

SCIENTIFIC GAMES CORP
Form 10-K/A
August 14, 2003

[QuickLinks](#) -- Click here to rapidly navigate through this document

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K/A
AMENDMENT NO. 3**

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

For the fiscal year ended: December 31, 2002,

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, 25th Floor
New York, New York 10022**
(Address of principal executive offices)

Registrant's telephone number: **(212) 754-2233**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of each class
Class A Common Stock, \$.01 par value

Name of each exchange on which registered
Nasdaq National Market

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

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

As of June 28, 2002 the aggregate market value of voting stock held by non-affiliates of the registrant was approximately \$297,284,152.

Common shares outstanding as of March 20, 2003 were 59,460,531.

DOCUMENTS INCORPORATED BY REFERENCE

The following document is incorporated herein by reference:

<u>Document</u>	<u>Parts Into Which Incorporated</u>
Proxy Statement for the Company's 2003 Annual Meeting of Stockholders	Part III

EXPLANATORY NOTE

This Amendment No. 3 on Form 10-K/A filed by Scientific Games Corporation (the "Company") amends the Company's Annual Report on Form 10-K, as previously amended, for the year ended December 31, 2002.

Subsequent to the filing of such Annual Report and the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003, it was determined that a portion of the deferred tax benefit, in the form of a net operating loss carryforward, recognized by the Company in the fourth quarter of 2002 should have been recognized at the time of the Company's acquisition of Scientific Games Holdings Corp. on September 6, 2000. Accordingly, the Company has amended and restated its consolidated financial statements as of and for the year ended October 31, 2000, the two-month period ended December 31, 2000 and the years ended December 31, 2001 and 2002. This Form 10-K/A is being filed to give effect to such amendments and restatements by amending and restating the following sections of the Company's Annual Report: (i) Selected Financial Data (Part II, Item 6); (ii) Management's Discussion and Analysis of Financial Condition and Results of Operations (Part II, Item 7); and (iii) Financial Statements and Supplementary Data (including the Notes to Consolidated Financial Statements) (Part II, Item 8). Items 1 (Business) and 5 (Market for Registrant's Common Equity and Related Stockholder Matters) are also being amended and restated by this Form 10-K/A, solely to make conforming changes with respect to the identifying numbers of the Notes to Consolidated Financial Statements referenced in such items. For convenience, Parts I and II of the Company's Annual Report are included in their entirety in this Form 10-K/A, although the items therein are not amended except as specifically indicated above. In addition, (x) Item 15 (Exhibits, Financial Statement Schedules, and Reports on Form 8-K) is being amended solely to include currently dated certifications of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 as Exhibits 99.1 and 99.2, respectively, and (y) the Annual Report is also being amended to include currently dated certifications of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and to reflect such certifications in Controls and Procedures (Part III, Item 14). No other information in the Company's Annual Report, as previously amended, is being amended by this Form 10-K/A.

The Company has not updated the information in this Form 10-K/A to speak as of a date after the filing of the Company's Annual Report, and this Form 10-K/A does not amend or update the information in such Annual Report in any way other than to give effect to the amendments and restatements described above, to the extent specified.

EXHIBIT INDEX APPEARS ON PAGE 112

PART I

FORWARD-LOOKING STATEMENTS

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Certain statements contained in this Form 10-K/A constitute "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. In some cases, forward-looking statements can be identified by the use of forward-looking terminology such as "may," "will," "estimate," "intend," "continue," "believe," "expect" or "anticipate" or the negatives thereof, variations thereon or similar terminology. The forward-looking statements contained in this Form 10-K/A are generally located in the material set forth under the headings "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," but may be found in other locations as well. These forward-looking statements generally relate to plans and objectives for future operations and are based upon management's reasonable estimates of future results or trends. Although we believe that the plans and objectives reflected in or suggested by such forward-looking statements are reasonable, such plans or objectives may not be achieved. Actual results may differ from projected results due, but not limited, to unforeseen developments, including developments relating to the following:

the availability and adequacy of our cash flow to satisfy our obligations, including our debt service obligations and our need for additional funds required to support capital improvements, development and acquisitions;

economic, competitive, demographic, business and other conditions in our local and regional markets;

changes or developments in the laws, regulations or taxes in the gaming and lottery industries;

actions taken or omitted to be taken by third parties, including customers, suppliers, competitors, members and shareholders, as well as legislative, regulatory, judicial and other governmental authorities;

changes in business strategy, capital improvements, development plans, including those due to environmental remediation concerns, or changes in personnel or their compensation, including federal, state and local minimum wage requirements;

an inability to renew or early termination of our contracts;

an inability to engage in future acquisitions;

the loss of any license or permit, including the failure to obtain an unconditional renewal of a required gaming license on a timely basis; and

resolution of any pending or future litigation in a manner adverse to us.

You should read this Form 10-K/A completely and with the understanding that actual future results may be materially different from what we expect. All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the foregoing factors. These forward-looking statements speak only as of the date of the document in which they are made. We disclaim any obligation or undertaking to provide any updates or revisions to any forward-looking statement to reflect any change in our expectations or any change in events, conditions or circumstances in which the forward-looking statement is based.

As you read this Form 10-K/A, you should also note the following: This Form 10-K/A contains various references to industry market data and certain industry forecasts. The industry market data and industry forecasts were 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, have not been independently verified by us and we do not make any representation as to the accuracy of that information.

ITEM 1. BUSINESS

Overview

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Unless the context indicates otherwise, all references to "Scientific Games," "we," "our," "ours," "us" and "the Company" refer to Scientific Games Corporation and its consolidated subsidiaries after giving effect to the September 6, 2000 acquisition by Autotote Corporation of Scientific Games Holdings Corp. and to Autotote Corporation and its consolidated subsidiaries prior to the completion of the acquisition. "SGHC" refers to Scientific Games Holdings Corp. and its consolidated subsidiaries, and "Autotote" refers to Autotote Corporation and its consolidated subsidiaries, in each case prior to the completion of the acquisition of SGHC. "International" refers to non-United States jurisdictions. "On-line" lottery refers to a computerized system in which lottery terminals in retail outlets are continuously connected to a central computer system for the sale and validation of lottery tickets and related functions. "OTB" refers to off-track betting facilities, including those owned and operated by our subsidiaries Autotote Enterprises, Inc. (in Connecticut) and Autotote Nederland B.V. (in The Netherlands). "Handle" is an industry term for dollars wagered.

On September 6, 2000, Autotote completed the acquisition of SGHC. The acquisition was completed through a merger in which SGHC became our wholly-owned subsidiary at a cost of approximately \$308 million in aggregate merger consideration paid to SGHC stockholders, plus related fees and expenses. The acquisition was recorded using the purchase method of accounting, and the acquired assets and liabilities were recorded at their estimated fair value at the date of acquisition. The operating results of the SGHC businesses have been included in the consolidated statements of operations from the date of the acquisition.

In connection with the acquisition of SGHC, we changed our fiscal year-end from an October 31 year-end to a calendar year-end, beginning with the year ending December 31, 2001. On April 27, 2001, Autotote Corporation changed its name to Scientific Games Corporation. On January 29, 2002, we transferred the listing for our Class A common stock to the Nasdaq National Market from the American Stock Exchange and changed our trading symbol to "SGMS".

We are a leading worldwide provider of services, systems and products to both the instant ticket lottery industry and the pari-mutuel wagering industry based on revenues. We believe we offer our customers the widest array of some of the most technologically advanced products and services in each of these industries. We also believe that we are the world's only fully integrated lottery service provider, offering lottery authorities on-line lottery systems, instant tickets and related facilities management, or cooperative services, programs, which effectively enable such authorities to outsource all of their instant ticket lottery operations to us.

We operate in four business segments: Lottery Group, Pari-mutuel Group, Venue Management Group and Telecommunications Products Group.

Lottery Group (57% of 2002 revenue)

We are a leading worldwide provider of services, systems and products to the instant ticket lottery industry based on revenues. We believe that we are the world's only fully integrated lottery service provider, offering on-line lottery systems, instant tickets and related facilities management, or cooperative services, programs to lottery authorities.

Our instant ticket and related services business is the industry leader in the United States, with approximately 65% of all retail sales. Our instant ticket customers include 28 of the 40 jurisdictions in the U.S. that currently sell instant lottery tickets, and we have sold instant tickets to lotteries in over 50 other countries. In addition to ticket design and manufacturing, we provide lotteries with related value-added services through our cooperative services program, including game design, sales and marketing support, inventory management and warehousing and fulfillment services. We also provide lotteries with licensed brand products, including Mandalay Bay, National Basketball Association ("NBA"), Harley Davidson and Wheel of Fortune, to name a few. Additionally, we provide lotteries with our probability-based instant lottery tickets, which utilize a patented electronic circuit printed in each ticket to produce a ticket with multiple possible outcomes, and probability ticket validation terminals based on our proprietary security technology. We believe that these innovative products will allow lotteries to increase retail sales of instant tickets. Our instant ticket contracts typically have an initial term of three years and frequently include multiple renewal

4

options which our customers generally exercise for additional periods ranging from one to five years. We typically sell our instant tickets for a per unit price or are paid a fee equal to a percentage of the retail value of the instant tickets sold. Instant tickets and related services accounted for approximately 74% of the revenue of our Lottery Group in 2002.

Our lottery systems business primarily provides sophisticated, customized computer software, equipment, and data communication services to lottery authorities for on-line and instant ticket games. In the U.S., we typically provide the necessary equipment, software and maintenance services pursuant to long-term contracts that typically have a minimum initial term of five years, under which we are generally paid a fee equal to a percentage of all dollars wagered on lottery tickets. Our U.S. systems contracts typically contain multiple renewal options that generally have been exercised by our customers. Internationally, we typically sell terminals and systems to lottery authorities outright and provide ongoing

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

fee-based software support under long-term contracts. We currently operate on-line lottery systems for seven of the 40 on-line lottery authorities in the U.S., and we believe we are the second largest on-line lottery provider in Europe.

Pari-mutuel Group (19% of 2002 revenue)

We are a leading worldwide provider of computerized wagering systems to the pari-mutuel wagering industry. We provide our systems and services to horse and greyhound racetracks, OTBs, casinos, jai alai frontons and other establishments where pari-mutuel wagering is permitted. In addition, we are a leading provider of ancillary services to the industry, such as race simulcasting and telecommunications services, video gaming terminals, and telephone and Internet account wagering.

In 2002, our systems processed approximately 65% of the estimated \$18 billion in pari-mutuel wagering conducted on horse racing in North America. Based on Handle, our customers include 10 of the 15 largest thoroughbred racetracks in North America and 10 of the 12 largest North American OTB networks. In our North American pari-mutuel business, we enter into service contracts, typically with an initial term of five years, pursuant to which we are paid a weighted average fee of approximately 0.32% of all wagers processed by our wagering systems, and we receive additional fees for our ancillary services, on either a per event or a monthly subscription basis. In most international markets, we sell our pari-mutuel wagering systems and terminals to pari-mutuel operators.

Venue Management Group (14% of 2002 revenue)

We own and have the right to operate in perpetuity substantially all off-track pari-mutuel wagering in Connecticut, subject to our compliance with certain licensing requirements. Our Connecticut operations consist of 12 OTB facilities, including simulcasting at two teletheaters and four other branches, and telephone account wagering for customers in 27 states. We are also the exclusive licensed operator for all pari-mutuel wagering in The Netherlands, with five racetracks and 34 OTBs under a contract with an initial term continuing through June 2003. We are currently in negotiations regarding the extension of our license in The Netherlands and believe we will be successful in obtaining such extension. Our revenues are based on a weighted average percentage of the Handle wagered at our OTB venues, which ranges from 22% to 32%. We also provide facilities management services to the Mohegan Sun Casino racebook in Connecticut.

Telecommunications Products Group (10% of 2002 revenue)

We are a leading manufacturer of prepaid phone cards in Europe, which cards entitle cellular phone users to a defined value of airtime. Prepaid phone cards offer consumers worldwide a cost-effective way to purchase cellular airtime, without requiring phone companies to extend credit or consumers to commit to contracts. We have approximately 20% of the European market for prepaid cellular phone cards and are the largest supplier of paper-based prepaid phone cards in the world. To prevent fraud, our phone cards incorporate proprietary security technology originally developed for our instant lottery ticket operations. We sell our prepaid phone cards to phone companies for a per unit price.

Industry Overview

Lottery Market

Lotteries are operated by domestic and foreign governmental authorities and their licensees in approximately 200 jurisdictions throughout the world. Currently, 40 jurisdictions in the U.S. (including the District of Columbia, Puerto Rico, and the U.S. Virgin Islands) sell instant and on-line lottery tickets. Governments typically authorize lotteries as a means of generating revenues without the imposition of

additional taxes. Net lottery proceeds are frequently set aside for particular public purposes, such as education, aid to the elderly, conservation, transportation and economic development. As proceeds derived from lottery ticket sales have become a significant source of funding for such programs, many jurisdictions have come to rely on such proceeds to support some of those public purposes.

Although there are many types of lottery games worldwide, governmentally authorized lotteries may generally be categorized into three principal groups: instant lotteries, on-line lotteries and the traditional draw-type lotteries. An instant ticket lottery is typically played by removing a coating from a preprinted ticket to determine whether it is a winner. On-line lotteries, such as Powerball, are based on a random selection of a series of numbers. On-line lottery prizes are generally based on the number of winners who share the prize pool, although fixed prizes are also offered. On-line lotteries are conducted through a computerized system in which lottery terminals in retail outlets are continuously connected to a central computer system. On-line lottery systems may also be used to validate instant tickets to confirm large prize levels and prevent duplicate payments, or separate instant ticket validation systems may be installed. Internationally, the older form of traditional draw-type lottery games, in which players purchase tickets which are manually processed for a future drawing for prizes of a fixed amount, is a

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

popular form of play. In addition, lotteries may offer keno, video lottery, sports and other lottery games. Quick draw keno is typically played every five minutes in restricted social settings such as bars and is usually offered as an extension of on-line lottery systems. There are video lotteries played on video lottery terminals, or VLTs, featuring "line-up" and card games, typically targeted to locations such as horse and greyhound racetracks, bars, nightclubs and similar establishments. Video lotteries generally use a system different from an on-line system for accounting, security and control purposes. In addition, in Oregon, several provinces in Canada and several countries outside the U.S., lotteries offer pari-mutuel or fixed odds wagers on various sports.

Instant ticket and on-line lottery retail sales comprise 92% of the U.S. market for lotteries. Based on industry information, 2001 U.S. on-line lottery retail sales totaled approximately \$19.3 billion, and 2001 U.S. instant ticket lottery sales totaled approximately \$17.5 billion. The U.S. instant ticket market grew at a compound annual growth rate of 7.4% from 1994 to 2001. Based on industry information, we estimate that 2001 international on-line lottery retail sales totaled approximately \$62.5 billion and that 2001 international instant ticket lottery sales totaled approximately \$13.5 billion. Industry data indicates that instant ticket retail sales have been growing faster than on-line games because of "instant" rewards rather than the delayed rewards of on-line games with periodic or weekly drawings.

U.S. Instant Ticket and On-line Lottery Sales

Source: LaFleur's World Lottery Almanac

Pari-mutuel Market

In pari-mutuel wagering, individuals bet against each other on horse races, greyhound races, jai alai matches and other events. Pari-mutuel wagering patrons place specific types of wagers (e.g., on a specified horse to win) and a patron's winnings are determined by dividing the total Handle wagered, less a set commission, among the winners. Wagering is generally conducted at horse and greyhound racetracks, jai alai frontons, OTBs and casino racebooks. Licenses to conduct races and/or offer pari-mutuel wagering are granted by governments to private enterprises, non-profit racing associations and occasionally government organizations, including lotteries.

Pari-mutuel wagering is currently authorized in 43 states in the U.S., Puerto Rico, all provinces in Canada and approximately 65 other countries around the world. We estimate that total worldwide annual

6

Handle in the pari-mutuel business is approximately \$116.0 billion. According to the most recent industry statistics, pari-mutuel wagering in the U.S. on thoroughbred racing grew from \$9.9 billion in 1994 to \$15.1 billion in 2002, a compound annual growth rate of 5.4%. Based on industry information, we estimate that the North American market for all forms of pari-mutuel wagering is approximately \$20 billion.

Remote wagering, where customers bet on races held at another location, has caused substantial changes in the distribution channels for pari-mutuel wagering and consolidation of live racing. Wagering within the pari-mutuel industry has evolved from wagering only at a racetrack where a race is held, to wagering at a racetrack on races simulcast from other racetracks, to wagering at an OTB or other off-track venue, and now, in some jurisdictions, to wagering via the telephone and the Internet.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

In addition to favorable changes in the applicable statutes and regulations, a number of technological advances have facilitated remote wagering, including the simulcasting of live races via private satellite video networks, public broadcasting and Internet video streaming. Remote wagering has also increased Handle by enabling wagering on most racing events, facilitating virtually around the clock wagering, year-round. Increases in remote Handle have more than offset a decline in live Handle (i.e., Handle at the race or event itself). Remote wagering increased its share of the total U.S. thoroughbred pari-mutuel racing industry Handle from 15% in 1986 to 86% in 2002. The dollar volume of remote wagering in North America on thoroughbred racing has grown from \$5.4 billion in 1993 to \$13.0 billion in 2002, a compound annual growth rate of approximately 10.4%.

U.S. Thoroughbred Industry Pari-Mutuel Wagering: Remote and Live Handle

Source: Equibase Company LLC; The Jockey Club

One of the most recent developments in remote wagering is account wagering, whereby a customer deposits money with a licensed account wagering operator and uses the account balance to fund wagers and receive winnings. This enables the customer to place wagers from locations remote to the licensed facility, including via telephone or the Internet. Subject in some jurisdictions to the adoption of the necessary enabling regulations, legislation explicitly permitting account wagering on pari-mutuel wagering has been passed in 15 U.S. states: California, Connecticut, Kentucky, Louisiana, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania and Wyoming. Such legislation has also been passed in Canada, the United Kingdom and other countries.

Prepaid Phone Cards Market

Prepaid phone cards offer consumers convenient cellular airtime purchases and help to increase the market for cellular services. We believe that the further growth of cellular phone penetration will expand the prepaid phone card business. It is estimated that approximately 50% of all European cellular phone subscribers use prepaid calling services. While less common in the U.S., prepaid phone cards offer consumers worldwide a cost-effective way to purchase cellular airtime, without requiring phone companies to extend credit or consumers to commit to contracts. We have approximately 20% of the European market for prepaid cellular phone cards and are the largest supplier of paper-based prepaid phone cards in the world. Because card access number theft is common, the security of the card is critical; our phone cards incorporate proprietary security technology originally developed for our instant lottery ticket operations.

7

Operational Overview

Lottery Group

Our Lottery Group provides instant tickets and related services and lottery systems.

Instant Ticket and Related Services. In 1974, we introduced the first secure instant game ticket. Today, we remain a leading designer, manufacturer and distributor of instant tickets worldwide. We market instant tickets and related services to domestic lottery jurisdictions, foreign lottery jurisdictions and commercial customers. We presently have contracts with 28 of the 40 jurisdictions in the U.S. that currently sell instant lottery tickets. Our instant ticket contracts typically have an initial term of three years and frequently include multiple renewal options which our

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

customers generally exercise for additional periods ranging from one to five years. We typically sell our instant tickets for a per unit price or are paid a fee equal to a percentage of the retail value of the instant tickets sold. In addition, we have sold instant lottery tickets to customers in over 50 countries internationally. In 2001 and 2002, we sold approximately 13.4 billion and 13.9 billion, respectively, 2 x 4 inch equivalent instant tickets, of which approximately 25% were sold outside the U.S. Some international customers purchase instant tickets as needed rather than through supply contracts.

The instant tickets we manufacture are typically printed on recyclable ticket stock by a series of computer controlled presses and ink-jet imagers, which we believe incorporate the most advanced technology and security currently available in the industry. Instant tickets generally range in size from 2 inches by 3 inches to ticket sizes as large as some calendars; instant tickets are normally played by removing a coating to determine if they are winning tickets.

The increased application of computer-based and communications technologies to the manufacturing and servicing of instant tickets continues to separate the printing of instant ticket from conventional forms of printing. We are generally recognized within the lottery industry as the leader in applying these technologies to the manufacturing and sale of instant tickets. In order to maintain our position as a leading innovator within the lottery industry, we intend to continue to explore and develop new technologies and their application to instant lottery tickets and systems. We also manufacture instant tickets for promotional games and sell pull-tab tickets to our lottery customers through a marketing agreement with International Gamco, Inc., a manufacturer of pull-tab lottery tickets.

We pioneered the idea of privatizing lottery functions, through our cooperative services program, whereby we manage a lottery authority's instant ticket operations, as a means of reducing the operating costs of lottery authorities while increasing lottery revenues. We are the only instant ticket manufacturer to provide such complete facilities management and support services to supplement its manufacturing operations. Cooperative services contracts bundle instant tickets, systems, facilities management and/or other services, including the design and installation of game management software, telemarketing, field sales, accounting, instant ticket game design, inventory and distribution, sales staff training, managing staff, advising with respect to security, maintenance, communication network and sales agent hot-line service for lottery jurisdictions. While the majority of lottery jurisdictions to date have chosen to manage the distribution and sales of tickets, we have been successful in demonstrating to a number of jurisdictions that we can perform these functions more effectively. We expect that more state or foreign governments will decide to privatize or outsource various lottery operations. We have significant experience in these services and are well-positioned to offer this privatization or outsourcing option to lottery authorities.

We have contracts for cooperative services with the states of Arizona (which commenced in January 2003), Delaware, Florida, Georgia, Maine, Pennsylvania and South Carolina. Under such contracts, we are paid a percentage of the lottery authority's total instant ticket revenues. Customers designate the services they want us to perform from a menu of cooperative services offered. Once our cooperative services programs are in place, replacement of these contractual arrangements may require the lottery authority to incur large conversion costs to hire and/or retrain staff and redesign and install a software system and other protocols to manage its instant ticket business.

8

In June 2002, we expanded our presence in Latin America with the purchase of a 65% equity interest in Serigrafica Chilena S.A., a leading supplier of lottery tickets, prepaid phone cards and promotional games in Latin America. This purchase will enable us to expand our share of the Latin American market for both the instant ticket and the prepaid phone card businesses.

In January 2003, we significantly expanded our offerings of licensed branded lottery products and prize fulfillment and related services with the acquisition of MDI Entertainment, Inc. ("MDI"). MDI has been successful in helping lotteries attract players to new kinds of tickets and second chance games that allow players to win merchandise, such as Harley Davidson motorcycles and trips and prizes like tickets to NBA playoff games. Our portfolio of licensed brands now includes Mandalay Bay, NBA, Harley Davidson and Wheel of Fortune, plus many others. We expect that our acquisition of MDI will enable us to further expand the use of branded games and prize fulfillment services to continue to help our customers generate additional revenues.

Lottery Systems. We are a leading provider of sophisticated, customized computer software, equipment and data communication services to government-sponsored and privately operated lotteries in the U.S. and internationally. This business includes the sale of on-line systems, instant ticket validation systems and terminals. Central computer systems, terminals and associated software are typically provided in the U.S. through facilities management contracts and internationally through outright sales, often from different vendors.

Our lottery systems utilize proprietary technology that is similar to that used for pari-mutuel wagering, but is specialized for lottery operations. Our systems facilitate high speed processing of on-line wagers as well as validation of winning on-line and instant play tickets, including probability-based instant lottery tickets. Our lottery business includes the supply of transaction processing software that accommodates instant ticket accounting and validation and on-line lottery games, point-of-sale terminal hardware which connects to these systems, central site computers and communication hardware which run these systems, and on-going operation support and maintenance services. We also provide software, hardware and support for sports betting and credit card processing systems for non-lottery customers.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

In the U.S., we provide on-line systems and services to seven state lotteries: Connecticut, Iowa, Maine, Montana, New Hampshire, South Carolina and Vermont. We also provide Missouri with a separate instant ticket validation system. Virginia leases SciScan Technology® terminals from us and continues to receive ongoing support. Recent on-line lottery system procurements have requested the capability to support the secure validation of probability-based instant lottery tickets, and we have bid SciScan Technology® terminals both with our on-line systems and through other on-line system providers. SciScan Technology® is a keyless validation system for retailers which significantly reduces the time required for ticket validation while at the same time improving security of the game. SciScan Technology® terminals can be operated on a stand-alone basis or attached to an on-line lottery terminal to validate traditional instant tickets utilizing optical bar code technology, or our proprietary Winner's Choice probability-based instant lottery tickets.

Internationally, we have systems operating in France, The Netherlands, Switzerland, Austria, Australia, Canada, Jamaica, seven states in Germany, and other countries, and we provide on-line system facilities management services to nationwide lotteries in Barbados and the Dominican Republic.

We also sell our lottery terminals separately from our sale of complete lottery systems. Our terminal product offerings include the EXTREMA® on-line lottery terminals, SciScan Technology® terminals and STAN self-serve terminals. Our EXTREMA® on-line terminals utilize a standard PC architecture, graphical interface touch screens for teller input without a keyboard and high speed thermal printers. Beginning in the fourth quarter of 1998 and through August 2000, we shipped approximately 20,000 EXTREMA® terminals to Sisal Sport Italia S.p.A. SGHC sold 15,000 SciScan Technology® terminals to the French national lottery, and we have also sold such terminals to lottery authorities in Greece and Australia.

In addition, we are part of a consortium which includes Lottomatica S.p.A., our largest equity investor, that has been awarded a contract to be the exclusive operator for instant tickets in Italy. This award has been protested and is being reviewed in the Italian courts. If the award is ratified, we expect to enter into a contract, which initially would provide for the printing of tickets and the installation of a new centralized system, along with a full complement of cooperative services.

9

United States Lottery Contracts

The table below lists the U.S. lottery contracts for which we had executed agreements as of March 1, 2003 and certain information with respect thereto. We are the exclusive provider of systems in all contracts and the primary supplier of instant tickets unless otherwise noted. The commencement date of the current contract is the date we began generating revenues under such contract, which for our on-line contracts is typically the start-up date. The table also includes instant ticket or on-line retail sales, as applicable, for each state or district.

State/District	Year 2001 State Instant Ticket or On-line Retail Sales (in millions)	Type of Contract*	Commencement Date of Current Contract	Expiration Date of Current Contract (before exercise of remaining renewal options)	Current Renewal Options Remaining
Arizona	\$ 143.7	ITRS	January 2003	January 2008	2 one-year
Colorado	262.2	ITRS	July 2000	June 2004	1 one-year
Connecticut	526.3	ITRS	August 2002	August 2004	3 one-year
Connecticut	360.7	On-line	May 1998	May 2008	none
Delaware	20.4	ITRS	November 2000	November 2005	none
District of Columbia	32.4	ITRS	December 2001	December 2003	3 one-year
Florida	730.9	ITRS	April 1997	September 2008	none
Georgia	1,134.8	ITRS	May 1993	September 2010	none
Idaho (1)	53.7	ITRS	October 1999	October 2003	none
Illinois	613.7	ITRS	June 2002	June 2005	2 one-year
Indiana (2)	325.0	ITRS	January 2002	January 2006	2 one-year
Iowa	74.0	On-line	July 2001	June 2008	3 one-year
Kentucky (2)	282.9	ITRS	September 2002	October 2005	4 one-year
Maine	40.4	On-line	July 2001	June 2007	2 two-year
Maine	111.5	ITRS	July 2001	June 2007	2 two-year
Massachusetts	2,767.1	ITRS	August 1999	August 2003	1 one-year
Minnesota (1)	249.7	ITRS	February 2000	January 2004	1 one-year

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

State/District	Year 2001 State Instant Ticket or On-line Retail Sales (in millions)	Type of Contract*	Commencement Date of Current Contract	Expiration Date of Current Contract (before exercise of remaining renewal options)	Current Renewal Options Remaining
Missouri	292.5	ITRS	April 2001	June 2005	1 two-year
Montana	24.1	On-line	March 1999	March 2006	none
New Hampshire	71.1	On-line	July 2000	June 2006	2 two-year
New Jersey (1)	717.6	ITRS	November 2001	October 2006	2 one-year
New Mexico (3)	78.0	ITRS	March 1997	March 2003	none
New York (1)	1,866.2	ITRS	November 2001	November 2004	2 one-year
Ohio	992.2	ITRS	July 2001	June 2003	2 two-year
Oregon (1)	132.4	ITRS	June 1998	June 2004	none
Pennsylvania	694.8	ITRS	April 1997	April 2005	2 one-year
South Carolina (4)	467.7	ITRS	October 2001	October 2004	2 one-year
South Carolina (4)	155.6	On-line	January 2002	December 2007	1 one-year
South Dakota	12.0	ITRS	June 2000	June 2003	2 one-year
Texas	1,718.8	ITRS	September 2002	September 2003	none
Vermont	13.2	On-line	July 2000	June 2006	2 two-year
Virginia (5)	NA	Systems	January 1997	November 2003	4 one-year
Virginia (1)	479.3	ITRS	May 2001	May 2003	5 one-year
Washington	242.5	ITRS	March 2000	March 2004	2 one-year
West Virginia	85.5	ITRS	June 2000	June 2003	2 one-year

(1) Secondary instant ticket supplier

(2) Pull-tab sales are included within instant ticket sales.

(3) A new contract that extends through March 17, 2007, with three one-year renewal options is being executed.

(4) New contract in 2002; ticket sales/on-line retail sales data are estimated.

(5) Support of previously sold lottery system; fee not based on Handle.

*ITRS = Instant ticket and related services

*Systems = Instant ticket validation systems

Pari-mutuel Group

We are a leading worldwide supplier of technologically advanced computerized wagering systems and related equipment. We also provide simulcasting and telecommunications services, video gaming terminals and telephone and Internet account wagering.

North American Pari-mutuel Operations. In 2002, our systems processed approximately 65% of the estimated \$18 billion in pari-mutuel wagering conducted on horse racing in North America. Based on

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Handle, our customers include 10 of the 15 largest thoroughbred racetracks in North America and 10 of the 12 largest North American OTB networks. We typically provide, install and maintain the necessary pari-mutuel wagering systems and equipment for our North American pari-mutuel customers, and we also provide race simulcasting and telecommunications services, video gaming terminals, and telephone and Internet account wagering systems.

The pari-mutuel wagering systems we provide in North America typically include the terminals that issue the wagering tickets, the central processing unit that calculates the betting odds of a particular event and tabulates and accounts for the Handle, the display board that indicates the betting odds of a particular event and the communication equipment necessary for additional wagering from sources outside the wagering facility. These systems utilize high volume, real-time transaction and data processing networks managed by central computers, communications equipment, special purpose microcomputer-based terminals, peripheral and display equipment and operations and applications software. The type of central processing unit and the number of ticket-issuing terminals used in a system are generally determined by the physical layout and amount of wagering at each facility. We also provide additional software and other support functions.

In recent years, we have focused on the creation of regional networks of large and medium sized racetracks and OTB networks, rather than single facilities at smaller racetracks. Our networks link multiple racetracks, OTBs, and regional networks of racetracks and OTBs to one another via dedicated, secure, high-speed communications channels, enabling operators to capitalize on the growth of the off-track wagering market in a more cost-effective manner. Additionally, when linked to our other regional and national pari-mutuel wagering networks, these networks provide our customers with access to new markets and revenue sources by increasing the number and variety of wagering opportunities that customers can offer to their patrons. We believe our established wagering networks will give us a competitive advantage in renewing existing contracts and winning new contracts in regions where such networks exist because of our ability to offer customers greater services more efficiently than our competitors. In North America, we currently operate regional pari-mutuel wagering networks in California, Connecticut, Florida, Illinois, New Jersey, New York, Oregon, Pennsylvania, Texas, Washington, West Virginia, Puerto Rico, British Columbia and Ontario.

Our pari-mutuel wagering system contracts typically have an initial term of five years, and we have generally been successful in renewing these contracts. Our contracts contain certain warranties regarding implementation, operation, performance and reliability of our wagering systems relating to, among other things, data accuracy, repairs and validation procedures. The terms of our warranties vary from contract to contract. We also provide the operations, maintenance and supervisory personnel necessary to operate the pari-mutuel wagering system. We maintain ownership of the pari-mutuel wagering systems, which enables us to employ such equipment in more than one racetrack at different times during the year as most customers do not operate live wagering all year long.

We typically receive revenue for our services in North America as a varying percentage of Handle, generally ranging up to approximately 0.55% of the Handle on a particular event (with a weighted average of approximately 0.32% of the Handle), subject, in many instances, to minimum fees which are usually exceeded under normal operating conditions. Minimum fees under our service contracts are generally based on the number of days the facility operates, as well as other factors, including the type of system and number of terminals installed at the facility. In addition to the Handle-based fees and minimums, fees for extra equipment and services may be charged, particularly for new terminal models and equipment levels which exceed those originally contracted.

In addition, we may also receive an "interface fee" of 0.125% or 0.15% of Handle for combining wagers into the "combined pools" of host tracks whose systems we operate, depending on whether we or another vendor provides such wagering services. We hold contracts with most of the U.S.'s premier thoroughbred venues that typically attract the greatest levels of simulcast and remote wagering, and therefore generate the highest interface revenues.

International Pari-mutuel Operations. In most international markets, we sell our pari-mutuel wagering systems and terminals to pari-mutuel operators; in other international markets, we provide pari-mutuel services similar to those provided by our pari-mutuel operations in North America. We provide and operate pari-mutuel wagering systems at all of the racetracks in Germany, Ireland, Turkey and Austria, as well as all of the OTBs in Germany, and in January 2003 we were awarded the contract to provide pari-mutuel services to STWK, the Poland racing organization. Our pari-mutuel wagering systems are comparable to those

deployed in North America and include computer software, ticket terminals, a central processing unit, display boards and communication equipment. These services are provided under long-term contracts of five to 10 years. We have generally been successful in renewing these contracts.

In Germany, we have been providing pari-mutuel wagering systems and services to the nine major harness racetracks since 1994, and simulcasting services since January 1998. In September 1999, we began providing both pari-mutuel and simulcasting services to Germany's 16 major thoroughbred racetracks, approximately 50 OTBs and approximately 120 bookmaker shops as a result of our acquisition of selected pari-mutuel assets of Datasport Toto Dienstleistung GmbH & Co KG. In April 1999, we sold a pari-mutuel wagering system and began to

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

provide ongoing maintenance and operating services through 2008 to Tote Ireland Ltd., a wholly-owned subsidiary of the Irish Horseracing Authority. In France, we provide pari-mutuel systems and services to approximately 28% of the racetracks in the provinces. In Turkey, we have provided a pari-mutuel system and associated maintenance services to the Turkey Jockey Club since 1995. In 2001, we completed the installation of 1,700 terminals and an ECLIPSE software conversion at the Turkey Jockey Club's six racetracks and 1,500 off-track betting agencies.

