2012, we repaid with cash on hand an additional RMB 106,000 in aggregate principal amount of the China loans. On April 26, 2012 the Chinese bank returned an $18,000 letter of credit previously issued to support this debt.

(6) Derivative Financial Instruments

In January 2012, we entered into foreign currency forward contracts to hedge a portion of the net investment in one of our subsidiaries that is denominated in Euros. The aggregate notional amount of the forward contracts, which provide for the sale of Euros for U.S. dollars at a weighted average exchange rate of approximately 1.3194, is €23,500. The forward contracts were scheduled for delivery between April and December 2012. In April 2012, three of the forward contracts expired and were replaced with two new forward contracts to maintain the same aggregate notional amount of €23,500. We have designated the forward contracts as qualified hedges in accordance with Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging. The fair value of the forward contracts, and subsequent changes to the fair value, are recorded on the Consolidated Balance Sheet in “Accrued liabilities” and “Accumulated other comprehensive loss” and on the Consolidated Statement of Operations and Comprehensive Income in "Other comprehensive income (loss)". During the three months ended March 31, 2012, we recorded a loss associated with the forward contracts of approximately $343 in "Other comprehensive income (loss)".

In accordance with ASC 323, Investments - Equity Method and Joint Ventures, we record our share of a derivative instrument held by Lotterie Nazionali S.r.l., the operator of the Gratta e Vinci instant ticket lottery in Italy ("LNS") in which we have a 20% equity investment. Changes in the fair value of the derivative instrument are recorded by LNS within “Other comprehensive income” in LNS' statement of comprehensive income. During the three months ended March 31, 2012, we recorded a gain, net of tax, associated with our share of this derivative instrument of $120 on the Consolidated Statement of Operations and Comprehensive Income in "Other comprehensive income (loss)" and in "Other assets" on our Consolidated Balance Sheet as of March 31, 2012.

(7) Intangible Assets and Goodwill

The following presents certain information regarding our intangible assets as of March 31, 2012 and December 31, 2011. Amortizable intangible assets are being amortized on a straight-line basis over their estimated useful lives with no estimated residual values.

Since the filing of our 2011 Annual Report on Form 10-K, we have made an adjustment to the preliminary fair value amounts recognized as of our acquisition of Barcrest Group Limited ("Barcrest") on September 23, 2011 to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. The adjustment resulted in an increase in goodwill and decrease in inventory of approximately $2,000. We have applied the adjustment retrospectively to the Consolidated Balance Sheet as of December 31, 2011, as previously reported in the 2011 Annual Report on Form 10-K.

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Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net Balance
Balance as of March 31, 2012			
Amortizable intangible assets:			
Patents	$13,278	$5,472	$7,806
Customer lists	36,330	21,804	14,526
Licenses	79,534	58,607	20,927
Intellectual property	23,958	18,889	5,069
Lottery contracts	1,500	1,221	279
	154,600	105,993	48,607
Non-amortizable intangible assets:			
Trade name	38,862	2,118	36,744
Total intangible assets	$193,462	$108,111	$85,351
Balance as of December 31, 2011			
Amortizable intangible assets:			
Patents	$12,941	$5,260	$7,681
Customer lists	35,742	20,511	15,231
Licenses	78,556	56,706	21,850
Intellectual property	23,335	18,102	5,233
Lottery contracts	1,500	1,195	305
	152,074	101,774	50,300
Non-amortizable intangible assets:			
Trade name	38,677	2,118	36,559
Total intangible assets	$190,751	$103,892	$86,859

The aggregate intangible amortization expense for the three months ended March 31, 2012 and March 31, 2011 was approximately $4,000 and $3,800, respectively.

The table below reconciles the change in the carrying amount of goodwill, by reporting segment, from December 31, 2011 to March 31, 2012. For the three months ended March 31, 2012, we recorded an increase of approximately $11,249 as a result of foreign currency translation.