In most international markets, we sell, deliver and install pari-mutuel wagering systems in racetracks and OTBs rather than operating them pursuant to service contracts. We have systems operating in approximately 20 countries. Each of these systems is customized to meet the unique needs of our customers, including game designs, regulatory requirements, language preferences, network communication standards and other key elements. The sale of a pari-mutuel wagering system includes a license for use of our proprietary system software as well as installation, training, technical assistance, support, accessories and limited spare parts.

Other Pari-mutuel Operations

Simulcasting. We are one of the leading providers of simulcasts of live horse and greyhound racing and jai alai matches to racetracks, OTBs, jai alai frontons and casinos in North America and Europe. We simulcast racing events from over 60 racetracks and jai alai frontons to more than 150 racetracks and almost 1,300 OTBs throughout North America. We provide similar services in Europe, particularly in The Netherlands and Germany, where we service all 29 racetracks and more than 250 OTBs and bookmaker shops.

Simulcasting of races entails the encryption and transmission of an audio/video signal from one of our uplink trucks located at a racetrack to one of five satellite transponders we lease pursuant to long-term contracts, and the retransmission of this signal to other racetracks, OTBs and casinos, where the race signal is received and decoded for viewing. In general, we receive a daily event fee from the racetracks for up-linking the video and audio signals and a monthly fee from racetracks, OTBs and casinos for the use of our decoders.

Our encryption/transmission equipment compresses each audio/video signal so that eight signals can be transmitted via one satellite transponder. This technology maximizes the transmission capacity of each of our transponders. Any capacity that we do not use for our simulcasting contracts represents excess time that we may sell to other users of satellite communications, generally for short periods, but, from time to time, under long-term contracts.

NASRIN®. In conjunction with our 70% interest in a joint venture with Churchill Downs, we operate a national voice/data telecommunications network, known as the North American Simulcast Racing Information Network, or NASRIN®, that serves almost 150 racetracks and OTBs. Built around AT&T's international frame relay network, NASRIN® securely transmits betting data at a fraction of the cost previously paid by the racetracks and other facilities, allowing racetracks and OTBs to expand their simulcast wagering opportunities. The system is designed to link all wagering locations in North America and to serve as a platform for future technology developments. In exchange for our services, we are paid certain fees based on bandwidth and level of service.

Video Gaming Machines. We have developed a proprietary line of progressive video gaming machines for use at racetracks in North America. They combine full gaming functionality, such as video poker, blackjack, simulated spinning reels and keno, with full race wagering functionality, including picture-in-picture capabilities. As a result, our video gaming machines allow patrons to wager on horse races and watch simulcasted races or other televised programs on a picture-in-picture video window, while

12

continuing to wager on selected video games. We typically collect a flat fee per terminal plus fees for software upgrades and maintenance.

Venue Management Group

We own and have the right to operate in perpetuity substantially all off-track pari-mutuel wagering in Connecticut, subject to our compliance with certain licensing requirements. Our Connecticut operations consist of 12 OTB facilities, including simulcasting at two teletheaters and four other branches, and telephone account wagering for customers in 27 states. We are also the exclusive licensed operator for all pari-mutuel wagering in The Netherlands, with five racetracks and 34 OTBs under a contract with an initial term continuing through June 2003. We are currently in negotiations regarding the extension of our license in The Netherlands and believe we will be successful in obtaining such extension. Our revenues are based on a weighted average percentage of the Handle wagered at our OTB venues, which ranges from 22% to 32%. We also provide facilities management services to the Mohegan Sun Casino racebook in Connecticut.

In Connecticut, approximately \$221 million was wagered in fiscal 2002 on more than 60 U.S.-based thoroughbred, harness and greyhound racetracks and jai alai frontons at or through our facilities. Since we commenced operations in 1993, we have implemented several important

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

product and service enhancements, including expanded simulcasting from across the country, common-pool wagering, seven day per week operations at nine locations and expanded telephone wagering. Our revenues are based on an allowed percentage of Handle wagered through the Connecticut OTB. The percentage of the total Handle, or commission, which we may receive is determined by the track where the event is held and varies by type of wager. Our weighted average commission, based on Handle, for our Connecticut operations is approximately 22%. In September 1998, we began providing an extension of our OTB services, including pari-mutuel wagering and simulcasting services, to the Mohegan Tribal Gaming Authority for its racebook located at the Mohegan Sun Casino in Uncasville, Connecticut under a seven-year agreement. We believe this racebook is a state-of-the-art facility which incorporates the latest wagering technology and the most advanced audio and video simulcasting signals.

In July 1998, we acquired the rights to, and began operating, all on-track and off-track pari-mutuel wagering in The Netherlands under a license granted by the Dutch Ministry of Agriculture which extends through June 30, 2003. We are currently in negotiations regarding the extension of our license in The Netherlands and believe we will be successful in obtaining such extension. We also received additional license approvals to allow us to modernize and expand pari-mutuel wagering in The Netherlands. These approvals allow us to open up to 10 teletheaters, increase the number of OTBs, expand into arcade shops, implement interactive account wagering, and expand national and international simulcasting of racing. We currently operate 35 OTB locations throughout The Netherlands, including three sports cafes, and four on-track OTBs, as well as at four tracks. Our weighted average commission, based on Handle, for our Dutch operations is approximately 32%.

Telecommunications Products Group

We are a leading manufacturer of prepaid phone cards in Europe, which entitle cellular phone users to a defined value of airtime. Prepaid phone cards offer consumers worldwide a cost-effective way to purchase cellular airtime, without requiring phone companies to extend credit or consumers to commit to contracts. We have approximately 20% of the fragmented European market for prepaid cellular phone cards and are the largest supplier of paper-based prepaid phone cards in the world. To prevent fraud, our phone cards incorporate proprietary security technology originally developed for our lottery ticket operations. We expect to participate in the anticipated continued growth in the cellular market. We invested approximately \$22 million in our U.K. operations, in 1999 and 2000, to modernize our facilities and increase our prepaid phone card printing capacity to approximately 700 million cards from a base of approximately 120 million cards before the investments. We sell our prepaid phone cards to phone companies for a per unit price.

For additional information concerning our business and geographic segments, see Note 20 to the Consolidated Financial Statements.

Contract Procurement

Lottery Group

Government operated lotteries in the U.S. typically operate under state mandated public procurement regulations. See "Government Regulation". Lotteries select an instant ticket or on-line supplier by issuing a Request for Proposal, or RFP, which outlines contractual obligations as well as products and services to be delivered. An evaluation committee frequently comprised of key lottery staff evaluates responses based on various criteria. These criteria usually include quality of product, security plan and features, experience in the industry, quality of personnel and services to be delivered and price. We believe that our product functionality, the quality of our personnel, our technical expertise and our manufacturing efficiency give us many advantages relative to the competition when responding to state lottery RFPs. However, many lotteries still award the contract to the qualified vendor with the lowest price, regardless of factors other than price. Contract awards by lottery authorities are sometimes challenged by unsuccessful competitors which can result in protracted legal proceedings. Internationally, lottery authorities do not always utilize such a formal bidding process, but rather negotiate with one or more potential vendors.

U.S. instant ticket lottery contracts typically have an initial term of three years and frequently include multiple renewal options which our customers have generally exercised for additional periods ranging from one to five years. Our U.S. on-line lottery contracts typically have a minimum initial term of five years, with additional renewal options. The length of these lottery contracts, together with their renewal options, limits the number of contracts available for bidding in any given year.

Pari-mutuel Group

Contract awards by owners of horse and greyhound racetracks, OTBs and casinos and jai alai frontons, and from state and foreign governments, often involve a lengthy competitive bid process, spanning from specification development to contract negotiation and award. In recent years, there has been continued consolidation of racetrack ownership, which may increase the competitive nature of the contract procurement process. Our contracts for the provision of pari-mutuel systems services in North America are typically for terms of five years. In

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

addition, our ancillary pari-mutuel services, such as simulcasting, are typically provided under one-year contracts. Historically, we have been successful in renewing our largest pari-mutuel contracts as they have come due for renewal.

Venue Management Group

Our license to provide on-track and off-track services in The Netherlands expires in the year 2003. We are currently in negotiations regarding the extension of our license in The Netherlands and believe we will be successful in obtaining such extension. New venue management opportunities generally occur via the privatization of existing government operated OTBs, as in the case of Connecticut and The Netherlands, the acquisition or outsourcing of an existing private racetrack or OTB operations, or new legislation or regulation enabling new distribution channels. These opportunities occur infrequently and may be subject to public procurement bidding requirements.

Telecommunications Products Group

Most telecommunications products customers issue purchase orders with agreed upon terms and conditions. In addition, certain customer purchase orders contain multiple delivery dates.

Research and Product Development

We believe that our ability to attract new lottery and wagering system customers and retain existing customers depends in part on our ability to continue to incorporate technological advances into, and to improve, our products, systems and related equipment. We maintain a development program directed toward systems development as well as toward the improvement and refinement of our present products and the expansion of their uses and applications. Many of our product developments and innovations have quickly become industry standards.

14

Intellectual Property

We have a number of U.S. and foreign patents that we consider, in the aggregate, to be of material importance to our business. Patents extend for varying periods of time according to the date of patent filing or grant and the legal term of patents in the various countries where patent protection is obtained. In the U.S., the term of a patent expires 20 years from the date of filing. The actual protection afforded by a patent, which can vary from country to country, depends upon the type of patent, the scope of its coverage and the availability of legal remedies in the country.

Certain technology material to our lottery and pari-mutuel wagering products, processes and systems is the subject of patents issued, and patent applications currently pending, in the U.S. and certain other countries. In our lottery business, we utilize our patented and patent-pending technology for the production, secure printing, validation and distribution of instant lottery tickets. In our pari-mutuel business, our patent-pending systems and methods provide racing and wagering data and related information. None of our material patents is scheduled to expire until August 2006, and most of our material patents are not scheduled to expire until 2013 or later.

We also have a number of U.S. and foreign registered trademarks and other common law trademark rights for certain of our products, including Winner's Choice, Terra 2000®, SciScan Technology®, Aegis, PROBE®, EXTREMA®, SGI-NET, ECLIPSE, NASRIN®, SAM®, STAN, MAX®, TINY TIM®, On the Wire®, Autotote.com and others. Trademark protection continues in some countries, including the U.S., for as long as the mark is used and in other countries for as long as it is registered. Registrations generally are for fixed, but renewable, terms.

In our lottery business, we have entered into a product development agreement pursuant to which we have an exclusive license to use certain third-party patented technology in our SciScan Technology® terminals. Subject to clauses providing for early termination, the agreement is scheduled to remain in effect until 2017. In our pari-mutuel business, we have a perpetual license to use certain software to monitor our simulcast systems, and a consortium of which we are a party has a license, scheduled to expire in 2021, to use certain software that supplies the database and various interfaces for our TrackPlay Internet and interactive television-based wagering platform. None of our licenses is material to our business as a whole. The software and control systems for our wagering systems are also the subject of copyright and/or trade secret laws.

We are not aware of any pending claims of infringement regarding our patents, trademarks or other intellectual property in any of our current businesses.

Seasonality

The first and fourth quarters of the calendar year traditionally comprise the weakest seasons for our pari-mutuel wagering businesses. As a result of inclement weather during the winter months, a number of racetracks do not operate and those that do operate often experience missed racing days. This adversely affects the amounts wagered and our corresponding service revenues. Wagering equipment sales and software license revenues usually reflect a limited number of large transactions, which do not recur on an annual basis. Consequently, revenues and operating results can vary substantially from period to period as a result of the timing of revenue recognition for major equipment sales and software license revenue. In addition, instant ticket and prepaid phone card sales may vary depending on the season and timing of contract awards, changes in customer budgets, ticket inventory levels, lottery retail sales and general economic conditions.

Production Processes; Sources and Availability of Components

Our dedicated computer-controlled printing process is specifically designed for producing instant lottery game tickets for governmentally sanctioned lotteries and promotional games as well as prepaid phone cards. Our facilities are designed for efficient, secure production of instant game tickets and support high-speed variable image printing, packaging and storage of instant game tickets. Instant ticket games are delivered finished and ready for distribution by the lottery authority, or by us in the jurisdictions which are part of an instant ticket contract with cooperative services. Paper and ink are the principal raw materials consumed in our ticket manufacturing operations. We have a variety of sources for both paper and ink and should, therefore, not be dependent on any particular supplier.

Production of our lottery and pari-mutuel wagering systems and related component products primarily involves the assembly of electronic components into more complex systems and products. We produce our terminal products primarily at our manufacturing facility in Ballymahon, Ireland, or on a limited basis at our Newark, Delaware administration and development facility. Other manufacturing may be contracted out to third party vendors, as needed.

We normally have sufficient lead-time between reaching an agreement to provide a lottery or pari-mutuel wagering system and the commencement of operations so that we are able to provide the customer with a fully functioning system, customized to meet their requirements. In the event that current suppliers of central processing units were no longer available, we believe we would be able to adapt our application software to run on the then available hardware in time to allow us to meet new contractual obligations, although the price competitiveness of our products might diminish. The lead-time for obtaining most of the electronic components we use is approximately 90 days. We believe that this is consistent with our competitors' lead-times and is also consistent with the needs of our customers.

Competition

Lottery Group

The instant ticket and on-line lottery business is highly competitive, and our business faces competition from a number of domestic and foreign instant ticket manufacturers, on-line lottery system providers and other competitors, some of whom have substantially greater financial resources than we do. Our business continues to operate in a period of intense price-based competition. The award of contracts by state officials is influenced by factors including price, the ability to optimize lottery revenues through game design, technical capability, marketing capability and applications, the quality, dependability and upgrade capability of the network, production capacity, the security and integrity of the vendor's production operations, the experience, financial condition and reputation of the vendor and the satisfaction of other requirements and qualifications that lottery authorities may impose. Contract awards by lottery authorities are sometimes challenged by unsuccessful competitors, which can result in protracted legal proceedings that can result in delayed implementation or cancellation of the award.

We currently have three instant lottery ticket competitors in the U.S.: Pollard Banknote Limited, or Pollard, Oberthur Gaming Technologies, or OGT, a subsidiary of Group Francois-Charles Oberthur of France, and Creative Games International, Inc., a subsidiary of Canadian Bank Note Company, Ltd. We estimate that the retail sales value of our U.S. customer base was approximately 65% of total U.S. instant ticket retail sales in 2002. Except as permitted by the applicable provisions of the North American Free Trade Act with respect to Canada and Mexico, it is currently illegal to import lottery tickets into the U.S. from a foreign country. Our business could be adversely affected should additional foreign competitors in Canada or Mexico export their lottery products to the U.S. or should other foreign competitors establish printing facilities in the U.S., Canada or Mexico to supply the U.S. market. Internationally, there are many lottery instant ticket vendors which compete with us including, among others, Pollard, OGT, Creative Games and GPS Honsel.

Our principal competitors in the U.S. on-line lottery systems business are GTECH Holdings Corporation (with approximately 72% of the U.S. market based on retail sales), Automated Wagering International Inc., or AWI, a subsidiary of International Game Technology, and Interlott Technologies, Inc. GTECH is also our major competitor in the international on-line market with the balance of the market being served by AWI, Interlott Technologies, Inc., EssNet AB, International Lottery and Totalizator Systems, Inc. and a few other companies.

Pari-mutuel Group

Our pari-mutuel operations face significant competition from other operators in the pari-mutuel business, other gaming venues such as casinos and state sponsored lotteries and other forms of legal and illegal gaming. We compete primarily on the basis of the design, performance, reliability and pricing of our products as well as customer service. To effectively compete, we expect to make continued investments in product development and/or acquisitions of technology.

Our two principal competitors in the North American pari-mutuel wagering systems business are AmTote International, Inc. and International Game Technology, which operates its pari-mutuel wagering systems business through its subsidiary United Tote. Our competition outside of North America is more fragmented, with competition being provided by several international and regional companies. In addition, we believe we are one of the leading providers in North America of video and data simulcasting services in this highly fragmented industry. Current and future competitors in Internet-based wagering include YouBet.com and TVG.

Venue Management Group

Our venue management business competes with other pari-mutuel operations as well as other forms of gaming and other entertainment. Competition for wagers comes from casinos, racetracks, lotteries and other forms of legal and illegal gambling. Other gaming competitors operate in our licensed markets and in surrounding areas and compete for our customers, and additional competitors could be licensed, or existing regulations could be changed, so as to adversely affect our competitive position.

Telecommunications Products Group

The market for prepaid phone cards is highly fragmented, but competition comes from other instant ticket lottery printers utilizing similar lottery security and printing technologies, as well as alternative printing and non-printing technologies. Our telecommunications products operations compete with other printing companies on the basis of price, availability, product features and product security. There is competition within our class of products and other technologies to provide the desired functionality. There are alternative technologies such as smart cards or alternative means to provide the funding of telephone services. We are investing in new higher speed and higher capacity printing and packaging technologies that we believe, in combination with our lottery security and logistics expertise, will provide us a competitive advantage in this market. Our competitors in this area include OGT, Schlumberger Limited and Gemplus S.A.

Security

Attempts to penetrate security measures may come from various combinations of customers, retailers, vendors, employees and others. We constantly assess the adequacy of our security systems to protect against any material loss to any of our customers.

Notwithstanding the foregoing, our wholly owned pari-mutuel wagering subsidiary, Autotote Systems, Inc. experienced a breach of security by an employee who altered betting data on previously placed wagering tickets the \$3 million "winning" wager on the races constituting the Pick Six at the Breeders' Cup at Arlington Park in Illinois on October 26, 2002, as well as two other multiple-race wagers from earlier in the month. The employee also engaged in a scheme whereby he used his authorized access to duplicate uncashed winning tickets.

During our review of the Breeders' Cup Pick Six wager, we discovered evidence of the employee's wrongdoing before any financial loss to bettors occurred and immediately terminated the employee. On February 13, 2003, the National Thoroughbred Racing Association's Wagering Technology Working Group and Giuliani Partners jointly issued an interim report that found no irregularities or suspicious circumstances apart from the unlawful activities of the former employee.

Following the Breeders' Cup incident, we and the other industry totalizator companies agreed to industry-wide security improvements, including the installation of software necessary to scan all wagering pools in connection with multi-race wagers after each race of a multi-race wager. We have completed the installation of that software. We and the other totalizator companies also agreed to permit an audit of our respective computer security and procedures by Ernst & Young. We also engaged Kroll, Inc., a leading worldwide risk mitigation and security company, to conduct a separate review of our physical security,

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

operational controls, hiring practices and internal compliance. In addition, we have independently committed to, and have begun, the deployment of a new control system to operate every one of our totalizator systems. This independent system runs in parallel with our computers, records data in real time and allows for a review by a third party of all data against the live system.

In 2002, we incurred approximately \$1.1 million of costs related to the former employee's malfeasance. Although we believe that any future losses, if any, that may arise from this matter will not result in a material adverse effect on our consolidated financial position or results of operations, it is not feasible to predict with certainty, and there can be no assurance that our business might not be materially affected or that other security breaches will not occur.

In our lottery business, we employ numerous security safeguards, including bar coding and providing additional layers of protection in our instant tickets. We have effected security measures in the areas of ticket specifications, production, packaging, delivery, distribution and accounting. We also incorporate computer function safeguards, including secure ticket data, control number encryption, winner file data, and ticket stock control, in our data processing and in the computer operations phase. In addition, we also retain a major public accounting firm to perform agreed upon security procedures for each game produced before it is sent to the customer.

As the incidence and severity of publicly reported cases of physical and computer crime continue, major lotteries periodically reassess key security questions concerning the vulnerability of lottery games. Although we have not uncovered any practical, economically feasible way to breach the security of our instant tickets or on-line lottery games that could result in a material loss to any of our customers, no assurances can be given that security breaches will not occur.

Employees

As of December 31, 2002, we employed approximately 2,780 persons. Most of our U.S. pari-mutuel employees involved in field operations and equipment repairs are represented by the International Brotherhood of Electrical Workers under two separate contracts, extending through October 2005 and May 2004, respectively. Most of our Canadian pari-mutuel employees are represented by the Service Employees International Union. Three of our lottery employee groups are represented by a labor union: our employees in Austria are represented by a Worker's Council, which is typical of many European companies; and at the United Kingdom facility, approximately 360 employees are members of the Graphic Print and Media Union.

Government Regulation

General

Lotteries, pari-mutuel wagering, sports wagering, and video gaming may be lawfully conducted only in jurisdictions that have enacted enabling legislation. In jurisdictions that currently permit various wagering activities, regulation is extensive and evolving but customarily includes some form of licensing of a license applicant and its subsidiaries. Regulators in those jurisdictions review many facets of an applicant for or holder of a license including, among other items, financial stability, integrity and business experience. We believe we are currently in substantial compliance with all regulatory requirements in the jurisdictions where we operate. Any failure to receive a material license or the loss of a material license that we currently hold could have a material adverse effect on our overall operations and financial condition.

In December 2000, Congress enacted legislation authorizing patrons to place pari-mutuel wagers, where lawful in each state involved, by "telephone or other electronic media" with off track betting systems in the same or different state. Regulatory authorities continue to review and interpret this legislation, which amended the federal Interstate Horseracing Act of 1978. New legislation may be enacted that would impose other restrictions on telephone and Internet wagering operations, and we are unable to predict whether such interpretations or legislation, if any, would have a material adverse impact on us.

While we believe that our current and planned business activities comply with all applicable laws, law enforcement authorities in certain jurisdictions have opposed the expansion of wagering via telephone and the Internet and state regulators have expressed concerns to us regarding such wagering by their citizens through racetracks serviced by our pari-mutuel wagering systems. We cannot assure you that our activities or the activities of our customers will not become the subject of any law enforcement proceeding or that such

proceeding, if any, would not have a material adverse impact on us or our business plans. Additionally, although we believe that the December 2000 amendment to the federal Interstate Horseracing Act of 1978 clarifies that account wagering, off-track betting and inter-track simulcasting, as currently conducted by the U.S. horse racing industry, are authorized under U.S. federal law, the amendment may not be interpreted in this manner by all concerned. We cannot assure you that we can continue to conduct our pari-mutuel, account wagering, OTB and

race simulcasting operations in all of the jurisdictions in which we currently operate or that a discontinuation of any of these operations would not have a material adverse impact on us or our business plans.

We have developed and implemented an extensive internal compliance program in an effort to ensure that we comply with legal requirements imposed in connection with our wagering-related activities, as well as legal requirements generally applicable to all publicly traded corporations. The compliance program is run on a day-to-day basis by a full-time compliance officer and is overseen by the Compliance Committee authorized by our Board of Directors. While we are firmly committed to full compliance with all applicable laws, there can be no assurance that such steps will prevent the violation of one or more laws or regulations, or that a violation by us or an employee will not result in the imposition of a monetary fine or suspension or revocation of one or more of our licenses.

Lottery Operations

At the present time, 40 jurisdictions in the U.S. (including the District of Columbia, Puerto Rico and the U.S. Virgin Islands), all the Canadian provinces, Mexico and many other foreign countries authorize lotteries. Lottery contracts and ongoing operations of lotteries both domestically and abroad are subject to extensive regulation. Although certain of the features of a lottery, such as the percentage of gross revenues that must be paid back to players in prize money, are usually fixed by legislation, the various lottery regulatory authorities generally exercise significant discretion, including the determination of the types of games played, the price of each wager, the manner in which the lottery is marketed and the selection of the vendors of equipment and services and retailers of lottery products. Furthermore, laws and regulations applicable to lotteries in the U.S. and foreign jurisdictions are subject to change, and the effect of such changes on our ongoing and potential operations cannot be predicted with certainty.

To ensure the integrity of the contract award and wagering process, most jurisdictions require detailed background disclosure on a continuous basis from, and conduct background investigations of, the vendor, its subsidiaries and affiliates and its principal shareholders. Background investigations of the vendor's employees who will be directly responsible for the operation of the system are also generally conducted, and most states reserve the right to require the removal of employees whom they deem to be unsuitable or whose presence they believe may adversely affect the operational security or integrity of the lottery. Certain jurisdictions also require extensive personal and financial disclosure and background checks from persons and entities beneficially owning a specified percentage (typically five percent or more) of a vendor's securities. The failure of beneficial owners of our securities to submit to background checks and provide such disclosure could result in the imposition of penalties upon these beneficial owners and could jeopardize the award of a lottery contract to us or provide grounds for termination of an existing lottery contract.

From time to time we retain governmental affairs representatives in various states of the U.S. to advise legislators and the public concerning our views on lottery legislation, to monitor such legislation and to advise us in our relations with lottery authorities. We also make campaign contributions to various state political parties and state political candidates. We believe we have complied with applicable laws and regulations concerning campaign contributions and lobbying disclosures.

The award of lottery contracts and ongoing operations of lotteries in international jurisdictions also are extensively regulated, although this regulation usually varies from that prevailing in the U.S. Restrictions are frequently imposed on foreign corporations seeking to do business in such jurisdictions and, as a consequence, we have, in a number of instances, allied ourselves with local companies when seeking foreign lottery contracts. Laws and regulations applicable to lotteries in the U.S. and foreign jurisdictions are subject to change, and the effect of such changes on our ongoing and potential operations cannot be predicted with certainty.

Pari-mutuel Wagering

Forty-three states in the U.S., Puerto Rico, all of the Canadian provinces, Mexico and many other foreign countries have authorized pari-mutuel wagering on horse races, and 16 states and many foreign countries, including Mexico, conduct pari-mutuel wagering on greyhound races. In addition, Connecticut, Rhode Island, Florida and Mexico also allow pari-mutuel wagering on jai alai matches.

Companies that manufacture, distribute and operate pari-mutuel wagering systems in these jurisdictions are subject to the regulations of the applicable regulatory authorities there. These authorities generally require a company, as well as its directors, officers, certain employees and holders of 5% or more of the company's common stock, to obtain various licenses, permits and approvals. Regulatory authorities may also conduct background investigations of the company and its key personnel and stockholders in order to ensure the integrity of the wagering system. These authorities have the power to refuse, revoke or restrict a license for any cause they deem reasonable. The loss of a license in one jurisdiction may cause the company's licensing status to come under review in other jurisdictions as well.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

In order for any of our subsidiaries to provide pari-mutuel wagering equipment and/or services to certain casinos located in Atlantic City, New Jersey, it must be licensed by the New Jersey Casino Control Commission, or the Casino Commission, as a gaming related casino service industry in accordance with the New Jersey Casino Control Act, or the Casino Control Act, and by the New Jersey Racing Commission. An applicant for a gaming related casino service industry license is required to establish, by clear and convincing evidence, financial stability, integrity and responsibility; good character, honesty and integrity; and sufficient business ability and experience to conduct a successful operation. We must also qualify under the standards of the Casino Control Act. We and any of our applicant subsidiaries may also be required to produce such information, documentation and assurances as required by the regulators to establish the integrity of all our directors, officers and financial backers, who may be required to seek qualification or waiver of qualification. For affiliates of New Jersey casinos, the Casino Commission traditionally has waived the qualification requirement for investors holding less than 15% of a debt issue. For institutional investors, the Casino Commission traditionally has waived the qualification requirement for holders if their positions are not more than 20% of the issuer's overall debt and not more than 50% of the specific debt issue.

The Casino Commission has broad discretion in licensing matters and may at any time condition a license or suspend or revoke a license or impose fines upon a finding of disqualification or non-compliance. The Casino Commission may require that persons holding five percent or more of our Class A common stock qualify under the Casino Control Act. Under the Casino Control Act, a security holder is rebuttably presumed to control a publicly traded corporation if the holder owns at least five percent of the corporation's equity securities; however, for passive institutional investors, qualification is generally not required for a position of less than 10%, and upon a showing of good cause, qualification may be excused for a position of 10% or more. Failure to qualify could jeopardize our license. In addition, the New Jersey Racing Commission also licenses our subsidiary and retains concurrent regulatory oversight over this subsidiary with the Casino Commission.

As a consequence of the sale of our Series A convertible preferred stock, in 2000 the Casino Control Act required our subsidiary that held a casino service industry license to relinquish said license upon the closing of that sale and apply anew for licensure. We obtained preliminary approval from the New Jersey Racing Commission and transactional waivers from the Casino Commission that allow us to continue providing services to Atlantic City casinos pending investigation of the new application that we filed and until our subsidiary is relicensed and our directors, officers and certain security holders are qualified. The purchasers of our Series A convertible preferred stock and certain of their directors, officers and shareholders may be required to seek qualification or to seek waiver of qualification. We believe that all the foregoing actions will be satisfactorily concluded in due course. However, there can be no assurance that this will be the case, and our failure to obtain any of the foregoing approvals could have a material adverse effect on us or our business plans.

Our rights to operate the Connecticut OTB system are conditioned on our continuing to hold all licenses required for the operation of the system. In addition, our officers and directors and certain other employees must be licensed. Licensees are generally required to submit to background investigations and provide required disclosures. The Division of Special Revenue of the State of Connecticut, or the Division, may revoke the license to operate the system under certain circumstances, including a false statement in the licensing disclosure materials, a transfer of ownership of the licensed entity without Division approval and

failure to meet financial obligations. The approval of the Connecticut regulatory authorities is required before any off-track betting facility is closed or relocated or any new branch or simulcast facility is established. Our telephone wagering operations, based in Connecticut, are subject to the Division's regulation. We have expanded the market for our "business-to-consumer" On the Wire® account wagering business through our Connecticut OTB from 13 states to 27 states.

While in the past we have been the subject of enforcement proceedings instituted by one or more regulatory bodies, we have been able to consensually resolve any such proceedings upon the implementation of remedial measures and/or the payment of settlements or monetary fines to such bodies. However, there can be no assurance that similar proceedings in the future will be similarly resolved, or that such proceedings will not have a material adverse impact on our ability to retain and renew existing licenses or to obtain new licenses in other jurisdictions.

Video Gaming

Coin or voucher operated gambling devices offering electronic, video versions of spinning reels, poker, blackjack and similar games are known as VGMs or video lottery terminals, or VLTs, depending on the jurisdiction. These devices represent a growing area in the wagering industry. We or our subsidiaries manufacture and supply terminals and wagering systems designed for use as VGMs or VLTs.

Twenty-seven states and Puerto Rico authorize wagering on VGMs or VLTs at casinos, riverboats, racetracks and/or other licensed facilities. Although some states, such as Rhode Island, currently restrict VGMs or VLTs to already existing wagering facilities, others permit these devices to be placed at bars and restaurants as well. Several Native American tribes throughout the U.S. are also authorized to operate these devices on reservation lands. In addition, all of the Canadian provinces and various foreign countries have authorized their use.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

From time to time, government officials in other states consider proposals to legalize or expand video gaming or video lottery in their states. Many legislators have been enthusiastic about the potential of video gaming to raise significant additional revenues. Some officials, however, are reluctant to expand gaming industry opportunities or have expressed a desire to limit video gaming to established wagering facilities if video gaming is authorized in their jurisdiction at all.

Companies that manufacture, sell or distribute VGMs or VLTs are subject to various provincial, state, county and municipal laws and regulations. The primary purposes of these rules are (i) to ensure the responsibility, financial stability and character of equipment manufacturers and their key personnel and stockholders through licensing requirements, (ii) to ensure the integrity and randomness of the machines, and (iii) to prohibit the use of VGMs or VLTs at unauthorized locations or for the benefit of undesirable individuals or entities. The regulations governing VGMs and VLTs generally resemble the pari-mutuel and sports wagering regulations in all the basic elements described above.

However, every jurisdiction has differing terminal design and operational requirements, and terminals generally must be certified by local regulatory authorities before being distributed in any particular jurisdiction. These requirements may require us or our subsidiaries to modify our terminals to some degree in order to achieve certification in particular locales. In addition, the intrastate movement of such devices in a jurisdiction where they will be used by the general public is usually allowed only upon prior notification and/or approval of the relevant regulatory authorities.

The West Virginia Lottery Commission has licensed us or our subsidiaries to supply VLTs to authorized pari-mutuel racing facilities in that state in accordance with the Racetrack Video Lottery Act.

In Canada, one of our subsidiaries has been granted registration as a casino gaming related supplier by the Alcohol and Gaming Commission of Ontario in accordance with Ontario's Gaming Control Act, 1992 and by the Alberta Gaming and Liquor Commission in accordance with its Gaming and Liquor Act of Alberta. Another subsidiary has been granted interim registration as a gaming related supplier to the Manitoba Lottery Commission by the Manitoba Gaming Control Commission. The gaming laws of Ontario, Alberta, and Manitoba primarily deal with the responsibility, honesty, integrity and financial stability of gaming equipment manufacturers, distributors and operators as well as persons financially interested or involved in gaming operations. To ensure the integrity of manufacturers and suppliers of gaming supplies, gaming regulators in Ontario, Alberta and Manitoba have the authority to conduct thorough background investigations of us, our officers, directors, key personnel and significant stockholders who are required to

21

file applications detailing their personal and financial information. The gaming regulators may at any time revoke, suspend, condition or restrict a registration for an appropriate cause as determined under the applicable gaming legislation. We believe that we are in compliance with the terms and conditions of our registrations in Ontario, Alberta and Manitoba.

We may apply for all necessary licenses in other jurisdictions that may now or in the future authorize video gaming or video lottery operations. We cannot predict the nature of the regulatory schemes or the terminal requirements that will be adopted in any of these jurisdictions, nor whether we or any of our subsidiaries can obtain any required licenses and equipment certifications or will be found suitable.

U.S. federal law also affects our video gaming industry activities. The Federal Gambling Devices Act of 1962, or the Devices Act, makes it unlawful for any person to manufacture, deliver or receive gambling devices, including VGMs and VLTs, across interstate lines unless that person has first registered with the Attorney General of the U.S., or to transport such devices into jurisdictions where their possession is not specifically authorized by state law. The Devices Act permits states to exempt themselves from its prohibition on transportation, and several states that authorize the manufacture or use of such devices within their jurisdictions have done so. Certain of our products, such as the PROBE® XLC terminal, are gaming devices subject to the Devices Act and state laws governing such devices. The Devices Act does not apply to machines designed for pari-mutuel wagering at a racetrack, such as our pari-mutuel wagering terminals. We have registered under the Devices Act and believe we are substantially in compliance with all of the Devices Act's record-keeping and equipment identification requirements.

Simulcasting

The Federal Communications Commission regulates the use and transfer of earth station licenses used to operate our domestic simulcasting operations.

At present, 43 states, Puerto Rico, all of the Canadian provinces, Mexico and many other foreign countries authorize interstate and/or intrastate pari-mutuel wagering, which may involve the simulcasting of the races in question. Licensing and other regulatory requirements associated with such simulcasting activities are similar to those governing pari-mutuel wagering and are generally enforced by pari-mutuel regulators. In addition, contracts with host tracks whose races are simulcast by us to other facilities within or outside the jurisdictions in which

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

such races are held may be subject to approval by regulatory authorities in the jurisdictions from and/or to which the races are simulcast. We believe that we are in substantial compliance with applicable regulations and that we, and/or the appropriate third parties, have entered into contracts and obtained the necessary regulatory approvals to conduct current simulcast operations lawfully.

Nevada Regulatory Matters

We and certain of our wholly-owned subsidiaries are applicants or will be applicants for certain registrations, approvals, findings of suitability and licenses in the State of Nevada. There can be no assurances that the pending applications by us and our subsidiaries operating in Nevada will be approved or that, if approved, they will be approved on a timely basis or without conditions or limitations.

The manufacture, sale and distribution of gaming devices for use or play in Nevada or for distribution outside of Nevada, the manufacture and distribution of associated equipment for use in Nevada, the operation of an off-track pari-mutuel wagering system in Nevada, the operation of an off-track pari-mutuel sports wagering system in Nevada and the operation of slot machine routes in Nevada are subject to: (i) the Nevada Gaming Control Act and the regulations promulgated thereunder, or the Nevada Act; and (ii) various local ordinances and regulations. Such activities are subject to the licensing and regulatory control of the Nevada Gaming Commission, or Nevada Commission, the Nevada State Gaming Control Board, or Nevada Board, and various local, city and county regulatory agencies.

The laws, regulations and supervisory procedures of the Nevada gaming authorities are based upon declarations of public policy which are concerned with, among other things: (i) the prevention of unsavory or unsuitable persons from having a direct or indirect involvement with gaming, or manufacturing or distribution of gaming devices at any time or in any capacity; (ii) the strict regulation of all persons, locations, practices, associations and activities related to the operation of licensed gaming establishments and the manufacture or distribution of gaming devices and equipment; (iii) the establishment and maintenance of responsible accounting practices and procedures; (iv) the maintenance of effective controls over the financial

practices of licensees, including the establishment of minimum procedures for internal fiscal affairs and the safeguarding of assets and revenues, providing reliable record keeping and requiring the filing of periodic reports with the Nevada gaming authorities; (v) the prevention of cheating and fraudulent practices; and (vi) to provide a source of state and local revenues through taxation and licensing fees. Changes in such laws, regulations and procedures could have an adverse effect on our various applications in the event they are granted. No assurances can be given that the applications will be granted by the Nevada gaming authorities. The grant or denial of the applications is within the discretion of the Nevada gaming authorities.

We are an applicant for registration by the Nevada Commission as a publicly traded corporation and are or will be an applicant to be found suitable to own the stock, both directly and indirectly of various wholly-owned subsidiaries which are or will be applicants for approvals and licensing as a manufacturer, distributor and operator of a slot machine route, an operator of an off-track pari-mutuel wagering system and an operator of an off-track pari-mutuel sports wagering system. As a registered corporation, we will be required periodically to submit detailed financial and operating reports to the Nevada Commission and furnish any other information that the Nevada Commission may require. No person may become a stockholder of, or receive any percentage of profits from, our subsidiaries operating in Nevada without first obtaining licenses and approvals from the Nevada gaming authorities. We and our subsidiaries operating in Nevada have or will apply to the Nevada gaming authorities for the various registrations, approvals, permits, findings of suitability and licenses in order to engage in manufacturing, distribution, slot route activities, and off-track pari-mutuel wagering systems operations in Nevada. The following regulatory requirements will apply to us and our subsidiaries operating in Nevada if they are approved and licensed. All gaming devices and cashless wagering systems that are manufactured, sold or distributed for use or play in Nevada, or for distribution outside of Nevada, must be manufactured by licensed manufacturers and distributed or sold by licensed distributors. All gaming devices manufactured for use or play in Nevada must be approved by the Nevada Commission before distribution or exposure for play. The approval process for gaming devices includes rigorous testing by the Nevada Board, a field trial and a determination as to whether the gaming device meets strict technical standards that are set forth in the regulations of the Nevada Commission. Associated equipment must be administratively approved by the Chairman of the Nevada Board before it is distributed for use in Nevada.

The Nevada gaming authorities may investigate any individual who has a material relationship to, or material involvement with, us or our subsidiaries operating in Nevada in order to determine whether such individual is suitable or should be licensed as a business associate of a gaming licensee. Officers, directors and certain key employees of our subsidiaries operating in Nevada are required to file applications with the Nevada gaming authorities and may be required to be licensed or found suitable by the Nevada gaming authorities. Our officers, directors and key employees who are actively and directly involved in the licensed activities of our subsidiaries operating in Nevada may be required to be licensed or found suitable by the Nevada gaming authorities. The Nevada gaming authorities may deny an application for licensing for any cause that they deem reasonable. A finding of suitability is comparable to licensing, and both require submission of detailed personal and financial information followed by a thorough investigation. The entity with which the applicant is employed or for which the applicant serves must pay all

the costs of the investigation. Changes in licensed positions must be reported to the Nevada gaming authorities and in addition to their authority to deny an application for a finding of suitability or licensure, the Nevada gaming authorities have jurisdiction to disapprove a change in a corporate position.

If the Nevada gaming authorities were to find an officer, director or key employee unsuitable for licensing or unsuitable to continue having a relationship with us or our subsidiaries operating in Nevada, the companies involved would have to sever all relationships with such person. In addition, the Nevada Commission may require us and our subsidiaries operating in Nevada to terminate the employment of any person who refuses to file appropriate applications. Determinations of suitability or of questions pertaining to licensing are not subject to judicial review in Nevada.

We and our subsidiaries operating in Nevada will be required to submit detailed financial and operating reports to the Nevada Commission. Substantially all material loans, leases, sales of securities and similar financing transactions by our subsidiaries operating in Nevada will be required to be reported to or approved by the Nevada Commission. If we are licensed by the Nevada gaming authorities, any (i) guarantees issued by our subsidiaries operating in Nevada in connection with any public financing; (ii) hypothecation of the assets of our subsidiaries operating in Nevada as security in connection with any financing; and/or (iii) pledges of the equity securities of our subsidiaries operating in Nevada as security in connection with any public financing will require the approval of the Nevada Commission to remain effective. If it were

determined that the Nevada Act was violated by us or any of our subsidiaries operating in Nevada, the licenses we or they hold could be limited, conditioned, suspended or revoked, subject to compliance with certain statutory and regulatory procedures. In addition, any of our subsidiaries operating in Nevada, us and the persons involved could be subject to substantial fines for each separate violation of the Nevada Act at the discretion of the Nevada Commission. Limitation, conditioning or suspension of the licenses held by us and our subsidiaries operating in Nevada could (and revocation of any license would) materially adversely affect our manufacturing, distribution and system operations in Nevada. Any beneficial holder of our voting securities, regardless of the number of shares owned, may be required to file an application, be investigated, and have his suitability determined as a beneficial holder of our voting securities if the Nevada Commission has reason to believe that such ownership would otherwise be inconsistent with the declared policies of the state of Nevada. The applicant must pay all costs of investigation incurred by the Nevada gaming authorities in conducting any such investigation. The Nevada Act requires any person who acquires beneficial ownership of more than 5% of a registered corporation's voting securities to report the acquisition to the Nevada Commission. The Nevada Act requires that beneficial owners of more than 10% of a registered corporation's voting securities apply to the Nevada Commission for a finding of suitability within thirty days after the Chairman of the Nevada Board mails the written notice requiring such filing. Under certain circumstances, an "institutional investor," as defined in the Nevada Act, which acquires more than 10%, but not more than 15%, of the registered corporation's voting securities may apply to the Nevada Commission for a waiver of such finding of suitability if such institutional investor holds the voting securities for investment purposes only. An institutional investor shall not be deemed to hold voting securities for investment purposes unless the voting securities were acquired and are held in the ordinary course of business as an institutional investor and not for the purpose of causing, directly or indirectly, the election of a majority of the members of the board of directors of the registered corporation, any change in the registered corporation's corporate charter, bylaws, management, policies or operations of the registered corporation, or any of its gaming affiliates, or any other action which the Nevada Commission finds to be inconsistent with holding the registered corporation's voting securities for investment purposes only. Activities which are not deemed to be inconsistent with holding voting securities for investment purposes only include: (i) voting on all matters voted on by stockholders; (ii) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in its management, policies or operations; and (iii) such other activities as the Nevada Commission may determine to be consistent with such investment intent. If the beneficial holder of voting securities who must be licensed or found suitable is a corporation, partnership or trust, it must submit detailed business and financial information including a list of beneficial owners. The applicant is required to pay all costs of investigation.

Also under the Nevada Act and under certain circumstances, an "institutional investor" as defined in the Nevada Act, which intends to acquire not more than 15% of any class of nonvoting securities of a privately-held corporation, limited partnership or limited liability company that is also a registered holding or intermediary company or the holder of a gaming license, may apply to the Nevada Commission for a waiver of the usual prior licensing or finding of suitability requirements if such institutional investor holds such nonvoting securities for investment purposes only. An institutional investor shall not be deemed to hold nonvoting securities for investment purposes unless the nonvoting securities were acquired and are held in the ordinary course of business as an institutional investor, do not give the institutional investor management authority, and do not, directly or indirectly, allow the institutional investor to vote for the election or appointment of members of the board of directors, a general partner or manager, cause any change in the articles of organization, operating agreement, other organic document, management, policies or operations, or cause any other action that the Nevada Commission finds to be inconsistent with holding nonvoting securities for investment purposes only. Activities that are not deemed to be inconsistent with holding nonvoting securities for investment purposes only include: (i) nominating any candidate for election or appointment to the entity's board of directors or equivalent in connection with a debt restructuring; (ii) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in the entity's management, policies or operations; and (iii) such other activities as the Nevada

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Commission may determine to be consistent with such investment intent. If the beneficial holder of nonvoting securities who must be licensed or found suitable is a corporation, partnership or trust, it must submit detailed business and financial information including a list of beneficial owners. The applicant is required to pay all costs of investigation.

Any person who fails or refuses to apply for a finding of suitability or a license within thirty days after being ordered to do so by the Nevada Commission or the Chairman of the Nevada Board, may be found

24

unsuitable. The same restrictions apply to a record owner if the record owner, after request, fails to identify the beneficial owner. Any stockholder found unsuitable and who holds, directly or indirectly, any beneficial ownership of the common stock beyond such period of time as may be prescribed by the Nevada Commission may be guilty of a criminal offense. We will be subject to disciplinary action if, after we receive notice that a person is unsuitable to be a stockholder or to have any other relationship with us, our subsidiaries operating in Nevada or we (i) pay that person any dividend or interest upon our voting securities, (ii) allow that person to exercise, directly or indirectly, any voting right conferred through securities held by that person, (iii) pay remuneration in any form to that person for services rendered or otherwise, or (iv) fail to pursue all lawful efforts to require such unsuitable person to relinquish his voting securities including, if necessary, the immediate purchase of said voting securities for cash at fair market value.

The Nevada Commission may, in its discretion, require the holder of any debt security of a registered corporation to file applications, be investigated and be found suitable to own the debt security of a registered corporation if the Nevada Commission has reason to believe that his acquisition of such debt security would otherwise be inconsistent with the declared policy of the State of Nevada. If the Nevada Commission determines that a person is unsuitable to own such security, then pursuant to the Nevada Act, the registered corporation can be sanctioned, including the loss of its approvals, if without the prior approval of the Nevada Commission, it: (i) pays to the unsuitable person any dividend, interest, or any distribution whatsoever; (ii) recognizes any voting right by such unsuitable person in connection with such securities; (iii) pays the unsuitable person remuneration in any form; or (iv) makes any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation, or similar transaction.

We and our subsidiaries operating in Nevada will be required to maintain a current stock ledger in Nevada, which may be examined by the Nevada gaming authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to the Nevada gaming authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. We are also required to render maximum assistance in determining the identity of the beneficial owner. The Nevada Commission has the power to require our stock certificates to bear a legend indicating that the securities are subject to the Nevada Act.

After becoming a registered corporation, we may not make a public offering of our securities without the prior approval of the Nevada Commission if the securities or proceeds from that sale are intended to be used to construct, acquire or finance gaming facilities in Nevada, or to retire or extend obligations incurred for such purposes. Such approval, if given, does not constitute a finding, recommendation or approval by the Nevada Commission or the Nevada Board as to the accuracy or adequacy of the prospectus or the investment merits of the securities offered. Any representation to the contrary is unlawful. While we are not yet subject to the provisions of the Nevada Act or the regulations of the Nevada Commission, such regulations also provide that any entity that is not an "affiliated company," as such term is defined in the Nevada Act, or which is not otherwise subject to the Nevada Act or such regulations, which plans to make a public offering of securities intending to use such securities, or the proceeds from the sale thereof, for the construction or operation of gaming facilities in Nevada, or to retire or extend obligations incurred for such purposes, may apply to the Nevada Commission for prior approval of such offering. The Nevada Commission may find an applicant unsuitable based solely on the fact that it did not submit such an application, unless upon a written request for a ruling, the Nevada Board Chairman has ruled that it is not necessary to submit an application.

Changes in control of a registered corporation through merger, consolidation, stock or asset acquisitions, management or consulting agreements, or any act or conduct by a person whereby he obtains control, may not occur without the prior approval of the Nevada Commission. Entities seeking to acquire control of a registered corporation must satisfy the Nevada Board and the Nevada Commission in a variety of stringent standards prior to assuming control of such Registered Corporation. The Nevada Commission may also require controlling stockholders, officers, directors and other persons having a material relationship or involvement with the entity proposing to acquire control, to be investigated and licensed as part of the approval process relating to the transaction.

The Nevada Legislature has declared that some corporate acquisitions opposed by management, repurchases of voting securities and corporate defense tactics affecting Nevada corporate gaming licensees, and registered corporations that are affiliated with those operations, may be injurious to stable and

25

productive corporate gaming. The Nevada Commission has established a regulatory scheme to ameliorate the potentially adverse effects of these business practices upon Nevada's gaming industry and to further Nevada's policy to: (i) assure the financial stability of corporate gaming licensees and their affiliates; (ii) preserve the beneficial aspects of conducting business in the corporate form; and (iii) promote a neutral environment for the orderly governance of corporate affairs. Approvals are, in certain circumstances, required from the Nevada Commission before the registered corporation can make exceptional repurchases of voting securities above the current market price thereof and before a corporate acquisition opposed by management can be consummated. The Nevada Act also requires prior approval of a plan of recapitalization proposed by the registered corporation's Board of Directors in response to a tender offer made directly to the registered corporation's stockholders for the purposes of acquiring control of the registered corporation.

License fees and taxes, computed in various ways depending on the type of gaming or activity involved, are payable to the State of Nevada and to the counties and cities in which gaming operations are to be conducted. Depending upon the particular fee or tax involved, these fees and taxes are payable either monthly, quarterly or annually and are based upon either: (i) a percentage of the gross revenues received; or (ii) the number of gaming devices operated. Annual fees are also payable to the State of Nevada for renewal of licenses as a manufacturer, distributor, operator of a slot machine route and operator of an off-track pari-mutuel wagering system.

Any person who is licensed, required to be licensed, registered, required to be registered, or is under common control with such persons, and who proposes to become involved in a gaming venture outside of Nevada, is required to deposit with the Nevada Board, and thereafter maintain, a revolving fund in the amount of \$10,000 to pay the expenses of investigation by the Nevada Board of their participation in such foreign gaming. The revolving fund is subject to increase or decrease in the discretion of the Nevada Commission. Thereafter, licensees are required to comply with certain reporting requirements imposed by the Nevada Act. A licensee is also subject to disciplinary action by the Nevada Commission if it knowingly violates any laws of the foreign jurisdiction pertaining to the foreign gaming operation, fails to conduct the foreign gaming operation in accordance with the standards of honesty and integrity required of Nevada gaming operations, engages in activities that are harmful to the state of Nevada or its ability to collect gaming taxes and fees, or employs a person in the foreign operation who has been denied a license or finding of suitability in Nevada on the ground of personal unsuitability.

Application of Additional or Future Regulatory Requirements

In the future, we intend to seek the necessary licenses, approvals and findings of suitability for us, our personnel and products in other jurisdictions throughout the world wherever significant sales are anticipated to be made. There can be no assurance, however, that such licenses, approvals or findings of suitability will be obtained or, if obtained, will not be conditioned, suspended or revoked or that we will be able to obtain the necessary approvals for any future products as they are developed. If a license, approval or a finding of suitability is required by a regulatory authority and we fail to obtain the necessary license, approval or finding, we may be prohibited from selling our products for use in the respective jurisdiction or may be required to sell our products through other licensed entities at a reduced profit.

Executive Officers of the Company

Certain information concerning our executive officers is set forth below:

Name	Age	Position
A. Lorne Weil	57	Chairman of the Board, President and Chief Executive Officer
Martin E. Schloss	56	Vice President, General Counsel and Secretary
DeWayne E. Laird	55	Vice President, Chief Financial Officer and Controller
William J. Huntley	53	Vice President of Lottery Systems
Cliff O. Bickell	60	Vice President of Printed Products
Brooks Pierce	41	Vice President of Pari-mutuel Operations
Robert E. Becker	44	Vice President and Treasurer
Sally Conkright	50	Vice President of Organization Development
Richard M. Weil	48	Vice President of International Business Development

Our Executive Officers hold office for an indefinite term, subject to the discretion of our Board of Directors.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

A. Lorne Weil has served as a director since December 1989, Chairman of the Board since October 31, 1991, Chief Executive Officer since April 1992, and President since August 1997. Mr. Weil held various senior management positions with Scientific Games Corporation and its subsidiaries from October 1990 to April 1992 and was a director and consultant to Autotote Systems, Inc. from 1982 until it was acquired by the Company in 1989. Mr. Weil was President of Lorne Weil, Inc., a firm providing strategic planning and corporate development services to high technology industries, from 1979 to November 1992.

Martin E. Schloss has served as Vice President and General Counsel since December 1992 and Secretary since May 1995. Mr. Schloss also serves as a Vice President and Secretary of most of our subsidiaries. From 1976 to 1992, Mr. Schloss served in various positions in the legal department of General Instrument Corporation, with the exception of a hiatus of approximately one and one-half years.

DeWayne E. Laird, has served as Vice President and Chief Financial Officer since November 1998 and corporate Controller since April 1996. From January 1992 to March 1996, Mr. Laird was President of Laird Associates, PC, a CPA firm providing financial consulting services to a variety of industries. From April 1984 to December 1991, he held various senior positions with Philadelphia Suburban Corporation, including Chief Financial Officer and Treasurer.

William J. Huntley joined the Company in 1973 and has served as Vice President of Lottery Systems since October 2002 and as President of Scientific Games International, Inc.'s Systems division since September 2000. Mr. Huntley served as President of Autotote Lottery Corporation from November 1997 until its merger into Scientific Games International, Inc. He served as Vice President of Autotote Systems, Inc. from June 1989 to November 1997 and as Vice President of Operations of the Company from 1991 to 1994.

Cliff O. Bickell has served as Vice President of Printed Products since October 2002 and as President of the Printed Products division of Scientific Games International, Inc. since the September 2000 acquisition of SGHC. Mr. Bickell joined SGHC in 1995 and he previously served as its Vice President, Treasurer and Chief Financial Officer. Prior to joining SGHC, Mr. Bickell was Vice President, Chief Financial Officer and Treasurer of Paragon Trade Brands, a multi-national consumer products manufacturer. In addition, Mr. Bickell has held positions as Senior Vice President, Corporate Administration Chief Financial Officer of W.A. Krueger Co., a commercial printing company, and Treasurer of Dataproducts Corporation, a multinational electronics manufacturer.

Brooks H. Pierce has served as Vice President of Pari-mutuel Operations since October 2002, and as President of Autotote Systems, Inc. since November 1997. Mr. Pierce previously served as Vice President of Autotote Systems, Inc. from November 1991 to November 1997.

Robert C. Becker has served as Treasurer since October 1996 and as Vice President since April 2001. Prior to joining Scientific Games Corporation, Mr. Becker served as Assistant Treasurer for the Fuller Company from 1990 to 1994.

27

Sally L. Conkright has served as Vice President of Organizational Development since October 2002. Ms. Conkright served as Vice President of Converge, L.L.C. from 2001 to 2002, and as Director of Innovation & eLearning for Linkage, Inc. from 2000 to 2001. Ms. Conkright served as Director of Compensation and Benefits for Xerox Corporation from 1999 to 2000 and as Vice President of Human Resources and Public Relations for Xerox New Enterprises from 1997 to 1999.

Richard M. Weil has served as Vice President of International Business Development since March 2002 and he has also served as Vice President of International Business Development of Scientific Games International, Inc. since October 2000. Previously, he was in charge of international business development for Autotote Systems, Inc. where he started as Vice President of Manufacturing in 1994. Prior to joining Autotote, Mr. Weil was a consultant for strategic planning and corporate development with several firms. Richard M. Weil is the brother of A. Lorne Weil, the Chairman of the Board, President and Chief Executive Officer of the Company.

Access to Public Filings

We file annual, quarterly, current reports, proxy statements and other documents with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including us, that file electronically with the SEC. The public can obtain any documents that we file with the SEC at <http://www.sec.gov>.

We provide public access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports, which may be accessed free of charge on our website at the following address:

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

http://www.scientificgames.com/SGCorp/investorrelations.asp. These documents are provided as soon as practicable after filing with the SEC, although not generally on the same day.

28

ITEM 2. PROPERTIES

The following is a list of facilities that we use in the operation of our business.

Business	Location	Square Feet	Owned/leased	Purposes
Corporate	New York, NY	12,000	Leased	Corporate Headquarters
	Christiana, DE	8,000	Leased	Administration
Pari-Mutuel	Newark, DE	63,000	Leased	Administration, operations, warehouse space and manufacturing
	Essen, Germany	12,000	Leased	Administration and operations
	Various	33,000	Leased	Warehouse and office space
	Paris, France	10,000	Owned	Administration and operations
Venue Management	Various cities, CT	53,000	Leased	OTB facilities
	New Haven, CT	2,000	Leased	Administration
	The Netherlands	16,000	Leased	Administration and operations
	Various cities, The Netherlands	44,000	Leased	OTB facilities
	Windsor Locks, CT	39,000	Owned	OTB facility
	New Haven, CT	55,000	Owned	OTB facility, administration and operations
Lottery	Rocky Hill, CT	17,000	Leased	Administration and operations
	Barre, VT	3,100	Leased	Administration
	Concord, NH	5,400	Leased	Administration and operations
	Helena, MT	3,900	Leased	Administration and operations
	Urbandale, IA	35,000	Leased	Administration and operations
	Gardner, ME	10,000	Leased	Administration and operations
	Orlando, FL	50,000	Leased	Administration and operations
	Norcross, GA	27,000	Leased	Warehouse space
	Blythewood, SC	20,000	Leased	Administration and operations
	Ballymahon, Ireland	10,000	Leased	Manufacturing
	Vienna, Austria	46,300	Leased	Administration and operations
	Paris, France	12,000	Leased	Administration and operations
	Various	42,000	Leased	Warehouse space, administration and operations
	Santiago, Chile	73,000	Owned	Administration, operations, warehousing and manufacturing
	Alpharetta, GA	245,000	Owned	Manufacturing
Telecommunication Products	Leeds, England	150,000	Owned	Manufacturing
	Bradford, England	33,000	Leased	Manufacturing and administration

29

ITEM 3. LEGAL PROCEEDINGS

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Although we are a party to various claims and legal actions arising in the ordinary course of business, we believe, on the basis of information presently available to us, that the ultimate disposition of these matters will not likely have a material adverse effect on our consolidated financial position or results of operations.

Our subsidiary, SGI, owned a minority interest in Wintech de Colombia S.A., or Wintech (now in liquidation), which formerly operated the Colombian national lottery under contract with Empresa Colombiana de Recursos para la Salud, S.A. ("Ecosalud"), an agency of the Colombian government. The contract projected that certain levels of lottery ticket sales would be attained and provided a penalty against Wintech, SGI and the other shareholders of Wintech of up to \$5.0 million if such performance levels were not achieved. In addition, with respect to a further guarantee of performance under the contract with Ecosalud, SGI delivered to Ecosalud a \$4.0 million bond issued by a Colombian surety, Seguros del Estado ("Seguros"). Wintech started the instant lottery in Colombia, but, due to difficulties beyond its control, including, among other factors, social and political unrest in Colombia, frequently interrupted telephone service and power outages, and competition from another lottery being operated in a province of Colombia which we believe was in violation of Wintech's exclusive license from Ecosalud, the projected sales level was not met for the year ended June 30, 1993. On July 1, 1993, Ecosalud adopted resolutions declaring, among other things, that the contract was in default and asserted various claims for compensation and penalties against Wintech, SGI and other shareholders of Wintech. Litigation is pending and/or threatened in Colombia concerning various claims among Ecosalud, Wintech and SGI, relating to the termination of the contracts with Ecosalud. Ecosalud's claims are for, among other things, realization of the full amount of the penalty, plus interest and costs of the bond.

The Colombian surety, Seguros, paid \$2.4 million to Ecosalud under its \$4.0 million bond, and made demand upon SGI for that amount under the indemnity agreement between the surety and SGI. SGI declined to make or authorize any such payment and notified the surety that any payment in response to Ecosalud's demand on the bond was at the surety's risk. In a case brought in U.S. District Court in Georgia, the Colombian surety sought to recover from SGI sums paid (in SGI's view, improperly) under its surety bond, plus interest. In September 1999, the District Court granted summary judgment for the surety in the amount of approximately \$7 million (which included pre-judgment interest at a rate of 38.76% per annum). On appeal, the United States Court of Appeals for the Eleventh Circuit, on August 20, 2001, affirmed the judgment for the principal amount of \$2.4 million, but vacated that part of the judgment awarding approximately \$4.6 million based on a pre-judgment interest rate of 38.76% with instructions to the District Court to recalculate pre-judgment interest. On February 22, 2002, SGI agreed to settle this matter upon payment of \$3.7 million to the Colombian surety. On February 26, 2002, SGI drew upon a \$1.5 million letter of credit posted by a former Colombian partner in order to partially fund this payment. This settlement resolves the U.S. litigation with the surety, but the claims in Colombia remain unresolved.

In July 2002, a Colombian appellate tribunal denied SGI's motion to dismiss Ecosalud's pending lawsuit against SGI. While SGI's motion is subject to further appeal to the Colombian Council of State, the highest appellate court with jurisdiction over this matter, the proceeding in the lower court, which is in an early stage, will continue during the pendency of the appeal.

SGI has various defenses on the merits as well as procedural defenses that we plan to assert against Ecosalud's claims. We intend to vigorously pursue these defenses as appropriate. SGI also has certain cross indemnities and undertakings from the two other privately held shareholders of Wintech for their respective shares of any liability to Ecosalud. No assurance can be given that the other shareholders of Wintech will, or have sufficient assets to, honor their indemnity undertakings to SGI when the claims by Ecosalud against SGI and Wintech are finally resolved, in the event such claims result in any final liability. Although we believe that any potential losses arising from these claims will not result in a material adverse effect on our consolidated financial position or results of operations, it is not feasible to predict the final outcome, and there can be no assurance that these claims might not be finally resolved adversely to us or result in material liability.

On October 26, 2002, we experienced a breach of security by an employee who altered betting data on the \$3 million "winning" wagering ticket on the races constituting the Pick Six at the Breeders' Cup at

Arlington Park in Illinois. It was subsequently discovered that the employee, whom we terminated, also altered betting data on two other multiple-race wagers earlier in the month.

On December 4, 2002, a class action lawsuit (*Allard v. Autotote / Scientific Games Corporation, and Does 1-10* (L. A. Superior Court No. BC 286382)) was filed against us in state court in California by a professional Pick Six bettor on behalf of pari-mutuel bettors in the U.S., alleging, among other things, negligence, breach of contract and deceptive trade practices arising from our handling of multiple-race wagers. We removed the case to federal court, and moved to dismiss the lawsuit. In response, the plaintiff agreed to file an amended complaint in an attempt to address some of the deficiencies that were the subject of our motion. That amended complaint has not yet been filed. We believe that the lawsuit lacks merit, and we intend to contest the suit vigorously.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Also on December 4, 2002, a second class action lawsuit (*Cheldin v. Scientific Games Corporation, Autotote Systems, Inc., and Does 1-20* (L. A. Superior Court No. BC 286417)) was filed against us in state court in California by a bettor of the Breeders' Cup Pick Six wager, on behalf of all bettors of such Pick Six wagers. The lawsuit alleged negligence and fraud with respect to our wagering systems in connection with the Breeders' Cup Pick Six. We removed the case to federal court, and our motion to dismiss the complaint is currently pending. We believe that the lawsuit lacks merit, and we intend to contest the suit vigorously.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of fiscal 2002.

31

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Since January 29, 2002, our outstanding common stock has been listed for trading on the Nasdaq National Market under the symbol "SGMS". Our common stock was previously traded on the American Stock Exchange. The following table sets forth, for the periods indicated, the range of high and low closing prices of our Class A common stock.

	Market Price of Scientific Games Common Stock	
	High	Low
Fiscal 2001 (January 1, 2001 - December 31, 2001)		
First Quarter	\$ 3.60	\$ 1.95
Second Quarter	5.89	1.94
Third Quarter	5.93	3.00
Fourth Quarter	8.75	3.62
Fiscal 2002 (January 1, 2002 - December 31, 2002)		
First Quarter	10.05	8.10
Second Quarter	9.97	7.00
Third Quarter	7.99	5.98
Fourth Quarter	8.40	5.55
Fiscal 2003		
First Quarter through March 19, 2003	7.41	4.85

On March 20, 2003, the last reported sale price for our common stock on the Nasdaq National Market was \$5.74 per share. There were approximately 1,585 holders of record of our common stock as of March 20, 2003.

We have never paid any cash dividends on our Class A common stock. The Board presently intends to retain all earnings, if any, for use in the business. Any future determination as to payment of dividends will depend upon our financial condition and results of operations and such other factors as are deemed relevant by the Board. Further, under the terms of the Indenture governing our 12 $\frac{1}{2}$ % Senior Subordinated Notes, we and our Restricted Subsidiaries (as defined) are limited in our ability to pay any cash dividends or make certain other restricted payments (other than stock dividends) on our Class A common stock.

Recent Sales of Unregistered Securities; Uses of Proceeds From Registered Securities

The terms of our outstanding Series A Convertible Preferred Stock provide for quarterly dividends at a rate equal to 6% per annum, which are payable in kind in the form of additional shares of such preferred stock until the ninth dividend payment, in September 2002, and thereafter may be paid-in-kind or in cash at our option. In 2002, we issued an aggregate of 74,000 shares of our Series A Convertible Preferred Stock, pro

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

rata to the holders of such outstanding preferred stock, as quarterly dividend payments on such preferred stock. The Series A Convertible Preferred Stock was originally issued in a private transaction exempt from registration under the Securities Act in reliance on Section 4(2) thereof. In July 2002, in connection with certain waivers and consents by holders of our Series A Convertible Preferred Stock relating to our 2002 equity offering (as defined herein), we authorized 2,000 shares and issued an aggregate of 1,237.6 shares of Series B Preferred Stock in a private transaction exempt from registration under the Securities Act in reliance on Section 4(2) thereof. In addition, in December 2002, we issued 900,313 shares of our Class A Common Stock to a holder of our Preferred Stock in connection with the holder's conversion of 45,916 shares of the Series A Convertible Preferred Stock originally issued in a private transaction exempt from registration under the Securities Act in reliance on Section 4(2) thereof, and without additional consideration.

For additional information regarding our Series A Convertible Preferred Stock and our Series B Preferred Stock, please see Note 14 and Exhibit 3.(i), which exhibit is hereby incorporated by this reference.

32

Information on our Common Stock authorized for issuance under equity compensation plans is contained in Item 12 under the captions "Equity Compensation Plan Information". See Notes 14 and 15 to the Consolidated Financial Statements for a description of our employee stock purchase plan and our employee stock option plans, respectively.

ITEM 6. SELECTED FINANCIAL DATA

Selected historical financial data presented below as of and for the years ended October 31, 1998, 1999 and 2000, the two months ended December 31, 2000 and the years ended December 31, 2001 and 2002 have been derived from our audited consolidated financial statements, revised to reflect the restatement thereof as more fully discussed in Note 1 to the restated consolidated financial statements. These financial statements have been audited by KPMG LLP, independent auditors. The following financial information reflects the acquisitions and dispositions of certain businesses during the period 1998 through 2002, including the acquisition of SGHC since September 6, 2000 and the acquisition of 65% of the equity of Serigrafica Chilena S.A. ("SERCHI") since June 5, 2002. In connection with the acquisition of SGHC, we changed our fiscal year from an October 31 year-end to a calendar year-end, beginning with the year ended December 31, 2001. As a result, the following summary presents selected financial data for the years ended October 31, 1998, 1999 and 2000, the two-month transition period ended December 31, 2000 and the years ended December 31, 2001 and 2002, as restated. These data should be read in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and the Consolidated Financial Statements and the Notes thereto, included in Item 8 of this Form 10-K/A.

FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA (in thousands, except per share amounts)

	Years Ended October 31,			Two Months Ended	Year Ended	Year Ended
	December 31,					
	1998	1999(c)	Restated 2000(e)(l)	Restated 2000(l)	Restated 2001(l)	Restated 2002(l)
Selected Statement of Operations Data:						
Operating Revenues:						
Services	\$ 135,790	148,660	186,520	57,584	364,567	382,818
Sales	23,523	62,488	46,828	9,007	75,674	72,435
	<u>159,313</u>	<u>211,148</u>	<u>233,348</u>	<u>66,591</u>	<u>440,241</u>	<u>455,253</u>
Costs and Expenses:						
Cost of services	88,916	99,496	126,601	39,592	231,285	221,038
Cost of sales	15,739	43,937	29,299	5,547	47,158	47,412
Amortization of service contract software (a)	1,982	2,180	1,765	517	4,366	4,930

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

				Two Months Ended	Year Ended	Year Ended
Selling, general and administrative	26,205	27,178	35,664	9,902	56,695	63,132 (g)
Depreciation and amortization (k)	27,507	20,009	25,735	7,755	49,132	37,905
Interest expense	15,521	16,177	31,231	8,790	50,363	44,842 (h)
Other (income) expense	(1,064)	15	(456)	(247)	37	636
Loss on sale of businesses	66(b)	1,600(d)				
Total costs and expenses	174,872	210,592	249,839	71,856	439,036	419,895
Income (loss) before income tax expense (benefit) and extraordinary items	(15,559)	556	(16,491)	(5,265)	1,205	35,358
Income tax expense (benefit)	321	177	1,603	(465)	6,067	(17,875)(i)
Income (loss) before extraordinary items	(15,880)	379	(18,094)	(4,800)	(4,862)	53,233
Extraordinary losses			12,567 (f)			13,501 (j)
Net income (loss)	(15,880)	379	(30,661)	(4,800)	(4,862)	39,732
Convertible preferred paid-in-kind dividend			1,014	1,143	7,051	7,484
Net income (loss) available to common stockholders	\$ (15,880)	379	(31,675)	(5,943)	(11,913)	32,248
Basic and diluted income (loss) per share:						
Basic income (loss) before extraordinary items available to common stockholders	\$ (0.44)	0.01	(0.52)	(0.15)	(0.30)	0.91
Diluted income (loss) before extraordinary items available to common stockholders	\$ (0.44)	0.01	(0.52)	(0.15)	(0.30)	0.66
Basic extraordinary items, net of tax			(0.34)			(0.27)
Diluted extraordinary items, net of tax			(0.34)			(0.17)

33

Basic net income (loss) available to common stockholders (k)	\$ (0.44)	0.01	(0.86)	(0.15)	(0.30)	0.64
Diluted net income (loss) available to common stockholders (k)	\$ (0.44)	0.01	(0.86)	(0.15)	(0.30)	0.50
Weighted average number of shares used in per share calculation:						
Basic shares	35,696	36,118	36,928	40,025	40,340	50,221
Diluted shares	35,696	38,343	36,928	40,025	40,340	80,151
Selected Balance Sheet Data (End of Period):						
Total assets	\$ 156,500	165,559	608,449	598,527	585,796	657,822
Total long-term debt, including current installments	\$ 158,870	157,144	443,834	440,680	439,735	360,529
Stockholders' equity (deficit)	\$ (48,638)	(48,219)	34,645	28,593	20,240	168,770

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

The following notes are an integral part of these selected historical consolidated financial data.