Goodwill	Printed Products	Lottery Systems	Gaming	Totals
Balance as of December 31, 2011	$334,120	$186,620	$247,578	$768,318
Adjustments	1,216	2,567	7,466	11,249
Balance as of March 31, 2012	$335,336	$189,187	$255,044	$779,567

(8) Pension and Other Post-Retirement Plans

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

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The following table sets forth the combined amount of net periodic benefit cost recognized for the three months ended March 31, 2012 and 2011:

	Three Months Ended March 31, 2012	2011
Components of net periodic pension benefit cost:		
Service cost	$568	$462
Interest cost	1,147	1,173
Expected return on plan assets	(1,227)	(1,162)
Amortization of actuarial gains	251	95
Amortization of prior service costs	(19)	(3)
Net periodic cost	$720	$565

We have a 401(k) plan for U.S.-based employees. We contribute $37.5 cents on the dollar for the first 6% of participant contributions for a match of up to 2.25% of eligible compensation.

(9) Income Taxes

The effective tax rates of 72.8% and (294.4)%, respectively, for the three months ended March 31, 2012 and March 31, 2011 were determined using an estimated annual effective tax rate and after considering any discrete items for such periods. Due to a valuation allowance against our U.S. deferred tax assets, the effective tax rate for the three months ended March 31, 2012 does not include the benefit of the current year U.S. tax loss. Income tax expense for the three months ended March 31, 2012 is primarily due to income tax expense in foreign jurisdictions.

(10) Stockholders' Equity

The following table sets forth the change in the number of shares of our Class A common stock outstanding during the three months ended March 31, 2012 and during the fiscal year ended December 31, 2011:

	Three Months Ended March 31, 2012	Twelve Months Ended December 31, 2011
Shares outstanding as of beginning of period	92,433	91,725
Shares issued as part of equity-based compensation plans and the Employee Stock Purchase Plan ("ESPP"), net of RSUs surrendered	323	708
Shares outstanding as of end of period	92,756	92,433

(11) Stock-Based Compensation

We offer stock-based compensation through the use of stock options and restricted stock units ("RSUs"). We also offer the ESPP.

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

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The Company may grant certain awards the vesting of which is contingent upon the Company achieving certain performance targets. Upon determining that the performance target is probable, the fair value of the award is recognized over the service period, subject to potential adjustment.
On February 22, 2012, the Company granted approximately 494 RSUs to certain executives, which awards have a four-year vesting schedule, with 25% scheduled to vest each year if specified performance targets are met subject to certain "carryover" vesting provisions. The performance targets and carryover vesting provisions are consistent with those applicable to the performance-conditioned sign-on RSUs and options awarded to our Chief Executive Officer in December 2010, which are described in Note 12 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K. The performance-conditioned RSUs will be forfeited on March 15, 2016 to the extent that such awards remain unvested on such date.
Stock Options

A summary of the changes in stock options outstanding during the three months ended March 31, 2012 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, 2011	3,868	8.3	$9.67	$3,876
Granted	10		11.10	
Exercised	(4)		6.16	20
Canceled	—		—	
Options outstanding as of March 31, 2012	3,874	8.1	$9.68	$10,735
Options exercisable as of March 31, 2012	902	5.9	$12.51	$2,118

The weighted average grant date fair value of options granted during the three months ended March 31, 2012 was $5.81. For the three months ended March 31, 2012 and 2011, we recognized stock-based compensation expense of approximately $1,000 and $1,700, respectively, related to the vesting of stock options and the related tax benefit of approximately $380 and $630, respectively.

As of March 31, 2012, we had unrecognized compensation expense of approximately $10,400 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 RSUs outstanding during the three months ended March 31, 2012 is presented below:

	Number of RSUs	Weighted Average Grant Date Fair Value Per RSU
Unvested units as of December 31, 2011	4,771	$10.49
Granted	1,534	12.62
Vested	(660)	13.92
Canceled	(20)	12.02
Unvested units as of March 31, 2012	5,625	$10.66

For the three months ended March 31, 2012 and 2011, we recognized stock-based compensation expense of approximately $4,700 and $2,900, respectively, related to the vesting of RSUs and the related tax benefit of approximately $1,790 and $1,000, respectively.