- (a) Reflects the reclassification of "amortization of service contract software" as a component of operating expenses, which amounts had been included in depreciation and amortization in previous filings.
- (b) Reflects \$66 of unusual loss resulting from the adjustment of the prior sales of our CBS and Tele Control businesses for the fiscal year ended October 31, 1998.
- (c) Effective November 1, 1998, we lengthened the depreciable lives of pari-mutuel terminals from seven to ten years as a result of the renewal of a number of key service contracts and the realized equipment durability. The change in the depreciable lives of pari-mutuel terminals resulted in an approximate \$1,100 improvement in net income (loss) and a \$0.03 improvement in net income (loss) per basic and diluted share in each of the four quarters of fiscal 1999.
- (d) Reflects \$1,600 of unusual loss resulting from the sale of our SJC Video business.
- (e) In the fourth quarter of fiscal year ended October 31, 2000, we recognized unusual interest expense charges in the amount of \$7,511 attributable to payments, in the form of warrants to purchase 2,900 shares of common stock to certain financial advisors in connection with their services in obtaining certain financial commitments to acquire SGHC, \$1,200 of additional interest expense as a result of the required prefunding of our 12¹/₂% Senior Subordinated Notes, and approximately \$2,300 of incremental business integration costs as a result of the acquisition of SGHC. We also recorded a \$1,135 write-off of its option to purchase Atlantic City Race Course as a result of the New Jersey legislature's failure to pass the necessary legislation to allow OTB expansion in the state and recorded an extraordinary charge of \$12,567 in connection with the write-off of deferred financing fees and payment of the call premium on our 10⁷/₈% Series B Senior Notes due August 1, 2004.
- (f) Reflects the write-off of \$12,567 of deferred financing fees and payment of the call premium on our 10⁷/₈% Series B Senior Notes.
- (g) Includes approximately \$1.1 million of accrued incremental costs associated with the Pick Six matter.
- (h) Includes approximately \$3.3 million in debt restructuring charges related to interest rate swaps that were settled in connection with the refinancing of our 2000 Facility.
- (i) Includes an income tax benefit of \$32.9 million from the recognition of net operating loss carryforwards at December 31, 2002.
- (j) Reflects the write-off of approximately \$10.2 million of deferred financing fees related to the refinancing of the 2000 Facility, the payment of approximately \$11.2 million of redemption premium from the repurchase of a portion of the 12¹/₂% Senior Subordinated Notes and the payment of approximately \$1.1 million in bank fees to permit us to use a majority of the net proceeds from the 2002 Equity Offering to redeem subordinated debt. These charges have been reduced by approximately \$9.0 million in income tax benefits.

- (k) On January 1, 2002, we adopted Statement No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"). SFAS 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized. Instead, they will be tested for impairment at least annually in accordance with the provisions of SFAS 142.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

At December 31, 2001, we had unamortized goodwill of approximately \$179 million and unamortized identifiable intangible assets in the amount of approximately \$60 million, all of which were subject to the transition provisions of SFAS 142. In connection with the adoption of SFAS 142, we evaluated our intangible assets and determined that our Connecticut OTB operating right and our trade name with net carrying amounts at December 31, 2001 of approximately \$11.7 million and \$30.1 million, respectively, have indefinite useful lives and, accordingly, we ceased amortization as of January 1, 2002. In addition, as required by SFAS 142, we reclassified our employee work force intangible asset with a net carrying value of approximately \$3.2 million, net of related deferred tax liabilities, to goodwill effective January 1, 2002. As a result of adopting SFAS 142 and ceasing the amortization of our tradename and the employee workforce intangible assets, we reduced the recognized amount of our net operating loss carryforward ("NOL") by \$9.8 million. This reduction was charged to income tax expense in the first quarter of 2002.

35

The following table compares the pro forma net income (loss) available to common stockholders for the years ended October 31, 1998, 1999, and 2000, the two months ended December 31, 2000, and the year ended December 31, 2001, as restated, adjusted to reflect the adoption of SFAS 142 as if it had occurred at the beginning of the periods presented, to the reported net income (loss) available to common stockholders, as restated, for the year ended December 31, 2002:

	Year Ended October 31,			Two Months Ended	Year Ended	Year Ended
	December 31,					
	1998	1999	Restated 2000	Restated 2000	Restated 2001	Restated 2002
	Pro Forma	Pro Forma	Pro Forma	Pro Forma	Pro Forma	As Reported
Adjusted income available to common stockholders:						
Adjusted income (loss) before extraordinary item	\$ (12,539)	2,610	(15,360)	(3,335)	5,251	53,233
Adjusted income (loss) before extraordinary item available to common stockholders	\$ (12,539)	2,610	(16,374)	(4,478)	(1,800)	45,749
Adjusted net income (loss) available to common stockholders	\$ (12,539)	2,610	(28,941)	(4,478)	(1,800)	32,248
Adjusted earnings per share amounts basic and diluted:						
Adjusted income before extraordinary item per share available to common stockholders:						
Basic	\$ (0.35)	0.07	(0.44)	(0.11)	(0.04)	0.91
Diluted	\$ (0.35)	0.07	(0.44)	(0.11)	(0.04)	0.66
Adjusted net income (loss) per share available to common stockholders:						
Basic	\$ (0.35)	0.07	(0.78)	(0.11)	(0.04)	0.64
Diluted	\$ (0.35)	0.07	(0.78)	(0.11)	(0.04)	0.50
Shares used in calculating adjusted per share amounts:						
Basic	35,696	36,118	36,928	40,025	40,340	50,221

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

				Two Months Ended	Year Ended	Year Ended
Diluted	35,696	38,343	36,928	40,025	45,412	80,151
Reconciliation of reported net income to adjusted net income:						
Reported net income (loss) available to common stockholders	\$ (15,880)	379	(31,675)	(5,943)	(11,913)	32,248
Add back:						
Amortization of goodwill and Intangible assets with indefinite lives, net of tax benefit	3,341	2,231	2,734	1,465	10,113	
Adjusted net income (loss) available to common stockholders	\$ (12,539)	2,610	(28,941)	(4,478)	(1,800)	32,248

(1)

The effects of the restatement on the previously reported consolidated financial statements for each of the periods from October 31, 2000 to December 31, 2002 are summarized below:

	Year Ended October 31, 2000		Two Months Ended December 31, 2000		Year Ended December 31, 2001		Year Ended December 31, 2002	
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated
Selected Statement of Operations Data:								
Depreciation and amortization	\$ 26,061	25,735	8,081	7,755	50,843	49,132	37,905	37,905
Total costs and expenses	250,165	249,839	72,182	71,856	440,747	439,036	419,895	419,895
Income (loss) before income tax expense and extraordinary items	(16,817)	(16,491)	(5,591)	(5,265)	(506)	1,205		
Income tax expense (benefit)	1,603	1,603	(677)	(465)	78	6,067	(30,193)	(17,875)
Income (loss) before extraordinary items	(18,420)	(18,094)	(4,914)	(4,800)	(584)	(4,862)	65,551	53,233
Net income (loss)	(30,987)	(30,661)	(4,914)	(4,800)	(584)	(4,862)	52,050	39,732
Net income (loss) available to common stockholders	\$ (32,001)	(31,675)	(6,057)	(5,943)	(7,635)	(11,913)	44,566	32,248

36

Basic and diluted income (loss) per share:

Basic income (loss) before extraordinary items available to common stockholders	\$ (0.53)	(0.52)	(0.15)	(0.15)	(0.19)	(0.30)	1.16	0.91
	\$ (0.53)	(0.52)	(0.15)	(0.15)	(0.19)	(0.30)	0.82	0.66

Diluted income (loss) before extraordinary items available to common stockholders									
Basic net income (loss) available to common stockholders	\$	(0.87)	(0.86)	(0.15)	(0.15)	(0.19)	(0.30)	0.89	0.64
Diluted net income (loss) available to common stockholders									
	\$	(0.87)	(0.86)	(0.15)	(0.15)	(0.19)	(0.30)	0.65	0.50
Weighted average number of shares used in per share calculations:									
Basic Shares		36,928	36,928	40,025	40,025	40,340	40,340	50,221	50,221
Diluted Shares		36,928	36,928	40,025	40,025	40,340	40,340	80,151	80,151
Selected Balance Sheet Data (End of Period):									
Total assets	\$	647,215	608,449	636,967	598,527	601,952	585,796	673,978	657,822
Stockholders' equity	\$	34,319	34,645	28,153	28,593	24,078	20,240	184,926	168,770

The restatement adjustments affecting the periods from October 31, 2000 to December 31, 2002 are adjustments with respect to the carrying value and amortization of goodwill and the recognition of deferred tax assets and income tax benefits as described in Note 1, Restatement of Previously Reported Financial Statements, to the amended and restated consolidated financial statements.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Background

We are a leading worldwide provider of services, systems and products to both the instant ticket lottery industry and pari-mutuel wagering industry based on revenues. We believe we offer our customers the widest array of some of the most technologically advanced products and services in each of these industries. We also believe that we are the world's only fully integrated lottery service provider, offering lottery authorities on-line lottery systems, instant tickets and cooperative services programs.

On September 6, 2000, our predecessor company, Autotote Corporation, completed the acquisition of Scientific Games Holding Corporation ("SGHC"). The operating results of SGHC's businesses have been included in the consolidated statements of operations from the date of the acquisition.

On June 5, 2002, we completed the acquisition of 65% of the equity of Serigrafica Chilena S.A. ("SERCHI"). Subsequent to the acquisition, we changed the name of SERCHI to Scientific Games Latino America S.A. The purchase price was approximately \$3.9 million in cash and up to \$4.4 million in cash or stock payable to SERCHI stockholders upon the achievement of certain financial performance levels of SERCHI over the next four years. The acquisition was recorded using the purchase method of accounting and the acquired assets and liabilities have been recorded at their estimated fair values at the date of acquisition. The operating results of the SERCHI business have been included in the consolidated statements of operations since the date of acquisition.

Our revenues are derived from two principal sources: service revenues and sales revenues. Service revenues are generally earned pursuant to multi-year contracts to provide instant ticket and related services and on-line and pari-mutuel wagering systems and services, or are derived from wagering by customers at facilities we own or lease. We believe our service revenues are recurring in nature. Sales revenues are derived from sales of prepaid phone cards and from the sale of wagering systems, equipment, and software licenses.

We operate primarily in four business segments: Lottery Group, Pari-mutuel Group, Venue Management Group and Telecommunications Products Group.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Our Lottery Group derives revenues from the sale of instant lottery tickets and related services and the sale or operation of on-line lottery systems. In 2002, our Lottery Group accounted for approximately 65% of all retail sales of instant lottery tickets in the United States. In the instant ticket business, we typically sell our tickets for a per unit price or are paid a fee equal to a percentage of the retail value of the instant tickets sold by a state lottery. In the on-line lottery market in the United States, we are generally paid a fee equal to a percentage of all dollars wagered on lottery tickets; in international markets, we generally sell our lottery systems to the lottery operators. "On-line" lottery refers to a computerized system in which lottery terminals in retail outlets are continuously connected to a central computer system for the sale and validation of lottery tickets and related functions.

Our Lottery Group provides instant tickets and related services and lottery systems. Instant ticket and related services includes ticket design and manufacturing as well as value-added services, including game design, sales and marketing support, inventory management and warehousing and fulfillment services. In addition, this division includes promotional instant tickets and pull-tab tickets that we sell to both lottery and non-lottery customers. Our lottery systems business is comprised of Autotote's historical Lottery Operations segment as well as SGHC's systems business, both of which include the supply of transaction processing software for the accounting and validation of both instant ticket and on-line lottery games, point-of-sale terminal hardware sales, central site computers and communication hardware sales, and ongoing support and maintenance services for these products. This business line also includes software, hardware and support service for sports betting and credit card processing systems. We currently operate on-line lottery systems for seven of the 40 on-line lottery authorities in the United States, and we believe we are the second largest on-line lottery provider in Europe.

Our Pari-mutuel Group is a leading worldwide provider of wagering systems to the pari-mutuel wagering industry, to which we also provide related race broadcasting and telecommunications services. Our Pari-mutuel Group is comprised of our North American and international on-track, off-track and inter-track pari-mutuel services, simulcasting and communications services, and video gaming, as well as sales of pari-mutuel systems and equipment. We provide our systems and services to thoroughbred, harness and greyhound racetracks, OTBs, casinos, jai alai frontons and other establishments where pari-mutuel wagering is permitted. We are generally paid a percentage of all racing industry wagers, or Handle, processed by our wagering systems, and we receive a service fee for our satellite communications services on a per event or a monthly subscription basis. In 2002, our systems processed approximately 65% of the estimated \$18 billion in pari-mutuel wagering conducted on horse racing in North America.

Our Venue Management Group includes our Connecticut OTB operations and our Dutch on-track and off-track betting operations.

Our Telecommunications Products Group is comprised of our prepaid cellular phone card business.

The first and fourth quarters of the calendar year traditionally comprise the weakest seasons for our pari-mutuel wagering businesses. As a result of inclement weather during the winter months, a number of racetracks do not operate and those that do operate often experience missed racing days. This adversely affects the amounts wagered and our corresponding service revenues. Wagering equipment sales and software license revenues usually reflect a limited number of large transactions, which do not recur on an annual basis. Consequently, revenues and operating results can vary substantially from period to period as a result of the timing of revenue recognition for major equipment sales and software license revenue. In addition, instant ticket and prepaid phone card sales may vary depending on the season and timing of contract awards, changes in customer budgets, ticket inventory levels, lottery retail sales and general economic conditions.

Operating results may also vary significantly from period to period depending on the addition or disposition of business units in each period. The acquisition of SGHC in 2000 and, to a lesser extent, the acquisition of 65% of the equity of SERCHI in 2002, both of which were accounted for as purchases, affect the comparability of operations from period to period (see Note 4 to the Consolidated Financial Statements).

In connection with the acquisition of SGHC, we changed our fiscal year-end from an October 31 year-end to a calendar year-end, beginning with the year ended December 31, 2001. Effective April 27, 2001, we changed our corporate name from Autotote Corporation to Scientific Games Corporation. On January 29, 2002, we transferred the listing for our Class A common stock to the Nasdaq National Market, and our trading symbol was changed to SGMS.

Critical Accounting Policies

The SEC recently issued disclosure guidance for "critical accounting policies". The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

The following is not intended to be a comprehensive list of all of our accounting policies. Our significant accounting policies are more fully described in Note 2 to the Consolidated Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting an available alternative would not produce a materially different result.

We have identified the following as accounting policies critical to us: revenue recognition, valuation of long-lived and intangible assets and goodwill, income taxes and management estimates.

Revenue recognition

Almost all of our revenues, except revenues earned from the sale of wagering systems, are earned pursuant to contractual terms and conditions either as a percentage of the amount wagered or when products are shipped to the customer and the customer assumes ownership of the product. Such revenues do not involve difficult, subjective or complex judgements.

Revenues from fixed price contracts to provide wagering systems including equipment and software licenses are recognized on the percentage of completion method of accounting based on the ratio of costs incurred to estimated total costs to complete with revisions to estimated costs reflected in the period in which changes become known. Anticipated losses on fixed price contracts are recognized when the losses can be estimated. Recognition of revenue under the percentage of completion method requires us to make estimates regarding the resources required or the scope of work to be performed. If we do not accurately estimate the extent of work to be performed, manage our projects properly or complete our contracts within the specified time period, we may experience changes in revenues and resulting reductions in margins or losses on our contracts in subsequent periods.

At the time we enter into service or sales contracts, we assess whether the fee associated with our revenue transactions is fixed and determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed and determinable based on the payment terms associated with the transaction. If a significant portion of our fee is due beyond our normal payment terms which may vary depending on the nature of the contract and location of the customer, we account for the fee as not being fixed and determinable and recognize the revenue when payments become due. We assess collection based on a number of factors, including past transaction history with the customer and the credit worthiness of the customer. For our international customers, we frequently require collateral in the form of a letter of credit for all or a portion of our fee. If we determine collection is not reasonably assured, we defer the fee and recognize the revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash.

Valuation of long-lived and intangible assets and goodwill

We assess the recoverability of long-lived assets and intangible assets and goodwill whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors we consider important which could trigger an impairment review include:

significant under performance relative to expected historical performance or projected future operating results;

significant changes in the manner of or use of the acquired assets or the strategy of our overall business;

significant adverse change in the legality of our business ventures or the business climate in which we operate; and

loss of a significant customer.

When we determine that the carrying value of the long-lived assets, intangible assets and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on the projected discounted cash flow, using a discount rate equal to a risk-free rate of return, or by a comparison to third party indications of fair market value. At December 31, 2002, the net carrying value of our long-lived assets, intangible assets and goodwill amounted to approximately \$471 million.

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS 142"), we ceased amortizing goodwill and intangible assets determined to have indefinite useful lives as of January 1, 2002. Statement of Financial Accounting

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Standards No. 141, Business Combinations ("SFAS 141"), and SFAS 142 require that we evaluate our existing goodwill and intangible assets and make any necessary reclassifications to conform with the new criteria outlined in SFAS 141 and SFAS 142. We completed our assessment of goodwill and intangible assets in the second quarter of 2002, and we made all necessary reclassifications to goodwill in accordance with the provisions of SFAS 142. No material adjustments were made to the goodwill and intangible assets balances at December 31, 2001. We also evaluated the remaining useful lives of the intangible assets that will continue to be amortized and have determined that no revision to those useful lives is necessary. We are required to test goodwill and our intangible assets with indefinite useful lives for impairment at least annually. We intend to perform this annual impairment test after the completion of our annual financial operating plan which occurs in the fourth quarter of our fiscal year. We completed our annual impairment test for fiscal 2002 with no adjustment required to the carrying value of our goodwill or intangible assets with indefinite useful lives as of December 31, 2002.

Income Taxes

Income taxes are calculated using the asset and liability method under Statement of Financial Accounting Standards No. 109 ("SFAS 109"). Under this method, deferred income taxes are calculated by applying enacted statutory tax rates to cumulative temporary differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. Under SFAS 109, the effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

We have a history of losses, which have generated sizable net operating loss carryforwards for both state and federal tax purposes. Prior to the fourth quarter of 2002, we did not recognize any income tax benefits from these losses in excess of the net amount of taxable temporary differences that would reverse during the carryforward period because we were not able to demonstrate that it was more likely than not that we would generate sufficient taxable income in the future to utilize some or all of these net operating losses, and, accordingly, we recorded a valuation allowance offsetting our deferred tax asset associated with these net operating losses. Because of improved financial results in 2002 and anticipated taxable income in 2003 and beyond, we now believe that it is more likely than not that we will utilize a large portion of our tax losses to offset future taxable income. As a result, we recorded an increase in our deferred tax asset in the fourth quarter of 2002 of approximately \$41.9 million by reducing the corresponding deferred income tax valuation allowance, and recognized an income tax benefit in income from continuing operations of approximately \$32.9 million and an income tax benefit as an offset against the extraordinary charges of approximately \$9.0 million. Should our expectations for future levels of taxable income not materialize or occur in amounts significantly less than what we have forecasted, some of our deferred tax assets may not be recoverable. A significant change in our expectations for future taxable income could have a material affect on our consolidated results of operations and financial position.

Management estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates made by management involve percentage of completion for contracted lottery and pari-mutuel wagering systems, as discussed above, evaluation of the recoverability of assets including accounts receivable, inventories and long-lived assets and the assessment of litigation and contingencies, and income taxes.

40

Management specifically evaluates the recoverability of accounts receivable by analyzing historical bad debts, customer concentrations, customer credit-worthiness, past collection experiences with specific customers, current economic trends and changes in customer payment terms. We do not require our customers to provide collateral for services provided pursuant to our service contracts. For sales of equipment and wagering systems to international customers we generally require that no less than a significant portion of the amounts to be paid be collateralized by irrevocable letters of credit. Changes in the underlying financial condition of our customers could result in a material impact to our results of operation and financial position.

Our inventory consists principally of parts and finished goods to which we provide a reserve for obsolete and slow moving items. We continually evaluate the adequacy of our reserves by reviewing historical rates of scrap, on-hand quantities as compared to historical and projected usage levels, orders for new equipment, and contractual requirements to service our installed base of equipment.

We record a liability pertaining to pending litigation based on our best estimate of a potential loss, if any, or at the minimum end of the range of loss in circumstances where the range of loss can be reasonably estimated. Because of uncertainties surrounding the nature of litigation and the ultimate liability to us, if any, we continually revise our estimated losses as additional facts become known.

Related Party Transactions

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Statement of Financial Accounting Standards No. 57, Related Party Disclosures, requires us to identify and describe material transactions involving related persons or entities and to disclose information necessary to understand the effects of such transactions on our consolidated financial statements. We historically have not been a party to material transactions involving related persons or entities. We are currently part of a consortium which includes Lottomatica S.p.A., our largest equity investor, that has been awarded a contract to be the exclusive operator for instant tickets in Italy. This award has been protested and is being reviewed in the Italian courts. If the award is ratified, we expect to enter into a contract, which initially would provide for the printing of tickets and the installation of a new centralized system, along with a full complement of cooperative services.

41

Results of Operations

Restatement of Previously Reported Financial Statements

Subsequent to the issuance of our consolidated financial statements for the year ended December 31, 2002 and the quarterly period ended March 31, 2003, it was determined that a portion of the deferred tax benefit, in the form of a NOL, recognized in the fourth quarter of 2002 should have been recognized at the time of the acquisition of SGHC on September 6, 2000. As a result: (i) deferred tax benefits recognized at the date of the acquisition of SGHC have been increased, with a corresponding reduction in the carrying value of goodwill; (ii) goodwill amortization has been reduced for the periods from the date of acquisition of SGHC through December 31, 2001; and (iii) deferred income tax benefits recognized during the periods from the date of the acquisition of SGHC through December 31, 2002 have been adjusted to reflect the amount considered more likely than not realizable based on the reversing effect of taxable or deductible temporary differences and our NOL. In addition, we revised income tax expense for the first quarter of fiscal 2002 to reflect a charge of \$9.8 million as a result of the adoption of SFAS 142, which caused a reduction in the recorded amount of the NOL to reflect the reduced amount of net taxable temporary differences that are expected to reverse during the NOL carryforward period because of the cessation of amortization of certain indefinite lived intangible assets. The restatements did not impact the amounts presented in the consolidated statements of cash flows for net cash provided by operating activities, net cash used in investing activities or net cash provided by or used in financing activities in any of the restated periods, although it did impact certain non-cash components of cash flows from operating activities.

Accordingly, we have amended and restated our consolidated financial statements as of and for the year ended October 31, 2000, the two-month period ended December 31, 2000 and the years ended December 31, 2001 and 2002. Conforming changes reflecting these revisions have been made in our Summary of Selected Financial Data, Management's Discussion and Analysis of Financial Condition, and Results of Operations and Consolidated Financial Statements and Notes to Consolidated Financial Statements.

42

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

The following analysis compares our results of operations for the year ended December 31, 2002 to the results for the year ended December 31, 2001.

	Year Ended December 31, 2002				Totals
	Lottery Group	Pari- Mutuel Group	Venue Management Group	Telecommunications Group	
	(in thousands)				
Service revenues	\$ 239,219	81,546	62,053		382,818
Sales revenues	20,721	5,692		46,022	72,435
Total revenues	259,940	87,238	62,053	46,022	455,253
Cost of service	131,602	46,677	42,759		221,038
Cost of sales	14,474	2,751		30,187	47,412
Amortization of service contract software	2,328	2,602			4,930

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Year Ended December 31, 2002

Total operating expense	148,404	52,030	42,759	30,187	273,380
Gross profit	111,536	35,208	19,294	15,835	181,873
Selling, general and administrative	26,900	10,675	2,821	4,520	44,916
Depreciation and amortization	21,646	11,679	1,789	2,241	37,355
Segment operating income	\$ 62,990	12,854	14,684	9,074	99,602
Unallocated corporate selling, general and administrative costs					\$ 18,766
Consolidated operating income					\$ 80,836
Interest expense					\$ 44,842

Year Ended December 31, 2001

	Restated Lottery Group	Pari- Mutuel Group	Venue Management Group	Telecommunications Group	Restated Totals
(in thousands)					
Service revenues	\$ 223,875	79,779	60,913		364,567
Sales revenues	13,936	19,554		42,184	75,674
Total revenues	237,811	99,333	60,913	42,184	440,241
Cost of service	141,442	46,663	43,180		231,285
Cost of sales	9,602	11,817		25,739	47,158
Amortization of service contract software	1,705	2,661			4,366
Total operating expenses	152,749	61,141	43,180	25,739	282,809
Gross profit	85,062	38,192	17,733	16,445	157,432
Selling, general and administrative	25,635	10,738	2,625	4,935	43,933
Depreciation and amortization	32,217	12,131	2,674	1,804	48,826
Segment operating income	\$ 27,210	15,323	12,434	9,706	64,673
Unallocated corporate selling, general and administrative costs					\$ 13,068
Consolidated operating income					\$ 51,605
Interest expense					\$ 50,363

Revenue Analysis

For the year ended December 31, 2002, revenues of \$455.3 million improved \$15.0 million or 3.4% overall as compared to the prior year, reflecting an \$18.3 million or 5.0% increase in service revenue and a \$3.2 million or 4.3% decrease in sales revenue.

The increase in service revenues in 2002 is primarily attributable to a \$15.3 million or 7% increase in revenues in the Lottery Group, of which approximately \$5.0 million is attributable to a full year of operation of the Maine and Iowa lotteries which started in mid-2001; approximately \$11.0 million is attributable to the startup of the South Carolina Educational Lottery in January 2002; approximately \$2.0 million is attributable to continued growth in the instant ticket sales; and approximately \$5.0 million is attributable to the acquisition of SERCHI in June 2002. These gains were partially offset by the absence of the French lottery business that was sold in the third quarter of 2001. Cooperative service revenues were down slightly for the year as increased revenues at all of our other customers helped offset the loss of approximately \$9.0 million of revenues from the loss of the New York contract, which was awarded to another vendor prior to our acquisition of SGHC. Pari-mutuel Group service revenues increased \$1.8 million or 2%, primarily reflecting the additional revenue from the Churchill Downs simulcasting contract in 2002 and increased service fees. Venue Management Group service revenues increased \$1.1 million or 2%, of which \$0.5 million is attributable to the opening of the Hartford Raceview Center in 2002, plus continued growth in telephone account wagering, partially offset by a full year reduction in the New York Racing Association take-out rate. The balance of the increase is attributable to our Dutch operation, primarily due to higher Handle and a favorable exchange rate.

The \$3.2 million decrease in sales revenues in 2002 is primarily attributable to a \$13.9 million decrease in sales revenue in the Pari-mutuel Group reflecting the completion in 2001 of a systems and equipment contract to the Turkey Jockey Club. This decrease was partially offset by a \$6.8 million increase in systems and equipment sales revenue in the Lottery Group and a \$3.8 million or 9% increase in prepaid phone card sales in the Telecommunications Group reflecting the benefit from a 33% increase in volume, partially offset by product unit price decreases.

Gross Profit Analysis

Gross profit increased \$24.4 million or 16% in 2002 reflecting an improvement of \$27.9 million on service revenues, partially offset by a decrease of \$3.5 million on lower sales revenues. The increase in service revenues discussed above contributed approximately \$8.0 million to this gross margin improvement, with cost control measures contributing an additional benefit of approximately \$20.5 million, including benefits of approximately \$1.0 million in the Pari-mutuel Group and \$1.2 million in the Venue Management Group. In addition, cost control measures amounting to approximately \$5.7 million, in addition to increased volume, nearly offset the effect of selling price reductions in the prepaid phone card business.

Expense Analysis

Selling, general and administrative expenses of \$63.1 million in the year ended December 31, 2002 were \$6.4 million higher than in the same period in 2001, primarily due to \$1.1 million of investigation and other costs attributable to the Pick Six matter (see "Business: Security"), the reversal in the prior year period of a \$1.5 million litigation reserve when a lawsuit was settled, coupled with higher proposal costs, professional services and compensation.

Depreciation and amortization expense, including amortization of service contract software, of \$42.8 million in the year ended December 31, 2002 decreased \$10.7 million from \$53.5 million in the same period in 2001. Depreciation expense increased \$1.6 million in the year ended December 31, 2002 from the same period in 2001, primarily as a result of higher depreciation on new computer systems and terminals acquired in connection with the start-up of the new on-line lotteries. Amortization expense was \$12.2 million lower in the year ended December 31, 2002 than in the same period in 2001, primarily as a result of the adoption of SFAS 141 and SFAS 142 effective January 1, 2002.

Interest expense of \$44.8 million in the year ended December 31, 2002 decreased \$5.5 million from \$50.4 million in the same period in 2001, primarily due to lower average debt levels following the third quarter 2002 repurchase of \$83.0 million of our 12¹/₂% Senior Subordinated Notes, plus the effect of lower average interest rates on our outstanding term loans. In addition, interest expense in the year ended December 31, 2002 included approximately \$3.3 million of termination charges relating to the refinancing of our 2000 senior secured credit facility (the "2000 Facility") in December 2002. These charges resulted from the early cancellation of three interest rate swap agreements that we were required to maintain pursuant to the terms of the prior credit facility. (See "Liquidity, Capital Resources and Working Capital" for a

discussion of the 2002 Offering, the repurchase of our 12¹/₂% Senior Subordinated Notes and the replacement of the 2000 Facility with a new 2002 senior secured credit facility.)

Other Expense

Other expense of \$0.6 million in 2002 consists primarily of foreign currency losses.

Extraordinary Item

In 2002, we repaid approximately \$83.0 million of our outstanding 12¹/₂% Senior Subordinated Notes and refinanced 2000 Facility. As a result, we recorded extraordinary charges aggregating approximately \$22.5 million related to the redemption premium paid in the amount of approximately \$11.2 million on the redeemed Notes; the \$1.1 million fee paid to the term loan lenders to permit us to use the majority of the net proceeds from our 2002 Equity Offering to redeem the Notes; and the write off of approximately \$10.2 million of previously deferred financing costs. These extraordinary charges were partially offset by federal and state income tax benefits of approximately \$9.0 million attributable to these expenses. The resultant total of approximately \$13.5 million was reflected as an extraordinary expense in the accompanying consolidated financial statements.

Income Tax Expense

We recorded an income tax benefit of approximately \$26.9 million in the year ended December 31, 2002, of which approximately \$9.0 million was reflected as an offset against the extraordinary charges discussed above. We have a history of losses, which have generated sizable net operating loss carryforwards for both state and federal tax purposes. Prior to 2002, we did not recognize any income tax benefits from these losses in excess of the amount of net taxable temporary differences that would reverse during the carryforward period because we were not able to demonstrate that it was more likely than not that we would generate sufficient taxable income in the future to utilize some or all of these net operating losses, and, accordingly, we recorded a valuation allowance offsetting our deferred tax asset associated with these losses. Because of improved financial results in 2002 and anticipated taxable income in 2003 and beyond, we now believe that it is more likely than not that we will utilize our tax losses to offset future taxable income considering any limitations on the use of our tax losses imposed by the Internal Revenue Code of 1986. As a result, we recorded a deferred tax asset in the fourth quarter of 2002 of approximately \$41.9 million by reducing the corresponding deferred income tax valuation allowance, and recognized an income tax benefit in income from continuing operations of approximately \$32.9 million and an income tax benefit as an offset against the extraordinary charges of approximately \$9.0 million. As a result of our recognition of the income tax benefit of the net operating loss carryforward in 2002, the financial statement income tax provision is expected to increase from approximately 15% in 2002, excluding the effect of the SFAS 142 write-off, to approximately 34% in 2003; however, we anticipate that our cash tax rate in 2003 will be approximately 18% as a result of utilizing some of our tax losses to offset taxes that would otherwise be payable.

In the year ended December 31, 2001, we recorded an income tax expense of \$6.1 million, representing primarily state and foreign taxes. No current tax benefit was recognized in the year ended December 31, 2001 on the then remaining unrecorded value of the domestic net operating loss carryforwards.

Year Ended December 31, 2001 Compared to Pro Forma Year Ended December 31, 2000

On September 6, 2000, we completed the acquisition of SGHC. The operating results of SGHC's businesses have been included in the consolidated statements of operations from the date of the acquisition. Because the acquisition of SGHC had such a significant effect on our business and because we also changed our year end reporting date, we do not believe that a comparison of the actual results for the year ended December 31, 2001 to the actual results for the year ended October 31, 2000 is meaningful. Therefore, the following analysis compares our results of operations for 2001 to the pro forma results for the year ended December 31, 2000, as if SGHC had been acquired at the beginning of 2000.

45

	Year Ended December 31, 2001				
	Restated Lottery Group	Pari- Mutuel Group	Venue Management Group	Telecommunications Group	Restated Totals
	(in thousands)				
Service revenues	\$ 223,875	79,779	60,913		364,567
Sales revenues	13,936	19,554		42,184	75,674
Total revenues	237,811	99,333	60,913	42,184	440,241

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Year Ended December 31, 2001

Cost of service	141,442	46,663	43,180		231,285
Cost of sales	9,602	11,817		25,739	47,158
Amortization of service contract software	1,705	2,661			4,366
Total operating expenses	152,749	61,141	43,180	25,739	282,809
Gross profit	85,062	38,192	17,733	16,445	157,432
Selling, general and administrative	25,635	10,738	2,625	4,935	43,933
Depreciation and amortization	32,217	12,131	2,674	1,804	48,826
Segment operating income	\$ 27,210	15,323	12,434	9,706	64,673
Unallocated corporate selling, general and administrative costs					\$ 13,068
Consolidated operating income					\$ 51,605
Interest expense					\$ 50,363

Pro Forma Year Ended December 31, 2000 (Unaudited)

	Restated Lottery Group	Pari- Mutuel Group	Venue Management Group	Telecommunications Group	Restated Totals
(in thousands)					
Service revenues	\$ 199,692	79,776	61,987		341,455
Sales revenues	26,973	16,583		39,646	83,202
Total revenues	226,665	96,359	61,987	39,646	424,657
Cost of service	136,464	47,413	44,937		228,814
Cost of sales	19,908	8,894		22,705	51,507
Amortization of service contract software	1,218	1,137			2,355
Total operating expenses	157,590	57,444	44,937	22,705	282,676
Gross profit	69,075	38,915	17,050	16,941	141,981
Selling, general and administrative	33,864	12,869	2,914	5,601	55,248
Depreciation and amortization	27,239	15,762	2,802	1,633	47,436
Segment operating income	\$ 7,972	10,284	11,334	9,707	39,297
Unallocated corporate selling, general and administrative costs					\$ 14,892
Consolidated operating income					\$ 24,405
Interest expense					\$ 50,978

Revenue Analysis

For the year ended December 31, 2001, revenues of \$440.2 million improved \$15.6 million or 4% overall as compared to the pro forma prior year, reflecting a \$23.1 million or 7% increase in service revenues which was partially offset by a \$7.5 million or 9% decrease in sales revenues.

The increase in service revenues in 2001 is primarily attributable to a \$24.2 million or 12% increase in revenues in the Lottery Group of which \$4.0 million is attributable to a full year operation for the Vermont and New Hampshire lotteries, \$5.0 million is attributable to the start-up of the Iowa and Maine lotteries in July 2001, \$2.2 million is attributable to continued solid growth in instant ticket sales and \$9.6 million is attributable to increased cooperative service revenues. Pari-mutuel Group service revenues of \$79.8 million were flat compared to the pro forma prior year with increases in the North American market of \$2.0 million being offset by \$1.2 million related to lower Handle in the European markets and \$0.5 million caused by the strengthening of the dollar. The \$1.1 million decline in Venue Management Group revenues to \$60.9 million in 2001 as compared to pro forma 2000 is attributable to a \$0.4 million decline due to the strengthening of the dollar, a \$0.3 million decline due to lower revenues in Connecticut because of the reduced take-out rate implemented by the New York Racing Association in July 2001, and a \$0.3 million decline due to the loss of Handle immediately following the September 11, 2001 attack.

The \$7.5 million decrease in sales revenues to \$75.7 million in 2001 as compared to pro forma 2000 is primarily attributable to the completion in 2000 of the EXTREMA® terminal sales contract with Sisal Sport Italia S.p.A., which accounted for \$17.5 million of sales revenues in 2000. This decrease was partially offset by \$4.4 million of new lottery related equipment sales in 2001, \$3.1 million of pari-mutuel equipment sales to foreign customers, plus a \$2.5 million or 6% increase in prepaid phone card sales reflecting the benefit from a 22% volume growth rate, partially offset by product price decreases.

Gross Profit Analysis

Gross profit of \$157.4 million in the year ended December 31, 2001 increased \$15.5 million or 11% from the pro forma prior year. The Lottery Group revenue improvements discussed above contributed \$9.7 million to gross profits and cost control measures contributed approximately \$6.8 million. Cost control measures saving \$0.5 million in the Pari-mutuel Group and \$1.4 million in the Venue Management Group, which included the restructuring of the operations in Germany and The Netherlands, also contributed to the overall improvement in margins. In addition, cost control measures amounting to \$5.8 million and volume increases of \$3.7 million helped to reduce the \$10.0 million effect of selling price reductions in the prepaid phone card business.

Gross profit as a percentage of service revenues increased to 35% in the year ended December 31, 2001, compared to 32% in the pro forma prior year. This gross profit increase results primarily from revenue improvements and cost control measures across all segments of our service businesses, as discussed above. Gross profit as a percentage of sales revenues was 38% in the year ended December 31, 2001, the same as in the pro forma prior year, reflecting a comparable mix of systems and equipment sold in the periods.

Expense Analysis

Selling, general and administrative expenses, including software development costs, of \$56.7 million in the year ended December 31, 2001 were \$13.4 million or 19% lower than in the pro forma prior year primarily as a result of \$11.0 million in cost reduction programs and merger-related synergies.

Depreciation and amortization expense, including amortization of service contract software, of \$53.2 million in the year ended December 31, 2001 increased \$3.4 million or 7% from \$49.8 million in the pro forma prior year as a result of \$2.8 million of depreciation on new computer systems and terminals for the expanded domestic lottery business, \$3.7 million of depreciation on the year 2000 expansion of the Alpharetta, Georgia printing facility and the new Leeds, United Kingdom printing facility, partially offset by a \$1.8 million reduction for pari-mutuel assets that became fully depreciated.

Interest expense of \$50.4 million in the year ended December 31, 2001 decreased \$0.6 million from \$51.0 million in the pro forma prior year due to lower interest rates on floating rate debt and lower average debt outstanding during the year 2001.

Other expense of \$0.04 million in the year ended December 31, 2001 consisted primarily of currency translation expense, and other income of \$0.4 million in the pro forma year ended December 31, 2000 consisted primarily of interest on invested excess cash.

Income Tax Expense

We recorded an income tax expense of \$6.1 million in the year ended December 31, 2001 representing primarily state and foreign taxes. No current tax benefit has been recognized on the unrecorded remaining value of the domestic net operating loss carryforwards in the period.

Liquidity, Capital Resources and Working Capital

In order to finance the acquisition of SGHC in 2000 and refinance substantially all of our then existing indebtedness, we conducted a series of financings in September 2000, which significantly changed our capital structure and significantly increased our leverage.

In 2002, we initiated a debt reduction program. In July 2002, we completed the public offering and sale of 14.4 million shares of our Class A Common Stock at a price of \$7.25 per share (the "2002 Offering"), and used the net proceeds of approximately \$98.4 million (prior to deducting underwriting discounts, commissions and offering expenses), to redeem approximately \$83.0 million of our 12¹/₂% Senior Subordinated Notes. As a result of these transactions, our capital structure improved, and Standard & Poors Ratings Group and Moody's Investors Service, Inc. upgraded our credit ratings. In December 2002, we replaced our existing senior secured credit facility (the "2000 Facility"), with a new senior secured credit facility (the "2002 Facility"), consisting of a \$50.0 million revolving credit facility due 2006 that can be increased to \$70.0 million, and a \$290.0 million Term B Loan due 2008. As a result of the 2002 debt reduction program, we expect interest expense in 2003 to total approximately \$26.0 million, assuming debt levels and interest rates remain constant.

Our financing arrangements impose certain limitations on our and our subsidiaries' operations.

The credit agreement governing the 2002 Facility contains certain covenants that, among other things, limits our ability, and the ability of certain of our 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, and create certain liens and other encumbrances on new assets. Additionally, the credit agreement governing the 2002 Facility contains the following financial covenants that are computed quarterly on a rolling four-quarter basis as applicable:

A maximum Consolidated Leverage Ratio of 4.00, which will be reduced on the first day of each calendar quarter through July 1, 2005, from which date until December 2008 the ratio shall be 3.00. Consolidated Leverage Ratio means the ratio of (x) the aggregate stated balance sheet amount of our indebtedness determined on a consolidated basis in accordance with GAAP as of the last day of the fiscal quarter for which such determination is being made to (y) Consolidated EBITDA for the four consecutive fiscal quarters ended on the last day of the fiscal quarter for which such determination is being made.

A minimum Consolidated Interest Coverage Ratio of 2.50, which will be increased on the first day of each calendar quarter through July 1, 2004, from which date until December 2008 the ratio shall be 3.75. Consolidated Interest Coverage Ratio means the ratio computed for our four most recent fiscal quarters of (x) Consolidated EBITDA to (y) total interest expense less non-cash amortization costs included in interest expense.

A minimum Consolidated Fixed Charge Coverage Ratio of 1.65 which will be increased on the first day of each calendar quarter through July 1, 2005, from which date until December 2008 the ratio shall be 1.85. Consolidated Fixed Charge Coverage Ratio means, as of any date of determination, the ratio computed for our four most recent fiscal quarters of (x) Consolidated EBITDA to (y) the sum of (i) total interest expense less non-cash amortization costs included in interest expense, (ii) scheduled payments of principal on indebtedness, (iii) certain restricted payments and (iv) all income taxes paid in cash.

A maximum Consolidated Senior Debt Ratio of 3.25, which will be reduced on the first day of each calendar quarter through July 1, 2005, from which date until December 2008 the ratio shall be 2.50. Consolidated Leverage Ratio means the ratio of (x) the aggregate stated balance sheet amount of our indebtedness, less the amount of Notes, determined on a consolidated basis in accordance with GAAP as of the last day of the fiscal quarter for which such determination is being made to (y) Consolidated

EBITDA for the four consecutive fiscal quarters ended on the last day of the fiscal quarter for which such determination is being made.

For purposes of the foregoing limitations, Consolidated EBITDA means the sum of (i) consolidated net income, (ii) consolidated interest expense with respect to all outstanding indebtedness, (iii) provisions for taxes based on income, (iv) total depreciation expense, (v) total amortization expense and (vi) certain adjustments, in each case for the period being measured, all of the foregoing as determined on a consolidated basis for us and our subsidiaries in accordance with GAAP. Although we were in compliance with our loan covenants at December 31, 2002 and expect to continue to remain in compliance over the next 12 months, no assurances can be provided that we will be able to do so or that we will be able to continue to meet the covenant requirements beyond 12 months.

The 2002 Facility provides for borrowings up to \$50.0 million to be used for working capital and general corporate purpose loans and for letters of credit. At December 31, 2002, we had outstanding letters of credit of \$21.8 million, but no outstanding borrowings under the 2002 Facility, leaving us with a total availability of \$28.2 million as compared to \$31.0 million at December 31, 2001. Our ability to continue to borrow under the Facility will depend on remaining in compliance with the limitations imposed by our lenders, including maintenance of specified financial covenants. Presently, we have not sought and, therefore, do not have any other financing commitments.

Our contractual obligations and commercial commitments principally include obligations associated with our outstanding indebtedness and future minimum operating lease obligations as set forth in the table below.

Contractual Obligations:	Cash Payments Due by Period				
	(in thousands)				
	Total	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
Long term debt, 12 ¹ / ₂ % notes and 2002 Facility	\$ 357,043	2,900	5,800	5,800	342,543
Other long term debt	3,486	965	974	851	696
Operating leases	41,376	10,630	20,185	6,136	4,425
Total contractual cash obligations	\$ 401,905	14,495	26,959	12,787	347,664

Our Series A Convertible Preferred Stock requires dividend payments at a rate of 6% per annum. To date, we have satisfied the dividend requirement using additional shares of preferred stock. The terms of the convertible preferred stock provide us with the flexibility to satisfy the dividend in cash commencing on September 30, 2002, subject to bank approval. We expect that we will continue to make such payments in-kind; accordingly, this obligation has not been reflected in the table above.

Our pari-mutuel wagering and on-line lottery systems service contracts require us to, among other things, maintain the central computing system and related hardware in efficient working order, provide added software functionality upon request, provide on-site computer operators, and furnish necessary supplies. Our primary expenditures associated with these services are personnel and related costs, which are expensed as incurred and are included in Operating Expenses-Services in the consolidated statements of operations. Historically, the revenues we derive from our service contracts have exceeded the direct costs associated with fulfilling our obligations under these pari-mutuel wagering and lottery systems service contracts. We expect that we will continue to realize positive cash flow and operating income as we extend or renew existing service contracts. We also expect that we will enter into new contracts that are accretive to our cash flow. In addition, through advancements in technology, we are continually deploying more efficient and cost effective methods for manufacturing and delivering our products and services to our customers. We expect that technological efficiencies will continue to positively impact our future cash flows and operating results. We are not party to any other material short term or long-term obligations or commitments pursuant to these service contracts.

Periodically, we bid on new pari-mutuel and on-line lottery contracts. Once awarded, these contracts generally require significant up-front capital expenditures for terminal assembly, customization of software, software and equipment installation and telecommunications configuration. Historically we have funded these up front costs through cash flows generated from operations, available cash on hand and borrowings under our credit facilities. Our ability to continue to procure new contracts will depend on, among other things, our then present liquidity levels and/or our ability to obtain additional financing at commercially acceptable rates to finance the initial up front costs. Once operational, long term service contracts have been accretive to our

operating cash flow. For fiscal 2003, we anticipate that capital expenditures and software expenditures will be approximately \$35.0 million. However, the actual level of expenditures will ultimately depend on the extent to which we are successful in winning new contracts. The amount of capital expenditures in fiscal 2004 and beyond will largely depend on the extent to which we are successful in winning new contracts. Furthermore, our pari-mutuel wagering network consists of approximately 26,000 wagering terminals. Periodically, we elect to upgrade the technological capabilities of older terminals and replace terminals that have exhausted their useful lives. We presently have no commitments to replace our existing terminal base and our obligation to upgrade the terminals is discretionary. Servicing our installed terminal base requires that we maintain a supply of parts and accessories on hand. We are also required, contractually in some cases, to provide spare parts over an extended period of time, principally in connection with our systems and terminal sale transactions. To meet our contractual obligations and maintain sufficient levels of on-hand inventory quantities to service our installed base, we purchase inventory on an as needed basis. We presently have no inventory purchase obligations.

In connection with our 2002 debt reduction program, we received approximately \$96.4 million from the 2002 Offering after deducting the underwriting discounts and commissions and estimated offering expenses, and we used the net proceeds to redeem approximately \$83.0 million of our 12 $\frac{1}{2}$ % Senior Subordinated Notes. In connection with this redemption, we were required to pay the noteholders a premium of approximately \$11.2 million and bank amendment fees of approximately \$1.1 million. We also replaced our 2000 Facility with a new 2002 Facility. Of the \$290.0 million in proceeds from the new 2002 Facility, \$264.9 million was used to repay long term debt, \$0.9 million was used to pay accrued interest, \$5.4 million was used to pay related fees, and \$4.8 million was used to pay amounts due on interest rate swap agreements.

At December 31, 2002, our available cash and borrowing capacity totaled \$63.1 million compared to \$43.6 million at December 31, 2001. Our available cash and borrowing capacities fluctuate principally based on the timing of collections from our customers, cash expenditures associated with new and existing pari-mutuel wagering and lottery systems contracts, repayment of our outstanding debt and changes in our working capital position. The increase in our available cash and borrowing capacity from the December 31, 2001 level principally reflects the impact of the December 2002 senior secured debt refinancing, and the use of cash on hand to fund our wagering systems and other capital expenditures. Net cash provided by operating activities was \$69.9 million for the year ended December 31, 2002. Of this amount, \$75.6 million was provided by operations and \$5.7 million was used for changes in working capital. The working capital changes occurred principally from decreases in accounts payable, accrued liabilities, and primarily accrued interest as a result of the December 2002 senior secured debt refinancing.

For the year ended December 31, 2002, we spent \$31.0 million for wagering systems and capital expenditures, \$9.2 million in software and \$4.1 million for a majority ownership in SERCHI. These cash expenditures were funded primarily with net cash provided by operating activities and cash on hand. In addition we capitalized \$5.4 million of fees related to the 2002 Facility.

A portion of our cash flows from operations must be used to pay our interest expense and repay our indebtedness, which will reduce the funds that would otherwise be available to us for our operations and capital expenditures. Interest expense on our outstanding debt was approximately \$44.8 million for the year ended December 31, 2002 including approximately \$2.3 million of non-cash charges. As a result of the 2002 debt reduction program, we expect interest expense in 2003 to total approximately \$26.0 million, assuming debt levels and interest rates remain constant. Approximately, 81% of our debt is in variable rate instruments. Consequently, we are exposed to fluctuations in interest rates. The effect of a 0.125% change in the interest rates associated with our unhedged variable rate debt will result in a change of approximately \$365,000 per year in our interest expense assuming no change in our outstanding borrowings. In 2002, prior to the refinancing of our 2000 Facility, we entered into three interest rate swap contracts for an aggregate notional amount of \$140 million in response to the requirements of our 2000 Facility. These interest rate swaps obligated us to pay a fixed LIBOR rate and entitled us to receive a variable LIBOR rate on an aggregate \$140 million notional amount of debt thereby creating the equivalent of fixed rate debt until May 30, 2003. We structured these interest rate swap agreements to qualify for hedge accounting pursuant to the provisions of SFAS 133. Changes in the fair value of interest rate swaps designated as hedging instruments that effectively offset the variability of cash flows associated with variable rate credit facility obligations are reported as a component of stockholders' equity. These amounts are subsequently reclassified into interest expense as a yield adjustment of the hedged credit facility obligation in the same period in

which the related interest affects operations. These swap contracts were terminated when we refinanced the 2000 Facility, and accordingly, approximately \$3.2 million of cost was charged to interest expense in 2002.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

We believe that our cash flow from operations, available cash and available borrowing capacity under our revolving credit facility will be sufficient to meet our liquidity needs, including anticipated capital expenditures, for the foreseeable future; however, we cannot assure you that this will be the case. While we are not aware of any particular trends, our lottery contracts periodically renew and we cannot assure you that we will be successful in sustaining our cash flow from operations through renewal of our existing contracts or through the addition of new contracts. In addition, lottery customers in the United States generally require service providers to provide performance bonds in connection with each state contract. Our ability to obtain performance bonds on commercially reasonable terms is subject to prevailing market conditions, which may be impacted by economic and political events. Although we have not experienced any difficulty obtaining such bonds, we cannot assure you that we will continue to be able to obtain performance bonds on commercially reasonable terms or at all. While we are not aware of any reason to do so, if we need to refinance all or part of our indebtedness, including our 12¹/₂% Senior Subordinated Notes, on or before maturity, or provide letters of credit or cash in lieu of performance bonds, we cannot assure you that we will be able to obtain new financing or to refinance any of our indebtedness, including our revolving credit facility and our 12¹/₂% Senior Subordinated Notes, on commercially reasonable terms or at all.

Impact of Recently Issued Accounting Standards

In June 2001, the FASB issued Statement No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"). SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. This Statement amends FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, and it applies to all entities. We are required to adopt SFAS 143, effective for calendar year 2003. We do not expect the adoption of SFAS 143 to have a material impact on our future consolidated operations or financial position, as we are now constituted.

In April 2002, the FASB issued Statement No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections* ("SFAS 145"). SFAS 145 updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds Statement 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses because Statement 4 has been rescinded. Statement 44 was issued to establish accounting requirements for the effects of transition to the provisions of the Motor Carrier Act of 1980. Because the transition has been completed, Statement 44 is no longer necessary.

SFAS 145 amends Statement 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. This amendment is consistent with the FASB's goal of requiring similar accounting treatment for transactions that have similar economic effects. SFAS 145 also makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. We are required to adopt SFAS 145, effective January 1, 2003. We are currently evaluating the impact that the adoption of SFAS 145 will have on our consolidated operations and financial position, however it will be necessary in future years' reports for us to reclassify the extraordinary losses to other income/deductions, pursuant to SFAS 145.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS 146"). SFAS 146 will spread out the reporting of expenses related to restructurings initiated after 2002 because a commitment to a plan to exit an activity or dispose of long-lived assets will no longer be enough to record a liability for the anticipated costs. Instead, companies will record exit and disposal costs when they are "incurred" and can be measured at fair value, and they will subsequently adjust the recorded liability for changes in estimated cash flows. We are required to adopt SFAS 146, prospectively for exit or disposal activities initiated after December 31, 2002. We do not expect the adoption of SFAS 146 to have a material impact on our future consolidated operations or financial position, as we are now constituted.

Recent Developments

On February 20, 2003, the New Mexico Lottery Authority board of directors approved us as the choice for the lottery authority's instant ticket and related services contract. We anticipate that the contract will generate approximately \$5.3 million of revenue over its four-year term.

On January 17, 2003, we completed the acquisition of MDI Entertainment, Inc. ("MDI") through (i) a tender offer at \$1.60 per share, in cash, (ii) the purchase of shares from MDI's President and Chief Executive Officer pursuant to a separate stock purchase agreement and (iii) a merger agreement, whereby the remaining eight percent of MDI common shares were converted into the right to receive \$1.60 per share, in cash. The acquisition will be accounted for using the purchase method of accounting. Had the operating results of MDI been included as if the transaction had been consummated on January 1, 2002, our pro forma operating results for the year ended December 31, 2002 would not have

been materially different from our actual reported results.

On January 9, 2003, we announced that we were awarded the contract to provide pari-mutuel services to STWK, the Poland racing organization. We anticipate that the contract will generate approximately \$4.0 million of revenue over its ten-year term, plus up to an additional \$3.0 million of revenue relating to a significant expansion of the racing organization's OTB network and simulcasting systems.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our products and services are sold to a diverse group of customers throughout the world. As such, we are subject to certain risks and uncertainties as a result of changes in general economic conditions, sources of supply, competition, foreign exchange rates, tax reform, litigation and regulatory developments. The diversity and breadth of our products and geographic operations mitigate the risk that adverse changes from any single event would materially affect our financial position.

Additionally, as a result of the diversity of our customer base, we do not consider ourselves exposed to concentration of credit risks. These risks are further minimized by setting credit limits, ongoing monitoring of customer account balances, and assessment of the customers' financial strengths.

Inflation has not had an abnormal or unanticipated effect on our operations. Inflationary pressures would be significant to our business if raw materials used for instant lottery ticket production, prepaid phone card production or terminal manufacturing are significantly affected. Available supply from the paper and electronics industries tends to fluctuate and prices may be affected by supply.

For fiscal 2002, inflation was not a significant factor in our results of operations, and we were not impacted by significant pricing changes in our costs, except for personnel related expenditures. We are unable to forecast the prices or supply of substrate, component parts or other raw materials in 2003, but we currently do not anticipate any substantial changes that will materially affect our operating results.

In certain limited cases, our lottery contracts with our customers contain provisions to adjust for inflation on an annual basis, but we cannot be assured that this adjustment would cover raw material price increases or other costs of services. While we have long-term and generally satisfactory relationships with most of our suppliers, we also believe alternative sources to meet our raw material and production needs are available.

In the normal course of business, we are exposed to fluctuations in interest rates and equity market risks as we seek debt and equity capital to sustain our operations. At December 31, 2002 approximately one-fifth of our debt was in fixed rate instruments. We consider the fair value of all financial instruments to be not materially different from their carrying value at year-end. The following table provides information about our financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted-average interest rates by expected maturity dates. In the third quarter of 2002 we completed the 2002 Offering and used approximately \$83.0 million of the net proceeds to redeem a portion of our 12¹/₂% Senior Subordinated Notes. In the fourth quarter of 2002 we replaced our senior secured credit facility with a new facility consisting of a revolving credit facility due 2006 that is initially \$50.0 million and can be increased to \$70.0 million and a \$290.0 million Term B Loan due 2008. (See "Liquidity, Capital Resources and Working Capital".)

**Principal Amount by Expected Maturity Average Interest Rate
December 31, 2002
Expected Maturity Date**

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>There after</u>	<u>Total</u>	<u>Fair value</u>
	(dollars in thousands)							
Long-term debt:								
Fixed interest rate	\$					67,043	67,043	77,770
Interest rate						12.5%	12.5%	
Variable interest rate	\$	3,865	3,543	3,316	3,304	3,228	276,229	293,486
Average interest rate		5.73%	5.32%	4.98%	4.99%	4.97%	4.92%	4.94%

During 2002, we entered into derivative contracts to hedge part of our foreign currency exposure with respect to future cash receipts under our contract with the Ontario Lottery Commission. These instruments, which have a notional value of 47.7 million Canadian dollars at

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

December 31, 2002, have been designated as cash flow hedges. For the year ended December 31, 2002, we recorded a credit to other comprehensive income (loss) of \$0.4 million for the change in the fair value of these foreign exchange instruments.

The following table provides notional amounts and interest rate information about our Canadian currency hedge derivative financial instruments. We do not hold any market risk instruments for trading purposes.

Notional Amount by Expected Maturity Canadian Currency Hedge December 31, 2002

	2003	2004	2005	2006	2007	There after	Total	Fair value
(dollars in thousands)								
Canadian currency hedge:								
Notional U.S. \$ amount	\$ 27,440	2,725					30,165	352
Exchange rate	1.58	1.59					1.58	

We are also exposed to fluctuations in foreign currency exchange rates as the financial results of our foreign subsidiaries are translated into U.S. dollars in consolidation. Assets and liabilities outside the United States are primarily located in the United Kingdom, Germany, Netherlands, France and Austria. Our investment in foreign subsidiaries with a functional currency other than the U.S. dollar are generally considered long-term investments. Accordingly, we do not hedge these net investments. Translation gains and losses historically have not been material. We manage our foreign currency exchange risks on a global basis by one or more of the following: (i) securing payment from our customers in U.S. dollars, when possible, (ii) utilizing borrowings denominated in foreign currency, and (iii) entering into foreign currency exchange contracts. In addition, a significant portion of the cost attributable to our foreign operations is incurred in the local currencies. We believe that a 10% adverse change in currency exchange rates would not have a significant adverse effect on our net earnings or cash flows. We may, from time to time, enter into foreign currency exchange or other contracts to hedge the risk associated with certain firm sales commitments, anticipated revenue streams and certain assets and liabilities denominated in foreign currencies.

Our cash and cash equivalents and investments are in high-quality securities placed with a wide array of financial institutions with high credit ratings. This investment policy limits our exposure to concentration of credit risks.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

	Form 10-K/A (Page)
Independent Auditors' Report	56
Consolidated Financial Statements:	
Balance Sheets as of December 31, 2001 and 2002	57
Statements of Operations for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002	58
Statements of Stockholders' Equity and Comprehensive Income (Loss) for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002	59

Statements of Cash Flows for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002	60
Notes to Consolidated Financial Statements	62
Schedule:	
II. Valuation and Qualifying Accounts	112
All other schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.	

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Scientific Games Corporation:

We have audited the consolidated financial statements of Scientific Games Corporation and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Scientific Games Corporation and subsidiaries as of December 31, 2001 and 2002, and the results of their operations and their cash flows for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 7 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002.

As discussed in Note 1 to the consolidated financial statements, the Company has restated its consolidated financial statements as of and for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002.

KPMG LLP

Short Hills, New Jersey
February 21, 2003, except for
Note 1 which is as of August 11, 2003

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2001 and 2002
(in thousands, except per share amounts)

	Restated 2001	Restated 2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,649	34,929
Accounts receivable, net of allowance for doubtful accounts of \$3,889 and \$3,772 in 2001 and 2002, respectively	50,410	53,260
Inventories	19,547	20,535
Prepaid expenses, deposits and other current assets	15,537	22,654
Total current assets	98,143	131,378
Property and equipment, at cost	364,837	404,685
Less accumulated depreciation	168,049	203,819
Net property and equipment	196,788	200,866
Goodwill, net	179,099	183,770
Operating right, net	11,681	14,020
Other intangible assets, net	48,473	43,802
Other assets and investments	51,612	83,986
Total assets	\$ 585,796	657,822
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	\$ 9,437	3,865
Accounts payable	26,632	23,888
Accrued liabilities	51,118	53,513
Interest payable	8,381	3,597
Total current liabilities	95,568	84,863
Deferred income taxes	16,250	25,207
Other long-term liabilities	23,440	22,318
Long-term debt, excluding current installments	430,298	356,664
Total liabilities	565,556	489,052
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, par value \$1.00 per share, 1,600 shares authorized,	1,220	1,248

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated 2001	Restated 2002
1,220 and 1,248 shares outstanding at December 31, 2001 and 2002, respectively		
Series B preferred stock, par value \$1.00 per share, 2 shares authorized, none and 1.238 shares outstanding at December 31, 2001 and 2002, respectively		1
Class A common stock, par value \$0.01 per share, 199,300 shares authorized, 41,203 and 59,375 shares outstanding at December 31, 2001 and 2002, respectively	412	594
Class B non-voting common stock, par value \$0.01 per share, 700 shares authorized, none outstanding		
Additional paid-in capital	275,510	384,927
Accumulated losses	(246,383)	(214,135)
Treasury stock, at cost	(135)	(3,539)
Accumulated other comprehensive loss	(10,384)	(326)
Total stockholders' equity	20,240	168,770
Total liabilities and stockholders' equity	\$ 585,796	657,822

See accompanying notes to consolidated financial statements.

56

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Year Ended October 31, 2000, the Two Months Ended December 31, 2000,
and the Years Ended December 31, 2001 and 2002
(in thousands, except per share amounts)

	Year Ended October 31,	Two Months Ended	Years Ended	
		December 31,	Restated 2001	Restated 2002
Operating revenues:				
Services	\$ 186,520	57,584	364,567	382,818
Sales	46,828	9,007	75,674	72,435
	233,348	66,591	440,241	455,253
Operating expenses (exclusive of depreciation and amortization shown below):				
Services	126,601	39,592	231,285	221,038
Sales	29,299	5,547	47,158	47,412
Amortization of service contract software	1,765	517	4,366	4,930
	157,665	45,656	282,809	273,380

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

		Two Months Ended		
Total gross profit	75,683		157,432	181,873
Selling, general and administrative expenses	35,664	9,902	56,695	63,132
Depreciation and amortization	25,735	7,755 20,935	49,132	37,905
Operating income	14,284	3,278	51,605	80,836
Other (income) deductions:				
Interest expense	31,231	8,790	50,363	44,842
Other (income) expense	(456)	(247)	37	636
	30,775	8,543	50,400	45,478
Income (loss) before income tax expense (benefit) and extraordinary items	(16,491)	(5,265)	1,205	35,358
Income tax expense (benefit)	1,603	(465)	6,067	(17,875)
Income (loss) before extraordinary items	(18,094)	(4,800)	(4,862)	53,233
Extraordinary items early retirement of debt, net of income tax benefit	12,567			13,501
Net income (loss)	(30,661)	(4,800)	(4,862)	39,732
Convertible preferred stock paid-in-kind dividend	1,014	1,143	7,051	7,484
Net income (loss) available to common stockholders	\$ (31,675)	(5,943)	(11,913)	32,248
Basic and diluted net income (loss) per share:				
Basic income (loss) before extraordinary items available to common stockholders	\$ (0.52)	(0.15)	(0.30)	0.91
Diluted income (loss) before extraordinary items available to common stockholders	\$ (0.52)	(0.15)	(0.30)	0.66
Basic extraordinary items, net of tax benefit	\$ (0.34)			(0.27)
Diluted extraordinary items, net of tax benefit	\$ (0.34)			(0.17)
Basic net income (loss) available to common stockholders	\$ (0.86)	(0.15)	(0.30)	0.64
Diluted net income (loss) available to common stockholders	\$ (0.86)	(0.15)	(0.30)	0.50
Weighted average number of shares used in per share calculations:				
Basic shares	36,928	40,025	40,340	50,221
Diluted shares	36,928	40,025	40,340	80,151

See accompanying notes to consolidated financial statements.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME (LOSS)Year Ended October 31, 2000, the Two Months Ended December 31, 2000,
and the Years Ended December 31, 2001 and 2002
(in thousands)

	Year Ended October 31,	Two Months	Years Ended	
		Ended	December 31,	
		Restated 2000	Restated 2001	Restated 2002
Common stock:				
Beginning balance	\$ 364	399	402	412
Issuance of Class A common stock, net of issuance expenses				144
Issuance of Class A common stock in stock options and warrant exercises	35	3	10	29
Issuance of Class A common stock on conversion of Series A and B preferred stock				9
Ending balance	399	402	412	594
Series A Convertible and Series B Preferred stock:				
Beginning balance		1,132	1,149	1,220
Issuance of 1,128 shares of Series A convertible preferred stock, net of issuance expenses	1,128			
Issuance of Series A convertible preferred stock as paid-in-kind dividend	4	17	71	74
Issuance of Series B preferred stock				1
Conversion of Series A and B preferred stock to Class A common stock				(46)
Ending balance	1,132	1,149	1,220	1,249
Additional paid-in capital:				
Beginning balance	149,622	264,959	266,888	275,510
Issuance of Class A common stock, net of issuance expenses	1,079	188	1,070	96,336
Issuance of Series B preferred stock				(1)
Issuance of Class A common stock on conversion of Series A and B preferred stock, net				37
Issuance of Series A convertible preferred stock, net of issuance expenses	105,673	1,698	6,979	7,410
Issuance and exercise of stock options and warrants	8,321		305	5,294
Deferred compensation	264	43	268	341
Ending balance	264,959	266,888	275,510	384,927
Accumulated losses:				
Beginning balance	(196,852)	(228,527)	(234,470)	(246,383)
Net income (loss)	(30,661)	(4,800)	(4,862)	39,732
Convertible preferred stock paid-in-kind dividend	(1,014)	(1,143)	(7,051)	(7,484)
Ending balance	(228,527)	(234,470)	(246,383)	(214,135)
Treasury stock:				

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

		Two Months		
		Ended		
Beginning balance	(102)	(102)	(102)	(135)
Purchases of Class A common stock			(33)	(3,404)
Ending balance	(102)	(102)	(135)	(3,539)
Accumulated other comprehensive loss:				
Beginning balance	(1,251)	(3,216)	(5,274)	(10,384)
Other comprehensive income (loss)	(1,965)	(2,058)	(5,110)	10,058
Ending balance	(3,216)	(5,274)	(10,384)	(326)
Total stockholders' equity	\$ 34,645	28,593	20,240	168,770
Comprehensive income (loss):				
Net income (loss)	\$ (30,661)	(4,800)	(4,862)	39,732
Other comprehensive income (loss):				
Minimum pension liability adjustment	(5)		38	(2,261)
Foreign currency translation adjustment	(2,277)	1,611	(296)	4,758
Cash flow hedges		(2,364)	(7,816)	(1,193)
Reclassification adjustments for (gains)/losses reclassified into operations		(31)	2,962	8,654
Unrealized gain on investments	317	(1,274)	2	100
Other comprehensive income (loss)	(1,965)	(2,058)	(5,110)	10,058
Comprehensive income (loss)	\$ (32,626)	(6,858)	(9,972)	49,790

See accompanying notes to consolidated financial statements.