As of March 31, 2012, we had unrecognized compensation expense of approximately $52,000 relating to RSUs that will be amortized over a weighted-average period of approximately two years.

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

We conduct substantially all of our business through our domestic and foreign subsidiaries. SGI's obligations under the Credit Agreement, the 2016 Notes and the 2019 Notes are fully and unconditionally and jointly and severally guaranteed by Scientific Games Corporation (the "Parent Company") and our 100%-owned domestic subsidiaries other than SGI (the "Guarantor Subsidiaries"). Our 2018 Notes, which were issued by the Parent Company, are fully and unconditionally and jointly and severally guaranteed by our 100% owned domestic subsidiaries, including SGI.

Presented below is condensed consolidating financial information for (i) the Parent Company, (ii) SGI, (iii) the Guarantor Subsidiaries and (iv) our 100%-owned foreign subsidiaries and our non-100%-owned domestic and foreign subsidiaries (collectively, the "Non-Guarantor Subsidiaries") as of March 31, 2012 and December 31, 2011 and for the three months ended March 31, 2012 and 2011. The condensed consolidating financial information has been presented to show the nature of assets held, results of operations and cash flows of the Parent Company, SGI, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries assuming the guarantee structures of our obligations as disclosed in Note 8 of the Notes to Consolidated Financial Statements in our 2011 Annual Report on Form 10-K for all periods presented.

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
As of March 31, 2012

	Parent Company	SGI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Assets						
Cash and cash equivalents	$21,902	$298	$—	$ 80,644	$(2,441)	$ 100,403
Accounts receivable, net	—	51,552	37,488	88,358	—	177,398
Inventories	—	23,420	17,503	38,902	—	79,825
Other current assets	8,234	3,383	6,197	23,957	—	41,771
Property and equipment, net	3,850	163,167	34,297	218,202	—	419,516
Investment in subsidiaries	542,361	788,708	—	855,867	(2,186,936)	—
Goodwill	—	273,656	78,618	427,293	—	779,567
Intangible assets	—	41,527	24,730	19,094	—	85,351
Intercompany balances	98,616	—	244,313	—	(342,929)	—
Other assets	74,985	20,915	14,229	384,796	(2,613)	492,312
Total assets	$749,948	$1,366,626	$457,375	$ 2,137,113	$(2,534,919)	$2,176,143
Liabilities and stockholders' equity						
Current installments of long-term debt	$—	$6,280	$—	$ 27,539	$—	$33,819
Other current liabilities	17,098	61,711	28,324	86,253	(2,429)	190,957
Long-term debt, excluding current installments	250,000	1,103,473	—	93	—	1,353,566
Other non-current liabilities	5,266	39,112	13,010	62,829	—	120,217
Intercompany balances	—	119,804	—	223,135	(342,939)	—
Stockholders' equity	477,584	36,246	416,041	1,737,264	(2,189,551)	477,584
Total liabilities and stockholders' equity	$749,948	$1,366,626	$457,375	$ 2,137,113	$(2,534,919)	$2,176,143

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2011

	Parent Company	SGI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Assets						
Cash and cash equivalents	$24,042	$56	$—	$ 81,482	$(1,178)	$104,402
Accounts receivable, net	—	53,531	41,238	87,698	—	182,467
Inventories	—	23,714	16,884	39,144	—	79,742
Other current assets	8,699	3,409	5,117	23,277	—	40,502
Property and equipment, net	3,522	166,637	36,028	220,301	—	426,488
Investment in subsidiaries	551,256	721,909	—	909,379	(2,182,544)	—
Goodwill	—	273,656	78,618	416,044	—	768,318
Intangible assets	—	41,520	25,849	19,490	—	86,859
Intercompany balances	125,440	—	231,357	—	(356,797)	—
Other assets	17,002	82,748	12,265	367,209	(6,101)	473,123
Total assets	$729,961	$1,367,180	$447,356	$ 2,164,024	$(2,546,620)	$2,161,901
Liabilities and stockholders' equity						
Current installments of long-term debt	$—	$6,280	$—	$ 19,911	$—	$26,191
Other current liabilities	31,231	56,050	30,140	94,682	(1,211)	210,892
Long-term debt, excluding current installments	250,000	1,104,884	—	9,592	—	1,364,476
Other non-current liabilities	5,016	38,772	13,427	59,413	—	116,628
Intercompany balances	—	71,603	—	285,162	(356,765)	—
Stockholders' equity	443,714	89,591	403,789	1,695,264	(2,188,644)	443,714
Total liabilities and stockholders' equity	$729,961	$1,367,180	$447,356	$ 2,164,024	$(2,546,620)	$2,161,901