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

**Year Ended October 31, 2000, the Two Months Ended December 31, 2000,
and the Years Ended December 31, 2001 and 2002
(in thousands)**

		Two Months		Years Ended	
		Ended		December 31,	
	Year Ended				
	October 31,				
	Restated	Restated	Restated	Restated	
	2000	2000	2001	2002	
Cash flows from operating activities:					
Net income (loss)	\$ (30,661)	(4,800)	(4,862)	39,732	
Adjustments to reconcile net income (loss) to cash provided by operating activities:					

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

		Two Months Ended	Years Ended	
Depreciation and amortization	27,500	8,272	53,498	42,835
Change in deferred income taxes, net of effects of businesses acquired	120	(1,089)	4,177	(24,984)
Non-cash interest expense	8,735	384	2,435	2,298
Extraordinary items, net of income tax benefit	12,567			13,501
Changes in operating assets and liabilities, net of effects of acquisitions:				
Accounts receivable	8,605	(1,621)	4,030	358
Inventories	4,681	(2,722)	7,707	8
Accounts payable	(4,351)	4,601	(533)	(4,206)
Accrued liabilities	764	(2,915)	(5,620)	(3,383)
Other	(2,552)	1,918	1,579	3,695
	<u>56,069</u>	<u>6,828</u>	<u>67,273</u>	<u>30,122</u>
Net cash provided by operating activities	<u>25,408</u>	<u>2,028</u>	<u>62,411</u>	<u>69,854</u>
Cash flows from investing activities:				
Capital expenditures	(6,131)	(3,301)	(7,398)	(15,880)
Wagering systems expenditures	(28,915)	(2,802)	(39,095)	(15,137)
Change in other assets and liabilities	(6,195)	(2,419)	(9,591)	(14,131)
Business acquisitions, net of cash acquired	(316,242)			(4,104)
Net cash used in investing activities	<u>(357,483)</u>	<u>(8,522)</u>	<u>(56,084)</u>	<u>(49,252)</u>
Cash flows from financing activities:				
Net borrowings (repayments) under revolving credit facility	11,250	(2,250)	5,750	(14,750)
Proceeds from issuance of long-term debt	442,522			291,335
Payments on long-term debt	(201,362)	(1,324)	(6,573)	(357,463)
Payment of financing fees	(16,792)			(17,531)
Net proceeds from issuance of common stock	1,114	202	1,046	98,398
Net proceeds from issuance of convertible preferred stock	106,378			
Net cash provided by (used in) financing activities	<u>343,110</u>	<u>(3,372)</u>	<u>223</u>	<u>(11)</u>
Effect of exchange rate changes on cash	<u>(794)</u>	<u>1,046</u>	<u>(389)</u>	<u>1,689</u>
Increase (decrease) in cash and cash equivalents	10,241	(8,820)	6,161	22,280
Cash and cash equivalents, beginning of period	5,067	15,308	6,488	12,649
Cash and cash equivalents, end of period	<u>\$ 15,308</u>	<u>6,488</u>	<u>12,649</u>	<u>34,929</u>

See accompanying notes to consolidated financial statements.

Non-cash investing and financing activities

For the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

See Notes 11, 12 and 14 for a description of the write-off of deferred financing fees, capital lease transactions and the issuance of common stock warrants to the Company's financial advisors in connection with their services in 2000.

Supplemental cash flow information

Cash paid during the period for:

	Year Ended October 31,	Two Months Ended	Years Ended	
			December 31,	
	2000	2000	2001	2002
Interest	\$ 22,177	1,662	50,659	47,676
Income taxes, net of refunds	\$ 2,413	1,585	300	3,707
Non-cash financing activity during the period:				
Convertible preferred stock paid-in-kind dividends	\$ 1,014	1,143	7,051	7,484

See accompanying notes to consolidated financial statements.

60

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands, except per share amounts)

(1) Restatement of Previously Reported Financial Statements

Subsequent to the issuance of the Company's consolidated financial statements for the year ended December 31, 2002 and the quarterly period ended March 31, 2003, it was determined that a portion of the deferred tax benefit, in the form of a net operating loss carryforward ("NOL"), recognized in the fourth quarter of 2002, should have been recognized at the time of the acquisition of Scientific Games Holdings Corp. ("SGHC") on September 6, 2000. As a result: (i) deferred tax benefits recognized at the date of the acquisition of SGHC have been increased with a corresponding reduction in the carrying value of goodwill; (ii) goodwill amortization has been reduced for the periods from the date of acquisition of SGHC through December 31, 2001; and (iii) deferred income tax benefits recognized during the period from the date of the acquisition of SGHC through December 31, 2002 have been adjusted to reflect the amount considered more likely than not realizable based on the reversing effect of taxable or deductible temporary differences and the Company's NOL. In addition, the Company's restated income tax expense for the first quarter of fiscal 2002, reflects a charge of \$9,790 as a result of the adoption of SFAS 142, which caused the Company to reduce the recorded amount of its NOL to reflect the reduction in the amount of net taxable temporary differences that are expected to reverse during the NOL carryforward period because of the cessation of amortization of certain indefinite lived intangible assets. The restatements did not impact the amounts presented in the consolidated statements of cash flows for net cash provided by operating activities, net cash used in investing activities or net cash provided by or used in financing activities in any of the restated periods, although it did impact certain non-cash components of cash flows from operating activities.

Accordingly, the Company has amended and restated its consolidated financial statements as of and for the year ended October 31, 2000, the two-month period ended December 31, 2000 and the years ended December 31, 2001 and 2002. Conforming changes reflecting these revisions have been made in the Company's Summary of Selected Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and Consolidated Financial Statements and Notes to Consolidated Financial Statements.

The effects of this restatement on previously reported consolidated financial statements for each of the periods from October 31, 2000 to December 31, 2002 are summarized below. The balance sheet data for

61

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

October 31, 2000 and December 31, 2000 is included in the presentation so as to include herein all periods affected by the restatement.

	October 31, 2000		December 31, 2000		December 31, 2001		December 31, 2002	
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated
Selected Balance Sheet Data:								
Goodwill, net	\$ 156,557	117,791	157,591	119,151	195,255	179,099	199,926	183,770
Total assets	647,215	608,449	636,967	598,527	601,952	585,796	673,978	657,822
Deferred income taxes	60,834	21,742	59,261	20,381	28,568	16,250	25,207	25,207
Accumulated losses	(228,853)	(228,527)	(234,910)	(234,470)	(242,545)	(246,383)	(197,979)	(214,135)
Total stockholders' equity	34,319	34,645	28,153	28,593	24,078	20,240	184,926	168,770
Total liabilities and stockholders' equity	\$ 647,215	608,449	636,967	598,527	601,952	585,796	673,978	657,822
Selected Statement of Operations Data:								
	Year Ended October 31, 2000		Two Months Ended December 31, 2000		Year Ended December 31, 2001		Year Ended December 31, 2002	
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated
Depreciation and amortization	\$ 26,061	25,735	8,081	7,755	50,843	49,132	37,905	37,905
Operating Income	13,958	14,284	2,952	3,278	49,894	51,605	80,836	80,836
Income (loss) before income tax expense (benefit) and extraordinary items	(16,817)	(16,491)	(5,591)	(5,265)	(506)	1,205	35,358	35,358
Income tax expense (benefit)	1,603	1,603	(677)	(465)	78	6,067	(30,193)	(17,875)
Income (loss) before extraordinary items	(18,420)	(18,094)	(4,914)	(4,800)	(584)	(4,862)	65,551	53,233
Net income (loss)	(30,987)	(30,661)	(4,914)	(4,800)	(584)	(4,862)	52,050	39,732
Net income (loss) available to common stockholders	\$ (32,001)	(31,675)	(6,057)	(5,943)	(7,635)	(11,913)	44,566	32,248
Basic and diluted net income (loss) per share:								
Basic income (loss) before extraordinary items available to common stockholders	\$ (0.53)	(0.52)	(0.15)	(0.15)	(0.19)	(0.30)	1.16	0.91
Diluted income (loss) before extraordinary items available to common stockholders	\$ (0.53)	(0.52)	(0.15)	(0.15)	(0.19)	(0.30)	0.82	0.66
Basic net income (loss) available to common stockholders	\$ (0.87)	(0.86)	(0.15)	(0.15)	(0.19)	(0.30)	0.89	0.64
Diluted net income (loss) available to common stockholders	\$ (0.87)	(0.86)	(0.15)	(0.15)	(0.19)	(0.30)	0.65	0.50
Weighted average number of shares used in per share calculations:								
Basic Shares	36,928	36,928	40,025	40,025	40,340	40,340	50,221	50,221
Diluted Shares	36,928	36,928	40,025	40,025	40,340	40,340	80,151	80,151

(2) Description of the Business and Summary of Significant Accounting Policies

(a) Description of the Business

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Scientific Games Corporation (the "Company") operates primarily in four business segments: Lottery Group, Pari-mutuel Group, Venue Management Group and Telecommunications Products Group.

Lottery Group encompasses the full range of lottery game consulting and production services, including the manufacturing, warehousing and distribution of instant lottery tickets and related instant ticket services such as game design, sales and marketing support, retailer telemarketing and field services. The Company also provides on-line lottery systems and systems-related services, including transaction processing software that accommodates instant ticket game accounting and validation and on-line lottery games, point-of-sale terminal hardware which connect to these systems, central site computer and communications hardware which runs these systems and ongoing maintenance for each of these items. The Company's lottery products and services are provided primarily to domestic and international governmentally sanctioned lotteries worldwide.

Pari-mutuel Group includes all aspects of the Company's pari-mutuel service business, which encompass its North American and international on-track, off-track and inter-track pari-mutuel services, simulcasting and communications services, video gaming, and sales of pari-mutuel systems and equipment.

62

The Company is a leading worldwide provider of computerized pari-mutuel wagering. The Company is one of the leading providers of simulcasting services to the racing industry in the United States and Europe.

Venue Management Group the Company owns and operates off-track betting operations ("OTBs") in Connecticut and is the exclusive licensed operator of all on-track and off-track pari-mutuel wagering operations in The Netherlands.

Telecommunication Products Group through its United Kingdom based operations, the Company manufactures prepaid phone cards incorporating its superior lottery derived proprietary technology to create highly secure, paper-based, prepaid phone cards for the international cellular telephone markets.

In 2000, the Company elected to change the date of its fiscal year end to December 31. As a result, a transition period for the two months ended December 31, 2000 was previously reported on a transition report on Form 10-Q and is also presented herein. The consolidated balance sheets have been prepared at December 31, 2001 and 2002. The statements of operations, stockholders' equity and comprehensive income (loss) and cash flows present information for the year ended October 31, 2000, the two months ended December 31, 2000 and the years ended December 31, 2001 and 2002.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and subsidiaries in which the Company's ownership is greater than 50%. Investments in other entities where the Company has the ability to exercise significant influence over the investee are accounted for on the equity basis. Under the equity method, investments are stated at cost plus the Company's equity in undistributed earnings after acquisition. All significant inter-company balances and transactions have been eliminated in consolidation.

(c) Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with an original maturity at the date of purchase of three months or less to be cash equivalents.

(d) Inventories

Inventories are stated at the lower of cost or market. Cost is determined as follows:

Item	Cost method
Parts	First-in, first-out or weighted moving average.
Work-in-process & finished goods	First-in, first-out or weighted moving average for direct material and labor; other fixed and variable production costs

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Item	Cost method
------	-------------

are allocated as a percentage of direct labor cost.

The Company adjusts inventory accounts on a periodic basis to reflect the impact of potential obsolescence.

(e) Property and Equipment

Property and equipment are stated at cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets as follows:

Item	Estimated Life in Years
Machinery and equipment	3-10
Transportation equipment	3-7
Furniture and fixtures	5-10
Buildings and leasehold improvements	5-40

63

Depreciation expense includes the amortization of capital leased assets. The Company typically depreciates the equipment and installation costs for new customers on a straight-line method over the life of the initial term of their contracts.

(f) Deferred Installation Costs

Certain installation costs consisting of installation materials, customer contracted software and installation labor associated with leased systems are deferred and amortized over the lives of the leases unless such costs are reimbursed by the lessee, in which case such amounts are included in revenue and cost of sales. Deferred installation costs, net of accumulated depreciation, included in property and equipment were approximately \$17,113 and \$18,532 at December 31, 2001 and 2002, respectively.

(g) Goodwill and Acquired Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement 141, *Business Combinations* ("SFAS 141"), and Statement 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), and in August 2001 the FASB issued Statement 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after September 30, 2001. SFAS 142 requires, commencing January 1, 2002, that all goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead, be evaluated for impairment on an annual basis. SFAS 144 requires that intangible assets with definite useful lives continue to be amortized over their useful lives, but be tested for impairment whenever events or changes in circumstances indicate that the carrying value of such asset may not be recoverable. The Company adopted these statements upon issuance, thus all amortization related to goodwill and intangible assets with indefinite useful lives ceased as of January 1, 2002. The Company performs the impairment tests for goodwill and intangible assets with indefinite useful lives on an annual basis at the end of its fiscal year. (see Note 7).

(h) Other Assets and Investments

The Company capitalizes costs associated with internally developed and/or purchased software systems for new products and enhancements to existing products and for use in its wagering service contracts that meet technological feasibility and recoverability tests. The Company also capitalizes costs associated with the procurement of long-term financing, and costs attributable to transponder leases, patents, trademarks, marketing rights, and non-competition and employment agreements arising primarily from business acquisitions. These capitalized costs are amortized on the straight-line basis over their useful lives. The Company adopted the provisions of SFAS 141, 142, and 144 upon issuance by the FASB and has performed an evaluation of the assets that have been acquired in prior business combinations. Certain reclassifications have been made to comply with the provisions of the new Statements. As a result, amortization of certain reclassified intangible assets has been ceased. In accordance with the new Statements, an evaluation is performed to determine if any impairment has occurred with respect to any amortized or non-amortized assets. See Note 7 for further details relating to the amortization, reclassification, and impairment testing of all intangible assets.

(i) Impairment of Long-Lived Assets and Acquired Intangible Assets

The Company assesses the recoverability of long-lived assets (excluding goodwill) and identifiable acquired intangible assets with finite useful lives, whenever events or changes in circumstances indicate that the carrying value of such an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to the expected net future cash flows to be generated by that asset, or, for identifiable intangibles with finite useful lives, by determining whether the amortization of the intangible asset balance over its remaining life can be recovered through undiscounted future cash flows. The amount of impairment of identifiable intangible assets with finite useful lives, if any, to be recognized is measured based on projected discounted future cash flows. The amount of impairment of other long-lived assets (excluding goodwill) is measured by the amount by which the carrying value of the asset exceeds the fair market value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair market value, less costs to sell.

(j) Revenue Recognition

Revenues from pari-mutuel wagering services, on-line lottery systems services, cooperative service arrangements, certain instant ticket contracts and the operation of off-track betting venues is recognized based on a percentage of amounts wagered pursuant to the terms of the contract. Simulcasting and telecommunication service revenue is recognized as services are performed. Costs incurred in connection with the manufacture, installation, and integration of terminals, software and telecommunications configurations are initially capitalized and amortized on a straight line basis over the term of the contract. Costs of providing operating services are charged to operations in the period incurred. Revenues from sales of products including instant tickets, prepaid phone cards and stand alone terminals are recognized when shipped and the customer takes ownership and assumes risk of loss.

Liquidating damages assessed by the customer prior to the activation of the wagering systems are recognized as a reduction of revenue over the contract period.

Revenues from major contracts for the sale of lottery and pari-mutuel wagering systems and revenues for contracted software development are recognized on the percentage of completion method of accounting based on the ratio of costs incurred to estimated costs to complete. Any anticipated losses on fixed price contracts are charged to operations when such losses can be estimated. The Company recognizes revenue from software licenses upon shipment if post-delivery obligations are insignificant and if the terms of the agreement are such that the payment obligation is non-cancelable and non-refundable.

(k) Income Taxes

Income taxes are calculated using the asset and liability method under Statement of Financial Accounting Standards No. 109 ("SFAS 109"). Under this method, deferred income taxes are calculated by applying enacted statutory tax rates to cumulative temporary differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. Under SFAS 109, the effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

(l) Foreign Currency Translation

Assets and liabilities of foreign operations are translated at year-end rates of exchange and operations are translated at the average rates of exchange for the year. Gains or losses resulting from translating the foreign currency financial statements are accumulated as a separate component of accumulated other comprehensive income (loss) in stockholders' equity. Gains or losses resulting from foreign currency transactions are included in other income (expense) in the consolidated statements of operations.

(m) Stock-Based Compensation

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure, an Amendment of FASB Statement No. 123* ("SFAS 148"). SFAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. However, it allows an entity to continue to measure compensation cost for those instruments using the intrinsic-value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), *Accounting for Stock Issued to Employees*, provided it discloses the effect of SFAS 123, as amended by SFAS 148, in footnotes to the financial statements. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method. Accordingly, no stock option related compensation expense has been recognized for a substantial majority of its stock-based compensation plans. The Company was required to adopt SFAS 148 for the year ended December 31, 2002. The adoption of SFAS 148 did not have an impact on the consolidated results of operations or financial position of the Company for fiscal 2002 and is not expected to have an impact on the consolidated results of operations or financial position of the Company in future periods as the Company expects to continue to apply the intrinsic value based method prescribed by APB 25.

Had the Company, however, elected to recognize compensation cost based on fair value of the stock options at the date of grant under SFAS 123, as amended by SFAS 148, such costs would have been recognized ratably over the vesting period of the underlying instruments and the Company's net income (loss) and net income (loss) per share would have changed to the pro forma amounts indicated in the table below.

Pro forma net income (loss) and income (loss) per basic and diluted share were:

	Year Ended October 31, Restated 2000	Two Months Ended	Years Ended	
		December 31,		
		Restated 2000	Restated 2001	Restated 2002
Net income (loss) available to common stockholders as reported	\$ (31,675)	(5,943)	(11,913)	32,248
Add: Stock-based compensation expense included in reported net income, net of related tax effects				
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects (1)	(2,263)	(313)	(2,611)	(2,630)
Pro forma net income (loss) available to common stockholders	\$ (33,938)	(6,256)	(14,524)	29,618
Net income (loss) available to common stockholders per basic share:				
As reported	\$ (0.86)	(0.15)	(0.30)	0.64
Pro forma	\$ (0.92)	(0.16)	(0.36)	0.59
Net income (loss) available to common stockholders per diluted share:				
As reported	\$ (0.86)	(0.15)	(0.30)	0.50
Pro forma	\$ (0.92)	(0.16)	(0.36)	0.46

(1)

The amounts for year 2002 are net of income tax benefit. No adjustments were made for income tax benefit in prior periods as the Company had only recognized tax benefits of prior period operating losses to the extent such losses would be offset by net taxable temporary differences expected to reverse during the carryforward period.

The fair value of the options granted was estimated using the Black-Scholes option-pricing model based on the weighted average market price at date of grant of \$3.44 in fiscal 2000, \$4.72 in fiscal 2001 and \$6.75 in fiscal 2002 and the following weighted average assumptions: risk-free interest rate of 6.3% for fiscal 2000, 4.9% for fiscal 2001, and 4.2% for fiscal 2002; expected option life of 7.0 years for fiscal 2000, 2001 and 2002; volatility of 55% for fiscal 2000, 76% for fiscal 2001 and 74% for fiscal 2002; and no dividend yield in any year. The average fair values of options granted during fiscal years 2000, 2001, and 2002 were \$2.15, \$3.48 and \$4.82, respectively.

(n) Financial Statement Preparation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the significant estimates involve percentage of completion for contracted lottery development projects and

pari-mutuel systems software development projects, capitalization of software development costs, evaluation of the recoverability of assets and assessment of litigation and contingencies, and income and other taxes. Actual results could differ from estimates.

(o) Comprehensive Income (Loss)

Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130") establishes standards for the reporting and display of comprehensive income (loss) and its components in a full set of financial statements. SFAS 130 requires that unrealized losses from the Company's foreign currency translation adjustments, interest rate derivatives, unrecognized minimum pension liability and unrealized gains (losses) on investments be included in other comprehensive income (loss).

(p) Derivative Instruments and Hedging Activities

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"). In June 2000 the FASB issued Statement of Financial Accounting Standards No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS 133* ("SFAS 138"). SFAS 133 and SFAS 138 require that all derivative instruments be recorded on the balance sheet at their respective fair values. SFAS 133 and SFAS 138 are effective for all fiscal quarters of all fiscal years beginning after June 30, 2000; the Company adopted SFAS 133 and SFAS 138 on November 1, 2000.

The Company's principal derivative instruments in 2001 were interest rate swaps which allowed the Company to reduce its exposure to variability in interest payments due to changes in interest rates on its variable rate, long-term debt obligations. These interest rate swaps were cancelled in connection with the December 2002 debt refinancing (see Note 10). During 2002, the Company entered into several derivative contracts to hedge part of the Company's foreign currency exposure with respect to future cash receipts under a contract with the Ontario Lottery Commission. These derivative instruments have been designated as cash flow hedges and recorded on the balance sheet at their respective fair values as prescribed by SFAS 133 and 138.

All derivatives are recognized on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as a hedge of the variability of cash flows to be paid or received related to its long-term debt obligation or customer contract, respectively ("cash flow"). The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash-flow hedges to specific components of its long-term obligations and contract cash receipts. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income (loss), until operations are affected by the variability in cash flows of the designated hedge item. Changes in the fair value of derivative trading instruments are reported in current-period operations.

The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised. When hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the consolidated balance sheet, and recognizes any changes in its fair value in operations.

For interest rate swaps, the differential to be paid or received is accrued and recognized in interest expense and may change as a market interest rates change. If a swap was terminated prior to its maturity, the gain or loss is recognized over the remaining original life of the swap if the item hedged remains outstanding, or immediately, if the item hedged does not remain outstanding. If the swap was not terminated prior to maturity, but the underlying hedged item is no longer outstanding, the interest rate swap was marked to market and any unrealized gain or loss is recognized immediately.

(q) Reclassification

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Certain reclassifications have been made to the prior years consolidated financial statements to conform to the current presentation. The consolidated statements of operations reflect the reclassification of "amortization of service contract software" as a component of operating expenses, which amounts had been included in depreciation and amortization in previous filings.

(3) Basic Income (Loss) Per Common Share and Diluted Income (Loss) Per Common Share

Basic income (loss) per common share is computed by dividing income (loss) by the weighted average number of common shares outstanding during the period. Diluted income per common share gives effect to all dilutive potential common shares that were outstanding during the period. At December 31, 2002, the Company had outstanding stock options, warrants, Performance Accelerated Restricted Stock Units (representing shares of deferred stock), and Series A convertible preferred stock which could potentially dilute basic earnings per share in the future (see Notes 14 and 15).

The following represents a reconciliation of the numerator and denominator used in computing basic and diluted income (loss) available to common stockholders per common share for the year ended

68

October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002:

	Year Ended October 31,	Two Months	Years Ended	
		Ended	December 31,	
			Restated 2001	Restated 2002
	Restated 2000	Restated 2000	Restated 2001	Restated 2002
Income (loss) (numerator)				
Net income (loss) available to common stockholders	\$ (31,675)	(5,943)	(11,913)	32,248
Add back extraordinary items, net of tax benefit	12,567			13,501
Income (loss) before extraordinary items available to common stockholders (basic)	(19,108)	(5,943)	(11,913)	45,749
Add back preferred stock paid-in-kind dividend (1)				7,484
Income (loss) before extraordinary items and preferred stock dividend available to common stockholders (diluted)	\$ (19,108)	(5,943)	(11,913)	53,233
Extraordinary items, net of tax benefit (basic and diluted)	\$ 12,567			13,501
Net income (loss) after extraordinary items available to common stockholders (basic)	\$ (31,675)	(5,943)	(11,913)	32,248
Add back preferred stock paid-in-kind dividend (1)				7,484
Net income (loss) after extraordinary items without preferred stock dividend available to common stockholders (diluted)	\$ (31,675)	(5,943)	(11,913)	39,732
Shares (denominator)				
Basic weighted average common shares outstanding	36,928	40,025	40,340	50,221
Effect of diluted securities stock options, convertible preferred shares and deferred shares (2)(3)				29,930
Diluted weighted average common shares outstanding	36,928	40,025	40,340	80,151

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Two Months Ended			
Basic and Diluted per share amounts				
Basic income (loss) before extraordinary items available to common stockholders	\$ (0.52)	(0.30)	0.91
Diluted income (loss) before extraordinary items available to common stockholders (2)(3)	\$ (0.52)	(0.15)	(0.30)	0.66
Basic extraordinary items, net of tax benefit	\$ (0.34)			(0.27)
Diluted extraordinary items, net of tax benefit (3)	\$ (0.34)			(0.17)
Basic net income (loss) available to common stockholders	\$ (0.86)	(0.15)	(0.30)	0.64
Diluted net income (loss) available to common stockholders (3)	\$ (0.86)	(0.15)	(0.30)	0.50

- (1) Series A Convertible Preferred Stock paid-in-kind dividend is included in the calculation of diluted net income per share in the year ended October 31, 2000, the two months ended December 31, 2000, and the year ended December 31, 2001 since assuming conversion of the preferred shares would be anti-dilutive.
- (2) Potential common shares are not included in the calculation of dilutive net loss per share for the year ended October 31, 2000, the two months ended December 31, 2000, and the year ended December 31, 2001 since inclusion would be anti-dilutive.
- (3) As per Statement of Financial Accounting Standards No. 128, *Earnings Per Share* ("SFAS 128"), whenever a company reports an extraordinary item, the same number of potential common shares used in computing the diluted per share amounts for income before extraordinary items must be used in computing all other diluted per share amounts, even if those amounts are anti-dilutive to their respective basic per share amounts.

(4) Acquisitions

On June 5, 2002, the Company completed the purchase of 65% of the equity of Serigrafica Chilena S.A. ("SERCHI"). Subsequent to the acquisition, the Company changed the name of SERCHI to Scientific Games Latino America S.A. The purchase price was approximately \$3,900 in cash and up to \$4,355 in cash or stock payable to SERCHI stockholders upon the achievement of certain financial performance levels of SERCHI over the next four years. The acquisition was recorded using the purchase method of accounting and the acquired assets and liabilities have been recorded at their estimated fair values at the date of acquisition. The excess of the purchase price over the fair values of the net assets acquired is currently estimated to be approximately \$3,611 and has been recorded as goodwill. This estimate is subject to revisions until the valuations of SERCHI's assets and liabilities are completed in the first quarter of 2003. The operating results of the SERCHI business have been included in the consolidated statements of operations since the date of acquisition. Had the operating results of SERCHI been included as if the transaction had been consummated on January 1, 2002, the pro forma operating results of the Company for the year ended December 31, 2002 would not have been materially different.

On September 6, 2000, the Company completed the acquisition of Scientific Games Holdings Corp. ("SGHC"), a world-leading supplier of lottery products, integrated lottery systems and support services, and pre-paid telephone cards. The acquisition was completed through a merger in which SGHC became a wholly-owned subsidiary of the Company, at a cost of approximately \$308,000 in aggregate merger consideration to SGHC stockholders, plus related fees and expenses. The acquisition was recorded using the purchase method of accounting. The acquired assets and liabilities were recorded at their preliminarily estimated fair value at the date of acquisition. The excess of the purchase price over the fair values of the net assets acquired, including the recorded amount of the Company's NOL of \$39,100, was preliminarily estimated at \$115,200, subject to finalization, and has been recorded as goodwill which is being amortized over 20 years.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

The SGHC acquisition and the refinancing of substantially all existing debt of both the Company and SGHC, along with the payment of certain related fees and expenses, was completed with funds provided by: (1) proceeds from the issuance of \$150,000 principal amount of the Company's 12¹/₂% Senior Subordinated Notes due August 15, 2010; (2) \$280,000 of Term B Loan borrowings under the terms of the 2000 Facility; (3) \$2,987 of borrowings under the revolving credit portion of the 2000 Facility; (4) \$4,805 of cash on hand; and (5) \$110,000 of gross proceeds from the sale of new convertible preferred stock (see Notes 10 and 14).

In the third quarter of fiscal 2001, the Company finalized the allocation of the purchase price previously allocated on a preliminary basis to the estimated fair value of the assets acquired and liabilities assumed in connection with the acquisition of SGHC. The finalization of the allocation of the purchase price resulted in the reclassification of \$73,870 of previously estimated identified intangible assets, including capitalized software, and \$29,548 of related deferred income tax liabilities, or approximately \$44,322 to goodwill. The reclassifications were the result of the consideration of additional information regarding available products and costs of services, and the refinement of certain assumptions used in the determination of the estimated fair values of the acquired assets.

The Company has accounted for the reclassification of the intangible assets, including capitalized software, and related deferred income taxes as a change in estimate, and accordingly has reduced capitalized software by \$9,825, patents by \$13,901 and customer lists by \$50,144 having estimated useful lives of 10, 15 and 20 years, respectively. In addition, as a result of the reclassification of the intangible assets, the Company has reduced the initial recorded value of its NOL from \$39,100 to \$18,520 to reflect the reduction in net taxable temporary differences that are now expected to reverse during the NOL carryforward period. Accordingly, the accompanying consolidated balance sheet at December 31, 2001 and the consolidated statement of operations for the period subsequent to the date of reclassification have been adjusted to reflect the reclassification and the resulting affect on operations. Had the reclassification been made at the beginning of the current year, the positive effect on net income for the period through the date of reclassification would not have been material.

The following table presents unaudited pro forma results of operations as if the SGHC acquisition and related financing transactions had occurred at the beginning of the period presented after giving effect to certain adjustments, including amortization of goodwill and other identifiable intangible assets, additional depreciation expense, increased interest expense, convertible preferred stock dividends and related income tax effects. These unaudited pro forma results include amortization and deferred tax benefit computations

70

based on the estimated identifiable intangible assets and related deferred income tax amounts recorded prior to the reclassifications made in the third quarter of 2001, described above, because such reclassifications would not have had a material effect on the pro forma results. Additionally, these unaudited pro forma results were presented using then current generally accepted accounting principles. In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, *Business Combinations* ("SFAS 141"), and No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"). SFAS 141 became effective immediately and SFAS 142, became effective for the Company on January 1, 2002, which changed the accounting and reporting for goodwill and intangible assets. Consequently, beginning January 1, 2002, amortization of goodwill and intangibles with indefinite lives ceased.

These pro forma results have been prepared for comparative purposes and do not purport to be indicative of what would have occurred had the acquisition been made at the beginning of the Company's previous fiscal years ended October 31, 1999 and 2000, or the results that may occur in the future.

	Years Ended October 31,	
	Restated 1999	Restated 2000
	(unaudited)	
Operating revenues	\$ 439,811	437,073
Operating income	40,158	29,847
Loss before income tax expense and extraordinary items	(8,129)	(18,038)
Net loss	(11,783)	(22,051)
Convertible preferred stock dividend	(6,765)	(6,765)
Net loss available to common stockholders	\$ (18,548)	(28,816)

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	<u>Years Ended October 31,</u>	
Basic and diluted net loss per share	\$ (0.33)	(0.60)
Basic and diluted net loss per share available to common stockholders	\$ (0.51)	(0.78)

Subsequent Event Acquisition of MDI Entertainment, Inc.

On January 17, 2003, the Company completed the acquisition of MDI Entertainment, Inc. ("MDI") through (i) a tender offer at \$1.60 per share, in cash, (ii) the purchase of shares from MDI's President and Chief Executive Officer pursuant to a separate stock purchase agreement and (iii) a merger agreement, whereby the remaining eight percent of MDI common shares were converted into the right to receive \$1.60 per share in cash. With the purchase of MDI, the Company significantly expanded its offerings of licensed branded products and prize fulfillment and related services. MDI has been successful in helping lotteries attract players to new kinds of tickets and second chance games that allow players to win merchandise, such as Harley Davidson motorcycles and trips and prizes like tickets to NBA playoff games. The Company's portfolio of licensed brands now includes Mandalay Bay, NBA, Harley Davidson and Wheel of Fortune, plus many others. The Company expects that its acquisition of MDI will enable it to further expand the use of branded games and prize fulfillment services to continue to help its customers generate revenues to meet the needs of their beneficiaries. The acquisition will be accounted for using the purchase method of accounting. Had the operating results of MDI been included as if the transaction had been consummated on January 1, 2002, the Company's pro forma operating results for the year ended December 31, 2002 would not have been materially different from the actual reported results.

71

(5) Inventories

Inventories consist of the following:

	<u>December 31,</u>	
	<u>2001</u>	<u>2002</u>
Parts and work-in-process	\$ 10,130	10,850
Finished goods	9,417	9,685
	<u>\$ 19,547</u>	<u>20,535</u>

Point of sale terminals manufactured by the Company may be sold to customers or included as part of a long-term wagering system contract. 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 (see Note 6).

(6) Property and Equipment

Property and equipment, including assets under capital leases, consist of the following:

	<u>December 31,</u>	
	<u>2001</u>	<u>2002</u>
Machinery, equipment and deferred installation costs	\$ 278,227	311,785
Land and buildings	47,435	49,990
Transportation equipment	2,569	4,362
Furniture and fixtures	10,213	10,995
Leasehold improvements	11,748	14,515
Construction in progress	14,645	13,038

	December 31,	
	_____	_____
Property and equipment, at cost	364,837	404,685
Less: Accumulated depreciation	168,049	203,819
	_____	_____
Net property and equipment	\$ 196,788	200,866
	_____	_____

Depreciation expense for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002 amounted to \$20,171, \$5,118, \$32,919 and \$35,009, respectively.

Cost for equipment associated with specific wagering systems contracts not yet placed in service are recorded as construction in progress. When the equipment is placed in service at wagering facilities, the related costs are transferred from construction in progress to machinery and equipment, and the Company commences depreciation of the costs.

(7) Goodwill and Intangible Assets, Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of

In June 2001, the FASB issued Statement No. 141, *Business Combinations* ("SFAS 141"), and Statement No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), and in August 2001 the FASB issued Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001. The Company adopted the provisions of SFAS 141 upon issuance. SFAS 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. SFAS 142 requires, commencing January 1, 2002, that goodwill and intangible assets with indefinite useful lives no longer be amortized. Instead, they will be tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144. Goodwill and intangible assets acquired by the Company in its business combinations completed before July 1, 2001 continued to be amortized through December 31, 2001.

72

SFAS 142 requires that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and make any necessary reclassifications in order to conform with the new criteria in SFAS 141 for recognition apart from goodwill. The Company also adopted SFAS 142 and, accordingly, is required to reassess the useful lives and residual values of all intangible assets acquired in purchase business combinations and to make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company is required to test the intangible asset for impairment within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

In connection with the transitional goodwill impairment evaluation, SFAS 142 and SFAS 144 require that the Company perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To the extent a reporting unit's carrying amount (as defined in SFAS 142) exceeds its fair value, the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value, to all of its assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation in accordance with SFAS 141, to its carrying amount, both of which would be measured as of the date of adoption. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's consolidated statement of operations.

The Company had unamortized goodwill of approximately \$179,099 and unamortized identifiable intangible assets of approximately \$60,154 at December 31, 2001, all of which were subject to the transition provisions of SFAS 141 and SFAS 142. In connection with the adoption of SFAS 142, the Company evaluated its intangible assets and determined that its right to operate its Connecticut OTBs and its trade name with net carrying amounts of approximately \$11,681 and \$30,082, respectively, at December 31, 2001, have indefinite useful lives and, accordingly, the Company ceased amortization as of January 1, 2002. In addition, as required by SFAS 142, the Company reclassified its employee work force intangible asset with a net carrying value of approximately \$3,170, net of related deferred tax liabilities of \$2,113, to goodwill effective January 1, 2002. Amortization expense of these intangible assets and goodwill was approximately \$16,909 for the year ended December 31, 2001. As a result of adoption of SFAS 142, the Company also reduced the recognized amount of its NOL from \$18,520 to \$8,730

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

to reflect the reduction in the amount of the net taxable temporary differences that are expected to reverse during the loss carryforward period because of the cessation of amortization of the tradename and employee workforce intangible assets. This NOL reduction was charged to income tax expense in the first quarter of 2002. The Company also evaluated the remaining useful lives of its intangible assets that will continue to be amortized and has determined that no revision to the useful lives will be required. The Company completed its initial impairment review of intangible assets with indefinite useful lives during the second quarter of 2002 with no material adjustments to the December 31, 2001 balances for these assets. The Company completed its initial impairment review of goodwill during the second quarter of 2002 with no material adjustments to the December 31, 2001 balances for this asset. The annual impairment test is performed after completion of the Company's annual financial operating plan, which occurs in the fourth quarter of its fiscal year. The Company completed its annual impairment test with no adjustment to the carrying value of its intangible assets with indefinite useful lives and goodwill as of December 31, 2002. The Company has determined its reporting units to be the same as its reportable segments, and all assets including goodwill have been allocated to the reporting units.

SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* ("SFAS 121"). However, SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS 144 supersedes the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business. However, SFAS 144 retains the requirement of

73

Opinion 30 to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of (by sale, by abandonment, or in distribution to owners) or is classified as held for sale. SFAS 144 also amends ARB No. 51, *Consolidated Financial Statements*, to eliminate the exception to consolidation for a temporarily controlled subsidiary. The Company adopted SFAS 144 effective January 1, 2002. The adoption of SFAS 144 for long-lived assets held for sale had no material impact on the Company's consolidated financial statements for the year ended December 31, 2002. The provisions of this statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities and therefore, will depend on future actions initiated by management. As a result, the Company cannot determine the potential effects that adoption of SFAS 144 will have on its financial statements with respect to future disposal decisions, if any.

The following disclosure presents certain information on the Company's acquired intangible assets as of December 31, 2001 and 2002. Amortized intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.

Intangible Assets	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Balance
Balance at December 31, 2001				
Amortizable intangible assets:				
Patents	15	\$ 915	94	821
Customer lists	14	14,600	2,313	12,287
Employee work force	5	7,200	1,917	5,283
Trade name	20	32,200	2,118	30,082
Connecticut off-track betting system operating right	20	20,000	8,319	11,681
Total intangible assets		\$ 74,915	14,761	60,154
Balance at December 31, 2002				
Amortizable intangible assets:				
Patents	15	\$ 1,084	163	921
Customer lists	14	14,600	4,089	10,511
Customer service contracts	15	3,341	1,053	2,288

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Intangible Assets	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Balance
		19,025	5,305	13,720
Non-amortizable intangible assets:				
Trade name		32,200	2,118	30,082
Connecticut off-track betting system operating right		22,339	8,319	14,020
		54,539	10,437	44,102
Total intangible assets		\$ 73,564	15,742	57,822

The aggregate intangible amortization expense for the year ended December 31, 2002 was approximately \$2,035. The estimated intangible asset amortization expense for the year ending December 31, 2003 and for each of the subsequent four years, ending December 31, 2007, are approximately \$2,050, \$1,765, \$1,017, \$730 and \$730, respectively.

74

The table below reconciles the change in the carrying amount of goodwill, by reporting unit, which is the same as operating segment, for the period from December 31, 2001 to December 31, 2002. The Company recorded a \$3,170 increase in goodwill at January 1, 2002 in connection with the reclassification of employee work force intangible assets of \$5,283, less related deferred tax liability of \$2,113 acquired prior to July 1, 2001 that did not meet the criteria for recognition apart from goodwill under SFAS 141. Goodwill in the amount of \$2,110, net of amortization, which was directly related to the value of customer contracts acquired as part of the September 1, 1999 acquisition of Datasport assets and an interest in Datek, was reclassified to intangible assets effective January 1, 2002. Goodwill in the amount of \$3,611 was recorded during 2002 in connection with the acquisition of a majority interest in SERCHI.

Goodwill	Restated Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecom- munications Group	Restated Totals
Balance at December 31, 2001	\$ 176,502	2,597			179,099
Effect of adoption of SFAS 141 and SFAS 142:					
Reclassification of employee workforce intangible asset, net of tax	3,170				3,170
Reclassification of customer service contract to intangible assets		(2,110)			(2,110)
Record the goodwill acquired in the acquisition of a majority interest in SERCHI	3,611				3,611
Balance at December 31, 2002	\$ 183,283	487			183,770

The following table compares pro forma net income (loss) available to common stockholders for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31,

75

2001 and 2002, adjusted to reflect the adoption of SFAS 142 on November 1, 1999, to the reported net income for the year ended December 31, 2002:

Year Ended October 31,	Two Months Ended December 31,	Years Ended December 31,
---------------------------	----------------------------------	-----------------------------

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated 2000	Restated 2000	Restated 2001	Restated 2002
	Pro Forma	Pro Forma	Pro Forma	As Reported
Adjusted income available to common stockholders:				
Adjusted income (loss) before extraordinary item	\$ (15,360)	(3,335)	5,251	53,233
Adjusted income (loss) before extraordinary item available to common stockholders	\$ (16,374)	(4,478)	(1,800)	45,749
Adjusted net income (loss) available to common stockholders	\$ (28,941)	(4,478)	(1,800)	32,248
Adjusted earnings per share amounts basic and diluted:				
Adjusted income before extraordinary item per share available to common stockholders:				
Basic	\$ (0.44)	(0.11)	(0.04)	0.91
Diluted	\$ (0.44)	(0.11)	(0.04)	0.66
Adjusted net income (loss) per share available to common stockholders:				
Basic	\$ (0.78)	(0.11)	(0.04)	0.64
Diluted	\$ (0.78)	(0.11)	(0.04)	0.50
Shares used in calculating adjusted per share amounts:				
Basic	36,928	40,025	40,340	50,221
Diluted	36,928	40,025	45,412	80,151
Reconciliation of reported net income to adjusted net income (loss):				
Reported net income (loss) available to common stockholders	\$ (31,675)	(5,943)	(11,913)	32,248
Add back:				
Amortization of goodwill and intangible assets with indefinite lives, net of tax benefit	2,734	1,465	10,113	
Adjusted net income (loss) available to common stockholders	\$ (28,941)	(4,478)	(1,800)	32,248

(8) Other Assets and Investments

Other assets and investments, (net) consist of the following:

	December 31,	
	2001	2002
Software systems development costs	\$ 25,265	28,736
Deferred financing costs	14,899	7,786
Deferred tax asset		33,142
Other assets	11,448	14,322

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

December 31,	
2001	2002
\$ 51,612	83,986

In the years ended December 31, 2001 and 2002, the Company capitalized \$8,267 and \$9,194, respectively, of software systems development costs related primarily to lottery and pari-mutuel wagering systems and video gaming. Capitalized costs are amortized on a straight-line basis over a period of five to ten years.

76

Deferred financing costs arise in connection with the procurement of long term financing by the Company, and are amortized over the life of the financing agreements. In fiscal 2000, the Company capitalized \$16,517 of financing fees incurred in connection with the SGHC acquisition transactions and wrote-off, as an extraordinary charge, \$2,865 of previously deferred financing costs in connection with its repayment of the Old Facility and 1998 and 2000 Term Loans. In fiscal 2002, the Company capitalized \$5,374 in connection with replacing the 2000 Facility with the 2002 Facility and wrote-off, as an extraordinary charge, \$10,226 of previously deferred financing costs in connection with its refinancing of the 2000 Facility and the redemption of approximately \$82,957 of the Company's 12¹/₂% Senior Subordinated Notes. Amortization of deferred financing costs amounted to \$1,224, \$384, \$2,435 and \$2,261 for the fiscal year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002, respectively.

(9) Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	2001	2002
Compensation and benefits	\$ 15,781	20,393
Customer advances	1,948	8,376
Accrued income taxes	4,553	2,418
Taxes, other than income	2,372	2,625
Accrued acquisition costs	909	
Accrued contract costs	6,859	1,826
Other	18,696	17,875
	\$ 51,118	53,513

77

(10) Long-Term Debt

Long-term debt consists of the following:

	December 31,	
	2001	2002
12 ¹ / ₂ % Series B Senior Subordinated Notes due 2010	\$ 150,000	67,043
2000 Term A loan with varying interest rate due 2006	55,500	
2000 Term B loan with varying interest rate due 2007	217,250	
2002 Term B loan with varying interest rate due 2008		290,000
2000 Revolving credit facility with varying interest rate due September 2006	14,750	
2002 Revolving credit facility with varying interest rate due September 2006		

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	December 31,	
Capital lease obligations, payable monthly through October 2005 interest from 5.8% to 15.0%	165	567
Various loans and bank facilities, interest from 4.75% to 14.76%	2,070	2,919
Total long-term debt	439,735	360,529
Less current installments	9,437	3,865
Long-term debt, excluding current installments	\$ 430,298	356,664

On December 19, 2002, the Company entered into a new \$340,000 senior credit facility (the "2002 Facility") and refinanced all of the then outstanding obligations under the existing 2000 Facility. The 2002 Facility consists of: (a) a \$50,000 revolving credit facility available for working capital and general corporate purpose loans and for letters of credit (the "2002 Revolver"), which matures in September 2006 with interest at the Base Rate (as defined in the credit agreement governing the 2002 Facility) plus a margin of 1.75% per annum, or at the rate of LIBOR plus a margin of 2.75% per annum, plus a commitment fee on the unused portion of 0.05% per annum, for the first six months and thereafter as determined by reference to a leverage-based pricing grid and (b) a \$290,000 term loan (the "2002 Term B Loan") which matures in December 2008 with interest at the Base Rate plus a margin of 2.50% per annum, or at the rate of LIBOR plus 3.50% per annum. The 2002 Facility contains provisions permitting the 2002 Revolver to be increased up to \$70,000 at any time prior to December 19, 2004, provided that no Default or Event of Default has occurred and is continuing. The 2002 Facility is secured by a first priority, perfected lien on: (i) substantially all the property and assets (real and personal, tangible and intangible) of the Company and its wholly-owned domestic subsidiaries, (ii) 100% of the capital stock of all of the direct and indirect wholly-owned domestic subsidiaries and 65% of the capital stock of all of the wholly-owned first-tier foreign subsidiaries of the Company and (iii) all inter-company indebtedness owing between the Company and its wholly-owned domestic subsidiaries. The 2002 Facility is supported by guarantees provided by all of the Company's direct and indirect wholly-owned domestic subsidiaries.

At December 31, 2002, available borrowing capacity under the 2002 Revolver was \$28,171 net of outstanding letters of credit of \$21,829. As of December 31, 2002, \$290,000 of the 2002 Term B Loan and \$67,043 of the 12¹/₂% Senior Subordinated Notes were outstanding. The interest rate on the 2002 Term B Loan was 4.92% per annum.

The 2002 Term B Loan requires quarterly principal payments of \$725 through December 31, 2007 and \$68,875 in 2008. In addition, the 2002 Facility will be subject to the following mandatory prepayments, with certain customary exceptions: (i) 50% of the net cash proceeds from the sale or issuance of equity, (ii) 100% of the net cash proceeds from the sale or issuance of debt securities; (iii) 100% of the net proceeds from the sale of assets and casualty insurance proceeds, subject to a reinvestment exclusion limited to \$20,000 per annum, and (iv) 50% of the Company's excess cash flow (as defined in the credit agreement governing the 2002 Facility), or 0% if the leverage ratio is less than 2.50 to 1.00.

The credit agreement governing the 2002 Facility contains certain covenants that, among other things, limit the Company's ability, and the ability of certain of the Company's 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, sell, transfer, lease

or otherwise dispose of all or substantially all assets, or create certain liens and other encumbrances on assets. Additionally, the credit agreement governing the 2002 Facility contains the following financial covenants that are computed quarterly on a rolling four-quarter basis as applicable:

A maximum Consolidated Leverage Ratio of 4.00, which will be reduced on the first day of each calendar quarter through July 1, 2005, from which date until December 2008 the ratio shall be 3.00. Consolidated Leverage Ratio means the ratio of (x) the aggregate stated balance sheet amount of the Company's indebtedness determined on a consolidated basis in accordance with GAAP as of the last day of the fiscal quarter for which such determination is being made to (y) Consolidated EBITDA for the four consecutive fiscal quarters ended on the last day of the fiscal quarter for which such determination is being made.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

A minimum Consolidated Interest Coverage Ratio of 2.50, which will be increased on the first day of each calendar quarter through July 1, 2004, from which date until December 2008 the ratio shall be 3.75. Consolidated Interest Coverage Ratio means the ratio computed for the Company's four most recent fiscal quarters of (x) Consolidated EBITDA to (y) total interest expense less non-cash amortization costs included in interest expense.

A minimum Consolidated Fixed Charge Coverage Ratio of 1.65, which will be increased on the first day of each calendar quarter through July 1, 2006, from which date until December 2008 the ratio shall be 1.85. Consolidated Fixed Charge Coverage Ratio means, as of any date of determination, the ratio computed for the Company's four most recent fiscal quarters of (x) Consolidated EBITDA to (y) the sum of (i) total interest expense less non-cash amortization costs included in interest expense, (ii) scheduled payments of principal on indebtedness, (iii) certain restricted payments and (iv) all income taxes paid in cash.

A maximum Consolidated Senior Debt Ratio of 3.25, which will be reduced on the first day of each calendar quarter through July 1, 2005, from which date until December 2008 the ratio shall be 2.50. Consolidated Leverage Ratio means the ratio of (x) the aggregate stated balance sheet amount of the Company's indebtedness, less the amount of Notes, determined on a consolidated basis in accordance with GAAP as of the last day of the fiscal quarter for which such determination is being made to (y) Consolidated EBITDA for the four consecutive fiscal quarters ended on the last day of the fiscal quarter for which such determination is being made.

For purposes of the foregoing limitations, Consolidated EBITDA means the sum of (i) consolidated net income, (ii) consolidated interest expense with respect to all outstanding indebtedness, (iii) provisions for taxes based on income, (iv) total depreciation expense, (v) total amortization expense and (vi) certain adjustments, in each case for the period being measured, all of the foregoing as determined on a consolidated basis for the Company and its subsidiaries in accordance with GAAP. Although the Company was in compliance with its loan covenants at December 31, 2002 and expects to continue to remain in compliance over the next 12 months, no assurances can be provided that the Company will be able to do so or that the Company will be able to continue to meet the covenant requirements beyond 12 months.

On September 6, 2000, contemporaneously with the payment of the acquisition consideration to the shareholders of SGHC, the Company refinanced substantially all of the then existing debt of both the Company and SGHC and paid certain related fees and expenses (collectively, the "Transactions"). In addition to cash on hand and proceeds from the sale of convertible preferred stock, the Company incurred the following debt to fund the Transactions: (i) \$150,000 principal amount of 12¹/₂% Senior Subordinated Notes due August 15, 2010 (the "Notes"); (ii) \$280,000 of Term B Loan borrowings under the terms of a \$345,000 senior credit facility (the "2000 Facility"); and (iii) \$2,987 of borrowings under the revolving credit portion of the 2000 Facility.

The Notes bear interest at the rate of 12¹/₂% per annum payable semi-annually on each February 15 and August 15, commencing February 15, 2001. The Notes are senior subordinated, unsecured obligations of the Company, ranking junior to all existing and future senior debt including obligations under the 2002 Facility. The Notes are fully and unconditionally guaranteed on a senior subordinated basis by all of the Company's wholly-owned U.S. subsidiaries (see Note 25). The Notes will be redeemable, at the option of the Company, at any time on or after August 15, 2005, in whole or in part, at redemption prices equal to 106.250%, 104.167%, 102.083% and 100.000% of the principal amount thereof if redeemed during the 12-month periods commencing on August 15 of years 2005, 2006, 2007, and 2008 and thereafter, respectively. The

Notes mature August 15, 2010. The indenture governing the Notes contains certain covenants that, among other things, limit the Company's ability, and the ability of certain of the Company's 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 new assets.

In addition to the issuance of the Notes, the Company also entered into the 2000 Facility with certain lenders, providing for borrowings of up to \$345,000. The 2000 Facility consisted of: (a) a \$65,000 revolving credit facility available for working capital and general corporate purpose loans and for letters of credit (the "2000 Revolver"), which was to mature in September 2006 with interest at the Base Rate (as defined in the credit agreement that governed the 2000 Facility) plus a margin of 2.25% per annum, or at the rate of LIBOR plus a margin of 3.50% per annum, plus a commitment fee on the unused portion of 0.05% per annum, for the first six months and thereafter as determined by reference to a

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

leverage-based pricing grid; (b) a \$60,000 term loan (the "2000 Term A Loan") which was to mature in September 2006 with interest at the Base Rate plus a margin of 2.25% per annum, or at the rate of LIBOR plus 3.50% per annum for the first six months and thereafter as determined by reference to a leverage-based pricing grid; and (c) a \$220,000 term loan (the "2000 Term B Loan") which was to mature in September 2007 with interest at the Base Rate plus a margin of 3.00% per annum, or at the rate of LIBOR plus 4.25% per annum.

In the third quarter of 2002, the Company sold approximately 14,400 shares of its Class A Common Stock (the "2002 Offering") and used the net proceeds to redeem approximately \$82,957 of the Notes. In connection with this redemption, the Company paid the noteholders redemption premiums aggregating approximately \$11,172 and paid the term loan lenders and banks related fees of approximately \$1,103, to amend the 2000 Facility to permit the Company to use the majority of the net proceeds from the 2002 Offering to redeem the subordinated debt rather than pay down the 2000 Facility. In November 2002, the Company used approximately \$1,741 of the remaining proceeds to make mandatory repayments of the 2000 Term A and 2000 Term B loans. Following the mandatory repayment of the 2000 Facility, there was \$50,022 outstanding under the 2000 Term A loans and \$214,837 outstanding under the 2000 Term B loans.

Prior to the September 6, 2000 Transactions, the Company's debt consisted primarily of: (a) \$110,000 of 10⁷/₈% Series B Senior Notes due August 1, 2004 (the "Old Notes"), which bore interest at a rate of 10⁷/₈% per annum. In connection with the redemption of the Old Notes on September 6, 2000, the Company paid a call premium to the Old Note holders in the amount of \$9,702. This call premium was recorded as an extraordinary item in the Company's consolidated statements of operations in fiscal 2000; (b) \$35,000 of 5.5% convertible subordinated debentures due 2001 (the "Debentures"); (c) \$25,000 revolving credit facility (the "Old Facility"), which bore interest at a rate of prime plus 2.50% per annum or LIBOR plus 3.50% per annum; (d) a \$7,200 term loan (the "1998 Term Loan"), which bore interest at a fixed rate of 8.87%; and (e) a \$9,900 term loan (the "2000 Term Loan"), which bore interest at a rate of prime plus 2.50% per annum or LIBOR plus 3.50% per annum. The Old Notes, the Debentures, borrowings under the Old Facility, the 1998 Term Loan, and the 2000 Term Loan were all repaid in full with cash on hand and with proceeds from the debt and equity financing in the Transactions.

(11) Extraordinary Items

In 2002, the Company repaid approximately \$82,957 of its outstanding Notes and refinanced the 2000 Facility. As a result, the Company recorded extraordinary charges aggregating approximately \$22,501. These charges included payments related to the redemption premium in the amount of approximately \$11,172 on the redeemed Notes; the \$1,103 fees paid to the term loan lenders and banks to permit the Company to use the majority of the net proceeds from the 2002 Offering to redeem the subordinated debt rather than pay down the 2000 Facility; and the write off of approximately \$10,226 of previously deferred financing costs and other fees. These extraordinary charges were partially offset by federal and state income tax benefits of approximately \$9,000 attributable to these expenses. The resultant total of approximately \$13,501 was reflected as an extraordinary expense in the accompanying consolidated financial statements.

In connection with the 2000 acquisition of SGHC and the related financing transactions and the subsequent repayment of all amounts outstanding under the Company's previous credit facilities, the Company wrote off \$2,865 of deferred financing fees and expensed \$9,702 in call premium on the Old Notes

80

in fiscal year 2000. There were no tax benefits recognized on the net extraordinary loss because the Company was not in a position to utilize prior year net operating loss carryforwards.

(12) Commitments

At December 31, 2002, the Company was obligated under operating leases covering office equipment, office and warehouse space, transponders and transportation equipment expiring at various dates through 2007. Future minimum lease payments required under these leasing arrangements at December 31, 2002 are as follows: \$10,630 in 2003; \$10,431 in 2004; \$9,754 in 2005; \$3,845 in 2006; \$2,291 in 2007 and thereafter \$4,425. Total rental expense under these operating leases was \$9,051, \$1,718, \$10,941 and \$11,168 in the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002, respectively.

The Company acquired \$805 of capitalized leases with the acquisition of 65% of the equity of SERCHI on June 5, 2002.

(13) Fair Value of Financial Instruments

The fair value of financial instruments is determined by reference to market data and other valuation techniques as appropriate. The Company believes the fair value of its financial instruments, principally cash and cash equivalents, accounts receivable, other current assets, accounts payable, and accrued liabilities approximates their recorded values.

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

The Company believes that the fair value of the Notes approximated \$165,000 and \$77,770 at December 31, 2001 and 2002, respectively, based on reference to dealer markets and global market prices. The 2000 Term A Loan and 2000 Term B Loan and 2000 Facility were refinanced during 2002 and therefore have zero values at December 31, 2002. The 2002 Term B Loan and 2002 Facility borrowings approximate their recorded values (see Note 10), respectively, based on their respective variable rates and currently available terms and conditions for similar debt at December 31, 2002.

(14) Capital Stock

Preferred Stock

The Company has a total of 2,000 shares of preferred stock, \$1.00 par value, authorized for issuance.

On September 6, 2000, the Company authorized 1,600 shares and issued, for gross proceeds of \$110,000, 1,100 shares of Series A Convertible Preferred Stock (the "Series A Preferred Stock"), including \$100,000 of gross proceeds from the issuance to Cirmatica Gaming, S.A., an affiliate of Lottomatica S.p.A. (the state concessionaire for the Italian national lottery), and \$10,000 of gross proceeds from the issuance to other investors through Ramius Securities, LLC (together with its affiliates, "Ramius"), which acted as placement agent. The Company also issued 27.5 shares of Series A Preferred Stock to Ramius in partial payment of its placement fee.

81

The Series A Preferred Stock is convertible into the Company's common stock at prices of: (a) \$4.63 per share if the average 30 day per share closing market price (AMP) is less than \$4.63 per share; (b) current market price per share if AMP is between \$4.63 and \$5.09 per share; (c) \$5.10 per share if AMP is between \$5.10 and \$8.93 per share and; (d) \$5.56 per share if AMP is higher than \$8.93 per share. The Series A Preferred Stock pays dividends at the rate of 6% per annum (payable in kind in additional shares or, at the Company's option, in cash) and will mature and become mandatorily convertible into common stock on September 6, 2005. The holders of Series A Preferred Stock also have the right to participate on an as-converted basis in any dividends with respect to the common stock. The holders of Series A Preferred Stock have the right to vote along with the holders of common stock on all matters on which the holders of common stock are entitled to vote, are entitled to vote separately as a class with respect to certain matters, and are also entitled to certain rights of first refusal with respect to future financings. The Series A Preferred Stock is subject to certain customary anti-dilution provisions. In addition, the holders of Series A Preferred Stock have the right to elect up to four members of the Company's Board of Directors (and to elect three additional Directors in the event of certain defaults by the Company). The Series A Preferred Stock has preference over common stock with regard to the distribution of assets upon a liquidation, dissolution or other winding up of the Company.

On December 31, 2002, a holder of the Series A Preferred Stock elected to convert all 45.9 shares of Series A Preferred Stock that it owned. Based on the AMP in effect on December 31, 2002, the Series A Preferred Stock was converted at \$5.10 per share, resulting in the issuance of 900.3 shares of Class A common stock. In addition, the holder's shares of Series B Preferred Stock were redeemed for a nominal cash payment.

For the period from the date of issue through October 31, 2000, the two months ended December 31, 2000 and for the years ended December 31, 2001 and 2002, the Company issued approximately 32, 17, 71 and 74 shares of Series A Preferred Stock, respectively, in connection with payment of the paid-in-kind dividends on such stock and as partial payment of a placement agent fee. For the year ended October 31, 2000, the Company recorded preferred stock dividends of \$1,014; for the two months ended December 31, 2000, the Company recorded preferred stock dividends of \$1,143; for the year ended December 31, 2001, the Company recorded preferred stock dividends of \$7,051 and; for the year ended December 31, 2002, the Company recorded preferred stock dividends of \$7,484. There were no unpaid dividends at December 31, 2002. Preferred stock dividends have been deducted in determining the amount of the net income (loss) available to common stockholders in the consolidated statements of operations.

In connection with certain waivers and consents by holders of the Series A Preferred Stock relating to the 2002 Offering, the Company authorized 2.0 shares and issued an aggregate of 1.2376 shares of Series B Preferred Stock, \$1.00 par value (the "Series B Preferred Stock"), pro rata, to the holders of the Series A Preferred Stock. The Series B Preferred Stock has voting rights that, together with the voting rights of the Series A Preferred Stock, effectively reduce the aggregate ownership percentage of Series A Preferred Stock (on an "as-converted" basis) that the holders are required to maintain in order to elect directors of the Company. The threshold for electing four directors was effectively reduced from 25% to 22.5% and the threshold for electing three directors was effectively reduced from 20% to 17.5%. The issuance of the Series B Preferred Stock did not affect the existing 10% and 5% thresholds for electing two directors and one director, respectively. The Series B Preferred Stock does not pay dividends and has a liquidation preference of no more than \$2 in the aggregate. The Company considers the aggregate \$1.238 book value of the Series B Preferred Stock to be a cost of raising capital, and consequently recorded that amount as a reduction of additional paid-in capital.

Common Stock

The Company has two classes of common stock, consisting of Class A Common Stock and Class B Non-voting Common Stock (the "Class B Common Stock"). All shares of Class A Common Stock and Class B Common Stock entitle holders to the same rights and privileges except that the Class B Common

82

Stock is non-voting. Each share of Class B Common Stock is convertible into one share of Class A Common Stock.

In July 2002, the Company completed the public offering and sale of 14,375 shares of its Class A Common Stock at a price of \$7.25 per share, and used the net proceeds of approximately \$98,400 (prior to deducting underwriting discounts, commissions and offering expenses), to redeem approximately \$82,957 of its 12¹/₂% Senior Subordinated Notes (see Note 10).

Warrants

On September 6, 2000, the Company issued warrants (the "September 2000 Warrants") to purchase up to 2,900 shares of the Company's common stock with a nominal exercise price to its financial advisors, Donaldson, Lufkin & Jenrette Securities Corporation and LBI Group, Inc. (an affiliate of Lehman Brothers), which received 80% and 20%, respectively, of the September 2000 Warrants, in connection with their services to the Company in obtaining certain financing commitments related to the 2000 Facility. The Company recorded the estimated fair value of the September 2000 Warrants at the date of issue of approximately \$7,511 as interest expense, with a corresponding increase to additional paid in capital. On October 5, 2000, 2,900 shares of the Company's common stock were issued upon retirement of the September 2000 Warrants.

On October 2, 2000, in connection with the acquisition of SGHC, the Company issued warrants (the "October 2000 Warrants") to purchase up to 250 shares of the Company's common stock to a financial advisor in connection with their services to the Company related to such acquisition. The October 2000 Warrants are exercisable until October 1, 2004 at a price of \$3.58 per share, equal to the fair market value of the Company's common stock on the date of issue. The estimated fair market value of the October 2000 Warrants on the date of issue was \$305, which was recorded as an increase to goodwill with a corresponding increase in additional paid-in-capital.

During 2002, the Company issued 1,480 shares of Class A Common Stock upon exercise of certain warrants at a price of \$1.69 per share. Some of these warrants were exercised pursuant to an optionable exercise provision that permitted the payment of the exercise price with Class A Common Shares in lieu of a cash payment of the exercise price.

At December 31, 2002, the Company had the following warrants outstanding, after giving effect to adjustments made in accordance with certain anti-dilution provisions:

	<u>Shares</u>	<u>Exercise Price</u>	<u>Expiration</u>
Warrants to purchase Class A Common Stock:			
2000 Class A Warrants	43	\$ 3.32	April 30, 2003
October 2000 Warrants	250	\$ 3.58	October 1, 2004
	<hr/>		
Total Class A Common Stock Warrants	293		
	<hr/>		
Warrants to purchase Class B Common Stock	147	\$ 3.83	October 30, 2003
	<hr/>		

Employee Stock Purchase Plan

In 2002, the Company adopted, and its stockholders approved, the Scientific Games Corporation 2002 Employee Stock Purchase Plan (the "ESPP") and reserved 1,000 shares of the Company's Class A Common Stock for issuance under the ESPP. The purchase price of the Common Stock issued pursuant to the exercise of an option under the ESPP will equal 85% of the fair market value of the Common Stock on (i) the first day of the offering period, or (ii) the last day of the offering period, whichever is less. The number of shares of Common Stock a participant purchases in each offering period is determined by dividing the total amount of payroll deductions withheld from the participant's compensation during that offering period by the purchase price. The first offering period of the ESPP began in January 2003.

(15) Stock Options

The Company has granted stock options and other stock awards to employees, officers and directors under four stock option plans: the 1984 Stock Option Plan; the 1992 Equity Incentive Plan (the "1992 Plan"); the 1995 Equity Incentive Plan (the "1995 Plan"); and the 1997 Incentive Compensation Plan (the "1997 Plan"). On occasion, the Company has also granted stock options outside of these plans.

In May 1995, the Company offered holders of stock options with exercise prices above market value as of May 26, 1995 the right to cancel such options in exchange for Performance Accelerated Restricted Stock Units (the "PARS"). The PARS represent deferred shares of Class A Common Stock which vest in 20% increments on the sixth, seventh, eighth, ninth and tenth anniversaries of the date of grant, or, in certain circumstances, on an accelerated basis based on the Company's stock trading at certain per share prices, or at the discretion of the Board of Directors. Options to purchase 1,976 shares were exchanged for 504 PARS. In consideration for the election by certain employees to defer their scheduled vesting of PARS, additional PARS of 4 and 18 were granted for the years ended December 31, 2001 and 2002, respectively.

Restricted shares and deferred shares with a three year vesting schedule were granted to certain non-employee directors under the 1992 Plan and 1997 Plan. A total of 40 restricted shares at a fair market value of \$2.000 per share were granted in fiscal 1999, a total of 40 restricted shares at a fair market value of \$2.5625 per share were granted in fiscal 2000, a total of 87 restricted shares at a fair market value of \$3.10 per share were granted in the two months ended December 31, 2000, and a total of 31 restricted shares at a fair market value of \$8.75 per share were granted in 2002. Accordingly, the Company has recorded compensation expense of \$272, \$264, \$43, \$268, and \$340 in the years ended October 31, 1999 and 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002, respectively, as selling, general and administrative expenses in the consolidated statements of operations. Additional compensation expense aggregating \$155 will be charged to expense through fiscal 2005 as the PARS and restricted shares become fully vested.

Stock options granted under the Company's equity incentive plans are exercisable at not less than the fair market value of the stock at the date of grant, and none may be exercised more than 10 years from the date of grant. Options are generally exercisable in four equal installments on the first, second, third and fourth anniversaries of the date of grant. The Board of Directors may, in its discretion, accelerate the exercisability, the lapsing of restrictions, or the expiration of deferral or vesting period of any award under the plans.

Information with respect to the Company's stock options is as follows:

Stock Options	Shares	Average Price (1)
Outstanding at October 31, 1999	7,373	\$ 2.63
Granted	1,892	3.44
Canceled	237	3.40
Exercised	377	2.41
Outstanding at October 31, 2000	8,651	2.80
Granted	10	3.06
Canceled	126	2.64
Exercised	140	1.36
Outstanding at December 31, 2000	8,395	2.80
Granted	2,015	4.73
Canceled	305	3.99

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Stock Options	Shares	Average Price (1)
Exercised	578	1.86
Outstanding at December 31, 2001	9,527	3.24
Granted	1,732	6.75
Canceled	250	3.83
Exercised	1,782	2.90
Outstanding at December 31, 2002	9,227	3.95

(1) Weighted average exercise price

Summarized information about stock options outstanding and exercisable at December 31, 2002 is as follows:

Exercisable Price Range	Outstanding			Exercisable	
	Shares	Average Life(1)	Average Price(2)	Shares	Average Price(2)
\$1.00 to 2.00	1,664	4.7	\$ 1.30	1,512	\$ 1.26
\$2.01 to 3.00	3,214	5.9	2.75	2,149	2.74
\$3.01 to 4.00	1,518	7.2	3.50	832	3.49
\$4.01 to 7.00	1,543	8.5	6.17	48	4.34
over \$7.00	1,288	8.0	8.25	371	9.90
	9,227			4,912	

(1) Weighted average contractual life remaining in years.

(2) Weighted average exercise price.

The number of shares and weighted average exercise price per share of options exercisable at October 31, 2000, and December 31, 2001 and 2002 were 4,832 shares at \$2.85, 5,111 shares at \$2.76, 5,398 shares at \$2.81, and 4,912 shares at \$2.96, respectively. At October 31, 2000, and December 31, 2000, 2001 and 2002, 1,909 shares, 1,916 shares, 2,223 shares, and 670 shares, respectively, were available for future grants under the terms of the Company's stock option plans. Outstanding options expire prior to December 11, 2012 and are exercisable at prices ranging from \$1.0625 to \$17.00 per share.

(16) Service Contract Arrangements

Service contracts for North American pari-mutuel wagering systems and lottery systems generally provide for substantial related services such as software, maintenance personnel, computer operators and certain operating supplies. The service contracts cover a five to seven year period and frequently include renewal options that have generally been exercised by the customers. Under such contracts, the Company retains ownership of all equipment. The service contracts also provide for certain warranties covering operation of the equipment, machines, display equipment and central computing equipment. The breach of such warranties could result in significant liquidated damages. The service contracts

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

provide for revenue based on a percentage of total amounts wagered. Certain pari-mutuel wagering systems contracts provide for specified minimum levels of revenue. The Company has historically exceeded such minimums.

Instant ticket sales contracts provide for revenue based on a fixed fee per thousand instant tickets or a percentage of instant ticket retail sales of the lottery customer. Instant ticket contracts generally run for one to five years and frequently include renewal options.

(17) Export Sales and Major Customers

Sales to foreign customers amounted to \$41,389, \$1,532, \$45,891 and \$28,580 in the year ended October 31, 2000, the two months ended December 31, 2000 and the years ended December 31, 2001 and 2002, respectively. No single customer represented more than 10% of revenues during the year ended December 31, 2002.

(18) Pension Plans

The Company has a defined benefit plan for U.S. based union employees. Retirement benefits under the plan are based upon the number of years of credited service up to a maximum of thirty years for the majority of the employees. The Company also has a defined benefit plan for U.K. based employees. The defined benefit plan for U.K. employees was assumed in connection with the acquisition of SGHC. Retirement benefits under the plan are based on an average of the employee's compensation over two years preceding retirement or leave of service. The Company's policy is to fund the minimum contribution permissible by the respective tax authorities.