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF INCOME AND COMPREHENSIVE INCOME
Three Months Ended March 31, 2012

	Parent Company	SGI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Revenue	$—	$106,651	$9,549	$ 118,948	$(573)	$ 234,575
Cost of instant ticket revenue, cost of services and cost of sales (1)	—	32,990	34,214	67,171	(1,626)	132,749
Selling, general and administrative expenses	15,522	14,737	3,632	12,932	(651)	46,172
Employee termination and restructuring costs	—	—	—	2,875	—	2,875
Depreciation and amortization	149	7,320	4,777	18,272	—	30,518
Operating income (loss)	(15,671)	51,604	(33,074)	17,698	1,704	22,261
Interest expense	5,302	19,172	—	424	—	24,898
Other (income) expense, net	(2,188)	40,049	(45,321)	(3,567)	1,704	(9,323)
Income (loss) before equity in income of subsidiaries, and income taxes	(18,785)	(7,617)	12,247	20,841	—	6,686
Equity in income (loss) of subsidiaries	(34,319)	12,107	—	—	22,212	—
Income tax expense	(54,923)	58,199	—	1,591	—	4,867
Net income (loss)	$1,819	$(53,709)	$12,247	$ 19,250	$22,212	$ 1,819
Other comprehensive income (loss)	25,422	219	—	25,031	(25,250)	25,422
Comprehensive income (loss)	$27,241	$(53,490)	$12,247	$ 44,281	$(3,038)	$ 27,241

(1) Exclusive of depreciation and amortization.

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF INCOME AND COMPREHENSIVE INCOME
Three Months Ended March 31, 2011

	Parent Company	SGI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Revenue	$—	$98,057	$9,520	$ 89,373	$(294)	$ 196,656
Cost of instant ticket revenue, cost of services and cost of sales (1)	—	32,293	32,171	47,669	(288)	111,845
Selling, general and administrative expenses	15,565	12,456	2,636	9,255	(358)	39,554
Depreciation and amortization	128	7,564	4,946	18,266	—	30,904
Operating income (loss)	(15,693)	45,744	(30,233)	14,183	352	14,353
Interest expense	5,390	20,658	—	407	—	26,455
Other (income) expense, net	(1,221)	40,775	(42,640)	(7,610)	352	(10,344)
Income (loss) before equity in income of subsidiaries, and income taxes	(19,862)	(15,689)	12,407	21,386	—	(1,758)
Equity in income (loss) of subsidiaries	16,686	13,427	—	—	(30,113)	—
Income tax expense	3,756	(291)	—	1,709	—	5,174
Net income (loss)	$(6,932)	$(1,971)	$12,407	$ 19,677	$(30,113)	$ (6,932)
Other comprehensive income (loss)	$35,070	$1,304	$—	$ 33,373	$(34,677)	$ 35,070
Comprehensive income (loss)	$28,138	$(667)	$12,407	$ 53,050	$(64,790)	$ 28,138

(1) Exclusive of depreciation and amortization.

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SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Three Months Ended March 31, 2012

	Parent Company	SGI	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated
Net cash provided by operating activities	$(14,095)	$14,044	$1,337	$20,593	$45	$21,924
Cash flows from investing activities:						
Capital, lottery and gaming systems expenditures	(423)	(2,894)				