In September 2000, the Company adopted a Supplemental Executive Retirement Plan, or "SERP," in order to provide supplemental retirement benefits for certain senior executives of the Company. The SERP provides for retirement benefits according to a formula based on each participant's years of service with the

86

Company and average rate of compensation. The net cost for the Company's defined benefit plans consisted of the following components:

	Pension Benefits					
	U.S. Plan		U.K. Plan		SERP Plan	
	December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002
Change in benefit obligation						
Benefit obligation at beginning of period	\$ 1,921	\$ 2,102	\$ 13,926	\$ 14,246	\$ 4,567	\$ 5,320
Service cost	105	131	1,092	950	411	442
Interest cost	132	155	917	982	342	399
Participant contributions			597	805		
Amendments		179				699
Actuarial (gain) loss	(3)	184	(1,995)	3,670		524
Benefits paid	(53)	(61)	(291)	(241)		
Other, principally foreign exchange				1,400		
Benefit obligation at end of period	2,102	2,690	14,246	21,812	5,320	7,384
Change in plan assets						
Fair value of plan assets at beginning of period	1,691	1,924	13,623	13,041		
Actual gain (loss) on plan assets	86	61	(2,111)	(2,543)		
Employer contributions	200	224	1,223	1,706		
Plan participant contributions			597	805		

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Pension Benefits

Benefits paid	(53)	(61)	(291)	(241)		
Other, principally foreign exchange				1,286		
Fair value of plan assets at end of period	1,924	2,148	13,041	14,054		
Funded status	(178)	(542)	(1,205)	(7,758)	(5,320)	(7,384)
Unrecognized actuarial loss	546	812	1,729	9,288		524
Unrecognized prior service cost	104	261			3,919	4,164
Unrecognized net transition obligation	23	17				
Net asset (liability) amount recognized	\$ 495	548	524	1,530	(1,401)	(2,696)

Amounts recognized in the Consolidated Balance Sheet consist of:

Accrued benefit liability	\$ (673)	(542)			(3,903)	(5,919)
Intangible asset	104	261		3,477	2,502	3,223
Accumulated other comprehensive income	569	281		(3,477)		
Prepaid pension cost	495	548	524	1,530		
Net amount recognized	\$ 495	548	524	1,530	(1,401)	(2,696)

Pension Benefits

U.S. Plan		U.K. Plan		SERP Plan	
December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002

Weighted-average assumptions:

Discount rate	7.000%	6.500%	6.250%	5.750%	7.500%	6.750%
Expected return on plan assets	8.000%	6.500%	8.500%	8.000%	None	None
Rate of compensation	None	None	3.250%	2.500%	4.000%	4.000%

87

Pension Benefits

U.S. Plan			U.K. Plan			SERP Plan		
December 31,			December 31,			December 31,		
2000	2001	2002	2000	2001	2002	2000	2001	2002

Components of net periodic benefit cost:

Service cost	\$ 17	105	131	209	1,092	950	64	411	442
Interest cost	22	132	155	164	917	982	54	342	399
Expected return on plan assets	(22)	(142)	(161)	(179)	(1,063)	(1,304)			
Actuarial loss						129			
Net amortization and deferral	7	36	45		160		75	457	
Amortization of prior service costs									454

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Pension Benefits

Net periodic cost	\$	24	131	170	194	1,106	757	193	1,210	1,295
-------------------	----	----	-----	-----	-----	-------	-----	-----	-------	-------

The accumulated benefit obligation represents the actuarial present value of benefits based upon the benefit multiplied by the participants' historical years of service.

The plan assets for the U.S. based plan are invested in insurance company general accounts guaranteed as to principal. The plan assets for the U.K. based plan are primarily invested in equity securities.

As required by Financial Accounting Standards Board Statement No. 87 ("SFAS 87"), "Employers' Accounting for Pensions" for pension plans where the accumulated benefit obligation exceeds the fair value of plan assets, the Company has recognized in the consolidated balance sheet at December 31, 2001 and 2002 the additional minimum liability of the unfunded accumulated benefit obligation of \$3,175 and \$7,243, respectively, as a long-term liability, with a partially offsetting intangible asset and equity adjustment.

In connection with its U.S. based collective bargaining agreements, the Company participates with other companies in a defined benefit pension plan covering union employees. Payments made to the multi-employer plan were approximately \$479, \$49, \$259 and \$244 during the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002, respectively.

The Company has a 401K plan covering all U.S. based employees who are not covered by a collective bargaining agreement. Company contributions to the plan are at the discretion of the Board of Directors. Pension expense for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002 amounted to approximately \$1,004, \$560, \$1,624 and \$1,537, respectively. The Company has a 401K plan for all union employees which does not provide for Company contributions.

88

(19) Income Tax Expense

The consolidated income (loss) before income tax expense and extraordinary items, by domestic and foreign source, is as follows:

	Year Ended October 31,	Two Months Ended	Years Ended	
		December 31,	December 31,	December 31,
Domestic	\$ (14,162)	(6,920)	(12,350)	21,055
Foreign	(2,329)	1,655	13,555	14,303
Consolidated income (loss) before income tax expense and extraordinary items	\$ (16,491)	(5,265)	1,205	35,358

Income tax expense (benefit) consists of:

	Current	Restated Deferred	Restated Total
Year Ended October 31, 2000			
- Federal	\$		
- Foreign		1,079	1,222
- State		381	381

	Current	Restated Deferred	Restated Total
	<u> </u>	<u> </u>	<u> </u>
- Total	\$ 1,460	143	1,603
Two Months Ended December 31, 2000			
- Federal	\$	(1,129)	(1,129)
- Foreign	664		664
- State			
- Total	\$ 664	(1,129)	(465)
Year Ended December 31, 2001			
- Federal	\$ (499)	2,272	1,773
- Foreign	3,496	498	3,994
- State	672	(372)	300
- Total.	\$ 3,669	2,398	6,067
Year Ended December 31, 2002			
- Federal	\$	(20,909)	(20,909)
- Foreign	5,069	(427)	4,642
- State	775	(2,383)	(1,608)
- Total	\$ 5,844	(23,719)	(17,875)

Temporary differences between the financial statement carrying amounts and tax basis of assets and liabilities that give rise to significant portions of the deferred tax liability (asset) relate to the following:

	December 31,	
	Restated 2001	2002
	<u> </u>	<u> </u>
Net Deferred Tax Liability		
Accrued vacation	\$ (897)	(754)
Inventory	(2,516)	(2,726)
Accrued litigation expenses	(1,366)	(828)
Other accrued liabilities	(1,077)	(825)
Reserve for doubtful accounts	(893)	(715)
Current deferred tax asset	(6,749)	(5,848)
Prepaid expense	141	300
Deferred costs	3,235	3,155

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	December 31,	
	2001	2002
Current deferred tax liability	3,376	3,455
Intangible assets-difference in basis and amortization periods	23,318	22,806
Property and equipment-differences in basis and depreciation methods	13,332	10,926
Interest charge, Domestic International Sales Corp	6,741	6,493
Noncurrent deferred tax liability, net	43,391	40,225
Net operating loss carryforward	(59,093)	(60,701)
Accumulated other comprehensive income items	(3,509)	(1,323)
Deferred compensation	(1,134)	(1,702)
Partnership investments	(353)	(273)
Foreign tax credits		(1,600)
Alternative minimum tax credits	(221)	(221)
Research and experimentation credits	(32)	(32)
Noncurrent deferred tax asset	(64,342)	(65,852)
Valuation allowance	40,574	8,992
Noncurrent deferred tax asset, net	(23,768)	(56,860)
Noncurrent deferred tax liability (asset)	19,623	(16,635)
Net deferred tax liability (asset) on balance sheet	\$ 16,250	(19,028)
Amounts recognized in the Consolidated Balance Sheet consist of:		
Current deferred tax asset	\$	(11,093)
Non-current deferred tax asset		(33,142)
Non-current deferred tax liability	16,250	25,207
Net deferred tax liability (asset) on balance sheet	\$ 16,250	(19,028)

The aggregate deferred tax assets before valuation allowance at December 31, 2001 and 2002 were \$71,091 and \$71,700, respectively. The aggregate deferred tax liabilities at December 31, 2001 and 2002 were \$46,767 and \$43,680, respectively.

90

The actual tax expense differs from the "expected" tax expense (computed by applying the U.S. Federal corporate rate to income (loss) before income tax expense and extraordinary item) as follows:

Year Ended October 31,	Two Months Ended December 31,	Years Ended December 31,	
Restated 2000	Restated 2000	Restated 2001	Restated 2002

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Year Ended October 31,	Two Months Ended December 31,	Years Ended December 31,	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Statutory U.S. federal income tax rate	34%	34%	34%	35%
Computed "expected" tax expense (benefit)	\$ (5,607)	(1,790)	410	12,375
Increase (reduction) in income taxes resulting from:				
Change in valuation allowance	4,924	653	3,961	(30,110)
State income tax expense			300	1,381
Foreign tax differential	2,014	101	(615)	(1,928)
Non deductible goodwill amortization and other		489	2,272	
Other, net	272	82	(261)	407
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	\$ 1,603	(465)	6,067	(17,875)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The Company has regular tax net operating loss carryforwards of approximately \$30,670 that expire in 2009, \$40,777 that expire in 2010, \$25,406 that expire in 2011, \$9,150 that expire in 2012, \$9,460 that expire in 2018, \$34,356 that expire in 2020, and \$867 that expire in 2022. In connection with the fiscal 2000 acquisition of SGHC and the concurrent sale of Series A convertible preferred stock, the Company incurred an ownership change pursuant to Section 382 of the Internal Revenue Code of 1986. As a result, the availability of tax net operating loss carryforwards realized by the Company prior to the change in ownership, totaling approximately \$120,000, to offset post acquisition taxable income is limited to approximately \$7,500 annually, except with respect to any taxable income, if any, attributable to sales of pre-acquisition assets.

The Company has minimum tax credit carryforwards (which can be carried forward indefinitely) of approximately \$221 and research and experimentation credit carryforwards of approximately \$32. The research and experimentation credits expire through 2020.

The net changes in the valuation allowance for deferred tax assets for the two months ended December 31, 2000 and the years ended December 31, 2001 and 2002 were an increase of \$615, an increase of \$24,863 and a decrease of \$31,582, respectively.

The Company has a history of losses, which have generated sizable net operating loss carryforwards for both state and federal tax purposes. Prior to 2001, the Company did not recognize any income tax benefits from these losses in excess of the amount of net taxable temporary differences that were expected to reverse during the carryforward period because the Company was not able to demonstrate that it was more likely than not that it would generate sufficient taxable income in the future to utilize some or all of these net operating losses, and, accordingly, the Company recorded a valuation allowance offsetting its deferred tax asset associated with these net operating losses. Because of improved financial results in 2002 and anticipated taxable income in 2003 and beyond, the Company now believes that it is more likely than not that it will utilize the prior tax losses to offset future taxable income considering the annual limitation of \$7,500 imposed as described above. As a result, the Company recorded a deferred tax asset in the fourth quarter of 2002 of approximately \$41,900 by reducing the corresponding deferred income tax valuation allowance, and recognized an income tax benefit in income from continuing operations of approximately \$32,900 and an income tax benefit as an offset against the extraordinary charges of approximately \$9,000.

Subsequently recognized tax benefits relating to the valuation allowance for deferred tax assets as of December 31, 2002 will be allocated as follows:

Income tax benefit that would be reported in the consolidated statements of operations	\$ 4,008
Additional capital (benefit from exercise of stock options)	4,984
	<u> </u>
	\$ 8,992
	<u> </u>

U.S. income taxes have not been provided on undistributed earnings of international subsidiaries. The Company's intention is to reinvest these earnings permanently or to repatriate the earnings only when it is

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

tax effective to do so. Accordingly, the Company believes that any U.S. tax on repatriated earnings would be substantially offset by U.S. foreign tax credits.

(20) Business and Geographic Segments

Business segments are defined by Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131") as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker assessing performance and making operating and capital decisions.

The following tables represent revenues, profits, depreciation and amortization and assets by business and geographic segments for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002. In addition, unaudited pro forma segment information for the year ended December 31, 2000, as though SGHC had been acquired on January 1, 2000, has been included to aid in the year over year analysis. Operating revenues are allocated among geographic segments based on where the customer is located. Gross profit excludes depreciation and amortization. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in

92

Note 2. Corporate expenses, including depreciation and amortization, interest expenses and other income or expenses are not allocated among business and geographic segments.

	Year Ended October 31, 2000				
	Restated Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecommunications/ SJC Video Group	Restated Totals
Service revenues	\$ 43,219	81,563	61,411	327	186,520
Sales revenues	21,161	19,678		5,989	46,828
Total revenues	64,380	101,241	61,411	6,316	233,348
Cost of service	32,056	49,592	44,626	327	126,601
Cost of sales	15,188	10,764		3,347	29,299
Amortization of service contract software	628	1,137			1,765
Total operating expenses	47,872	61,493	44,626	3,674	157,665
Gross profit	16,508	39,748	16,785	2,642	75,683
Selling, general and administrative expenses	4,903	12,515	2,875	1,799	22,092
Depreciation and amortization	6,792	15,700	2,830	216	25,538
Segment operating income	4,813	11,533	11,080	627	28,053
Unallocated corporate selling, general and administrative costs					13,769
Consolidated operating income					\$ 14,284
Assets at October 31, 2000	\$ 311,601	227,049	34,207	35,592	608,449
Capital and wagering systems expenditures	\$ 11,306	20,851	2,373	516	35,046

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Two Months Ended December 31, 2000

	Restated Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecom- munications Group	Restated Totals
Service revenues	\$ 36,630	11,680	9,274		57,584
Sales revenues		1,805		7,202	9,007
Total revenues	36,630	13,485	9,274	7,202	66,591
Cost of service	25,351	7,481	6,760		39,592
Cost of sales	3	1,312		4,232	5,547
Amortization of service contract software	230	287			517
Total operating expenses	25,584	9,080	6,760	4,232	45,656
Gross profit	11,046	4,405	2,514	2,970	20,935
Selling, general and administrative expenses	3,767	2,336	499	430	7,032
Depreciation and amortization	4,753	2,254	427	286	7,720
Segment operating income (loss)	2,526	(185)	1,588	2,254	6,183
Unallocated corporate selling, general and administrative costs					2,905
Consolidated operating income					\$ 3,278
Assets at December 31, 2000	\$ 291,698	235,016	34,055	37,758	598,527
Capital and wagering systems expenditures	\$ 1,694	2,354	316	1,739	6,103

93

Pro Forma Year Ended December 31, 2000 (Unaudited)

	Restated Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecom- munications/ SJC Video Group	Restated Totals
Service revenues	\$ 199,692	79,776	61,987		341,455
Sales revenues	26,973	16,583		39,646	83,202
Total revenues	226,665	96,359	61,987	39,646	424,657
Cost of service	136,464	47,413	44,937		228,814
Cost of sales	19,908	8,894		22,705	51,507
Amortization of service contract software	1,218	1,137			2,355
Total operating expenses	157,590	57,444	44,937	22,705	282,676
Gross profit	69,075	38,915	17,050	16,941	141,981
Selling, general and administrative expenses	33,864	12,869	2,914	5,601	55,248

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Pro Forma Year Ended December 31, 2000 (Unaudited)

Depreciation and amortization	27,239	15,762	2,802	1,633	47,436
Segment operating income	7,972	10,284	11,334	9,707	39,297
Unallocated corporate selling, general and administrative costs					14,892
Consolidated operating income					\$ 24,405
Assets at December 31, 2000	\$ 291,698	235,016	34,055	37,758	598,527

94

Year Ended December 31, 2001

	Restated Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecom- munications Group	Restated Totals
Service revenues	\$ 223,875	79,779	60,913		364,567
Sales revenues	13,936	19,554		42,184	75,674
Total revenues	237,811	99,333	60,913	42,184	440,241
Cost of service	141,442	46,663	43,180		231,285
Cost of sales	9,602	11,817		25,739	47,158
Amortization of service contract software	1,705	2,661			4,366
Total operating expenses	152,749	61,141	43,180	25,739	282,809
Gross profit	85,062	38,192	17,733	16,445	157,432
Selling, general and administrative expenses	25,635	10,738	2,625	4,935	43,933
Depreciation and amortization	32,217	12,131	2,674	1,804	48,826
Segment operating income	27,210	15,323	12,434	9,706	64,673
Unallocated corporate selling, general and administrative costs					13,068
Consolidated operating income					\$ 51,605
Assets at December 31, 2001	\$ 289,971	226,650	32,977	36,198	585,796
Capital and wagering systems expenditures	\$ 39,756	3,721	1,169	1,847	46,493

Year Ended December 31, 2002

	Lottery Group	Pari-Mutuel Group	Venue Management Group	Telecom- munications Group	Totals
Service revenues	\$ 239,219	81,546	62,053		382,818

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Year Ended December 31, 2002

Sales revenues	20,721	5,692		46,022	72,435
Total revenues	259,940	87,238	62,053	46,022	455,253
Cost of service	131,602	46,677	42,759		221,038
Cost of sales	14,474	2,751		30,187	47,412
Amortization of service contract software	2,328	2,602			4,930
Total operating expenses	148,404	52,030	42,759	30,187	273,380
Gross profit	111,536	35,208	19,294	15,835	181,873
Selling, general and administrative expenses	26,900	10,675	2,821	4,520	44,916
Depreciation and amortization	21,646	11,679	1,789	2,241	37,355
Segment operating income	62,990	12,854	14,684	9,074	99,602
Unallocated corporate selling, general and administrative costs					18,766
Consolidated operating income					\$ 80,836
Assets at December 31, 2002	\$ 293,385	279,468	38,634	46,335	657,822
Capital and wagering systems expenditures	\$ 19,065	8,344	2,153	1,455	31,017

95

The following table provides a reconciliation of segment operating income to the consolidated income (loss) before income tax expense and extraordinary items for each period:

	Year Ended October 31,	Two Months Ended December 31,	Unaudited Pro Forma Year Ended December 31,	Years Ended December 31,	
	Restated 2000	Restated 2000	Restated 2000	Restated 2001	2002
Reportable segment operating income	\$ 28,053	6,183	39,297	64,673	99,602
Unallocated corporate expense	(13,769)	(2,905)	(14,892)	(13,068)	(18,766)
Interest expense	(31,231)	(8,790)	(50,978)	(50,363)	(44,842)
Other income (expense)	456	247	365	(37)	(636)
Income (loss) before income tax expense (benefit) and extraordinary item	\$ (16,491)	(5,265)	(26,208)	1,205	35,358
	Year Ended October 31,	Two Months Ended December 31,	Years Ended December 31,		
	2000	2000	2001	2002	

Geographic Segments

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Year Ended October 31,	Two Months Ended December 31,	Years Ended December 31,	
Service and Sales Revenue:				
North America	\$ 150,899	48,586	298,612	323,246
Italy	29,828	2		5,058
Europe, other than Italy and United Kingdom	36,964	8,598	107,401	83,282
United Kingdom	8,835	8,829	6,691	9,788
Other	6,822	576	27,537	33,879
	<u>\$ 233,348</u>	<u>66,591</u>	<u>440,241</u>	<u>455,253</u>
Long-lived assets (excluding identifiable intangibles):				
North America	\$ 152,201	147,391	160,952	156,746
Europe, other than United Kingdom	8,579	9,439	6,720	7,947
United Kingdom	25,501	27,421	26,988	30,872
Other	373	360	2,128	5,301
	<u>\$ 186,654</u>	<u>184,611</u>	<u>196,788</u>	<u>200,866</u>

(21) Selected Quarterly Financial Data (Unaudited)

The following quarterly financial data reflect the reclassification of "amortization of service contract software" as a component of operating expenses, which amounts had been included in depreciation and amortization in previous filings. For a description of the restated items and the effect on annual periods for

96

fiscal 2001 and 2002, which also affect the unaudited selected quarterly financial data, see Note 1 to these consolidated financial statements.

	Quarter Ended March 31, 2001		Quarter Ended June 30, 2001		Quarter Ended September 30, 2001		Quarter Ended December 31, 2001	
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated
Total operating revenues	\$ 112,108	112,108	112,573	112,573	107,203	107,203	108,357	108,357
Operating expenses	72,820	72,820	69,962	69,962	66,970	66,970	68,691	68,691
Amortization of service contract software	892	892	1,065	1,065	1,179	1,179	1,230	1,230
Gross profit	38,396	38,396	41,546	41,546	39,054	39,054	38,436	38,436
Net Income (loss)	(2,437)	(2,994)	1,940	1,383	1,522	(1,421)	(1,609)	(1,830)
Convertible preferred stock paid-in kind dividend	1,699	1,699	1,744	1,744	1,790	1,790	1,818	1,818
Net income (loss) available to common stockholders	<u>\$ (4,136)</u>	<u>(4,693)</u>	<u>196</u>	<u>(361)</u>	<u>(268)</u>	<u>(3,211)</u>	<u>(3,427)</u>	<u>(3,648)</u>

Basic and diluted earnings (loss) per share:

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Quarter Ended March 31, 2001		Quarter Ended June 30, 2001		Quarter Ended September 30, 2001		Quarter Ended December 31, 2001	
Basic income (loss) before extraordinary item available to common stockholders	\$	(0.10)	(0.12)	(0.01)	(0.01)	(0.08)	(0.08)	(0.09)
Diluted income (loss) before extraordinary Item available to common stockholders	\$	(0.10)	(0.12)	(0.01)	(0.01)	(0.08)	(0.08)	(0.09)
Basic net income (loss) available to common stockholders	\$	(0.10)	(0.12)	(0.01)	(0.01)	(0.08)	(0.08)	(0.09)
Diluted net income (loss) available to common stockholders	\$	(0.10)	(0.12)	(0.01)	(0.01)	(0.08)	(0.08)	(0.09)
Weighted average number of shares used in per share calculations:								
Basic Shares		40,163	40,163	40,209	40,209	40,383	40,383	40,600
Diluted Shares		40,163	40,163	44,441	40,209	40,383	40,383	40,600

97

	Quarter Ended March 31, 2002		Quarter Ended June 30, 2002		Quarter Ended September 30, 2002		Quarter Ended December 31, 2002		
	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	As Previously Reported	As Restated	
Total operating revenues	\$	106,972	106,972	114,267	114,267	115,152	115,152	118,862	118,862
Operating expenses		62,487	62,487	66,913	66,913	69,079	69,079	69,971	69,971
Amortization of service contract software		1,209	1,209	1,214	1,214	1,233	1,233	1,274	1,274
Gross profit		43,276	43,276	46,140	46,140	44,840	44,840	47,617	47,617
Extraordinary item, net of tax					14,853	14,853	(1,352)	(1,352)	
Net Income (loss)		7,205	(3,009)	8,356	8,122	(5,559)	(5,787)	42,048	40,406
Convertible preferred stock paid-in kind dividend		1,803	1,803	1,851	1,851	1,899	1,899	1,931	1,931
Net income (loss) available to common stockholders	\$	5,402	(4,812)	6,505	6,271	(7,458)	(7,686)	40,117	38,475
Basic and diluted earnings (loss) per share:									
Basic income (loss) before extraordinary item available to common stockholders	\$	0.13	(0.11)	0.15	0.15	0.13	0.13	0.67	0.64
Diluted income (loss) before extraordinary item available	\$	0.10	(0.11)	0.12	0.11	0.11	0.10	0.46	0.44

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Quarter Ended March 31, 2002		Quarter Ended June 30, 2002		Quarter Ended September 30, 2002		Quarter Ended December 31, 2002	
to common stockholders(1)								
Basic extraordinary item, net of tax benefit					(0.26)	(0.26)	0.02	0.02
Diluted extraordinary item, net of tax benefit (1)					(0.17)	(0.17)	0.02	0.02
Basic net income (loss) available to common stockholders	\$ 0.13	(0.11)	0.15	0.15	(0.13)	(0.13)	0.69	0.66
Diluted net income (loss) available to common stockholders(1)	\$ 0.10	(0.11)	0.12	0.11	(0.06)	(0.07)	0.48	0.46
Weighted average number of shares used in per share calculations:								
Basic Shares	42,067	42,067	43,048	43,048	57,301	57,301	58,243	58,243
Diluted Shares(1)	71,725	42,067	71,983	71,983	87,360	87,360	88,033	88,033

(1) As per Statement of Financial Accounting Standards No. 128, *Earnings Per Share* ("SFAS 128"), whenever a company reports an extraordinary item, the same number of potential common shares used in computing the diluted per-share amounts for income before extraordinary items must be used in computing all other reported diluted per-share amounts, even if those amounts are antidilutive to their respective basic per-share amounts.

(22) Accumulated Other Comprehensive Loss

The accumulated balances for each classification of comprehensive loss are as follows:

	Foreign Currency Items	Unrealized Gains (Losses) On Securities	Minimum Pension Liability	Cash Flow Hedges	Accumulated Other Comprehensive Loss
Beginning balance at November 1, 1999	\$ (649)		(602)		(1,251)
Change during period	(2,277)	317	(5)		(1,965)
Balance at October 31, 2000	\$ (2,926)	317	(607)		(3,216)
Change during period	1,611	(1,274)		(2,364)	(2,027)
Reclassification adjustments for gains reclassified into operations				(31)	(31)
Balance at December 31, 2000	\$ (1,315)	(957)	(607)	(2,395)	(5,274)

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Foreign Currency Items	Unrealized Gains (Losses) On Securities	Minimum Pension Liability	Cash Flow Hedges	Accumulated Other Comprehensive Loss
Change during period	(296)	2	38	(7,816)	(8,072)
Reclassification adjustments for losses reclassified into operations				2,962	2,962
Balance at December 31, 2001	\$ (1,611)	(955)	(569)	(7,249)	(10,384)
Change during period(1)	4,758	100	(2,261)	(1,193)	1,404
Reclassification adjustments for losses reclassified into operations				8,654	8,654
Balance at December 31, 2002	\$ 3,147	(855)	(2,830)	212	(326)

(1) Amounts originating in 2002 are net of income taxes. No adjustments were made for income tax benefits in prior periods as the Company had only recognized tax benefits of prior period operating losses to the extent such losses would be offset by net taxable temporary differences expected to reverse during the carryforward period.

(23) Unusual Items

In 2002, the Company recognized unusual charges in the amount of \$1,055 primarily due to investigation and other costs attributable to the Pick Six matter (see Note 24). In addition, interest expense in 2002 included approximately \$3,276 of debt restructuring charges relating to the refinancing of the 2000 Facility in December 2002. These charges resulted from the early termination of three interest rate swap agreements that were required to be maintained pursuant to the terms of the 2000 Facility. (See Note 10.)

In 2001, the Company reversed reserves of \$1,500 in connection with a litigation that was settled.

In fiscal 2000, the Company recognized unusual interest expense charges in the amount of \$7,511 attributable to payments, in the form of warrants, to purchase 2,900 shares of Scientific Games common stock, to certain financial advisors in connection with their services in obtaining certain financial commitments to acquire SGHC, \$1,200 of additional interest expense as a result of the required pre-funding of the Notes, and approximately \$2,300 of incremental business integration costs as a result of the SGHC acquisition. The Company also recorded a \$1,135 write-off of its option to purchase the Atlantic City Race Course as a result of the New Jersey legislature's failure to pass the necessary legislation to allow OTB expansion in the state and recorded an extraordinary charge of \$12,567 in connection with the payment of the call premium on the Old Notes and the write-off of deferred financing fees.

(24) Litigation

Although the Company is a party to various claims and legal actions arising in the ordinary course of business, the Company believes, on the basis of information presently available to it, that the ultimate disposition of these matters will not likely have a material adverse effect on its consolidated financial position or results of operations.

The Company's subsidiary Scientific Games International, Inc. ("SGI") owned a minority interest in Wintech de Colombia S.A., or Wintech (now in liquidation), which formerly operated the Colombian national lottery under contract with Empresa Colombiana de Recursos para la Salud, S.A. ("Ecosalud"), an

agency of the Colombian government. The contract projected that certain levels of lottery ticket sales would be attained and provided a penalty against Wintech, SGI and the other shareholders of Wintech of up to \$5,000 if such performance levels were not achieved. In addition, with respect to a further guarantee of performance under the contract with Ecosalud, SGI delivered to Ecosalud a \$4,000 bond issued by a Colombian surety, Seguros del Estado ("Seguros"). Wintech started the instant lottery in Colombia, but, due to difficulties beyond its control, including, among other factors, social and political unrest in Colombia, frequently interrupted telephone service and power outages, and competition from

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

another lottery being operated in a province of Colombia which the Company believes was in violation of Wintech's exclusive license from Ecosalud, the projected sales level was not met for the year ended June 30, 1993. On July 1, 1993, Ecosalud adopted resolutions declaring, among other things, that the contract was in default and asserted various claims for compensation and penalties against Wintech, SGI and other shareholders of Wintech. Litigation is pending and/or threatened in Colombia concerning various claims among Ecosalud, Wintech and SGI, relating to the termination of the contracts with Ecosalud. Ecosalud's claims are for, among other things, realization of the full amount of the penalty, plus interest and costs of the bond.

The Colombian surety, Seguros, paid \$2,400 to Ecosalud under its \$4,000 bond, and made demand upon SGI for that amount under the indemnity agreement between the surety and SGI. SGI declined to make or authorize any such payment and notified the surety that any payment in response to Ecosalud's demand on the bond was at the surety's risk. In a case brought in U.S. District Court in Georgia, the Colombian surety sought to recover from SGI sums paid (in SGI's view, improperly) under its surety bond, plus interest. In September 1999, the District Court granted summary judgment for the surety in the amount of approximately \$7,000 (which included pre-judgment interest at a rate of 38.76% per annum). On appeal, the United States Court of Appeals for the Eleventh Circuit, on August 20, 2001, affirmed the judgment for the principal amount of \$2,400, but vacated that part of the judgment awarding approximately \$4,600 based on a pre-judgment interest rate of 38.76% with instructions to the District Court to recalculate pre-judgment interest. On February 22, 2002, SGI agreed to settle this matter upon payment of \$3,700 to the Colombian surety. On February 26, 2002, SGI drew upon a \$1,500 letter of credit posted by a former Colombian partner in order to partially fund this payment. This settlement resolves the U.S. litigation with the surety, but the claims in Colombia remain unresolved.

In July 2002, a Colombian appellate tribunal denied SGI's motion to dismiss Ecosalud's pending lawsuit against SGI. While SGI's motion is subject to further appeal to the Colombian Council of State, the highest appellate court with jurisdiction over this matter, the proceeding in the lower court, which is in an early stage, will continue during the pendency of the appeal.

SGI has various defenses on the merits as well as procedural defenses that it plans to assert against Ecosalud's claims. The Company intends to vigorously pursue these defenses as appropriate. SGI also has certain cross indemnities and undertakings from the two other privately held shareholders of Wintech for their respective shares of any liability to Ecosalud. No assurance can be given that the other shareholders of Wintech will, or have sufficient assets to, honor their indemnity undertakings to SGI when the claims by Ecosalud against SGI and Wintech are finally resolved, in the event such claims result in any final liability. Although the Company believes that any potential losses arising from these claims will not result in a material adverse effect on its consolidated financial position or results of operations, it is not feasible to predict the final outcome, and there can be no assurance that these claims might not be finally resolved adversely to the Company or result in material liability.

On October 26, 2002, the Company experienced a breach of security by an employee who altered betting data on the \$3,000 "winning" wagering ticket on the races constituting the Pick Six at the Breeders' Cup at Arlington Park in Illinois. It was subsequently discovered that the employee, whom the Company terminated, also altered betting data on two other multiple-race wagers earlier in the month.

On December 4, 2002, a class action lawsuit (*Allard v. Autotote / Scientific Games Corporation, and Does 1-10* (L. A. Superior Court No. BC 286382)) was filed against the Company in state court in California by a professional Pick Six bettor on behalf of pari-mutuel bettors in the U.S., alleging, among other things, negligence, breach of contract and deceptive trade practices arising from the Company's handling of multiple-race wagers. The Company removed the case to federal court, and moved to dismiss the lawsuit. In response, the plaintiff agreed to file an amended complaint in an attempt to address some of the deficiencies that were the subject of the Company's motion. That amended complaint has not yet been filed. The Company believes that the lawsuit lacks merit and intends to contest the suit vigorously.

100

Also on December 4, 2002, a second class action lawsuit (*Cheldin v. Scientific Games Corporation, Autotote Systems, Inc., and Does 1-20* (L. A. Superior Court No. BC 286417)) was filed against the Company in state court in California by a bettor of the Breeders' Cup Pick Six wager, on behalf of all bettors of such Pick Six wagers. The lawsuit alleged negligence and fraud with respect to the Company's wagering systems in connection with the Breeders' Cup Pick Six. The Company removed the case to federal court, and its motion to dismiss the complaint is currently pending. The Company believes that the lawsuit lacks merit and intends to contest the suit vigorously.

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

The Company conducts substantially all of its business through its domestic and foreign subsidiaries. The Notes and the 2002 Facility entered into on December 19, 2002 to refinance all obligations under the then existing 2000 Facility are fully, unconditionally and jointly and severally guaranteed by substantially all of the Company's wholly-owned domestic subsidiaries (the "Guarantor Subsidiaries").

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Presented below is condensed consolidating financial information for (i) Scientific Games Corporation (the "Parent Company"), which includes the activities of Scientific Games Management Corporation, (ii) the Guarantor Subsidiaries and (iii) the wholly-owned foreign subsidiaries and the non-wholly owned domestic and foreign subsidiaries (the "Non-Guarantor Subsidiaries") as of December 31, 2001 and December 31, 2002 and for the year ended October 31, 2000, the two months ended December 31, 2000, and the years ended December 31, 2001 and 2002. 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, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries assuming the guarantee structure of the 2002 Facility and the Notes were in effect at the beginning of the periods presented. Separate financial statements for the Guarantor Subsidiaries are not presented based on management's determination that they would not provide additional information that is material to investors.

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

101

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2001
(in thousands)

	<u>Restated Parent Company</u>	<u>Restated Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Restated Eliminating Entries</u>	<u>Restated Consolidated</u>
ASSETS					
Cash and cash equivalents	\$ 7,612	(415)	5,452		12,649
Accounts receivable, net		34,322	16,088		50,410
Inventories		16,524	3,558	(535)	19,547
Other current assets	973	9,344	5,190	30	15,537
Property and equipment, net	2,159	156,224	38,822	(417)	196,788
Investment in subsidiaries	249,365			(249,365)	
Goodwill	183	176,502	2,414		179,099
Intangible assets		54,913	5,241		60,154
Other assets	20,378	44,071	6,487	(19,324)	51,612
	<u>280,670</u>	<u>491,485</u>	<u>83,252</u>	<u>(269,611)</u>	<u>585,796</u>
Total assets	\$ 280,670	491,485	83,252	(269,611)	585,796
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current installments of long-term debt	\$ 9,018	9	410		9,437
Current liabilities	14,999	50,672	19,661	799	86,131
Long-term debt, excluding current installments	429,917	10	371		430,298
Other non-current liabilities	1,903	32,702	4,356	729	39,690
Intercompany balances	(195,407)	169,896	27,154	(1,643)	
Stockholders' equity	20,240	238,196	31,300	(269,496)	20,240
	<u>280,670</u>	<u>491,485</u>	<u>83,252</u>	<u>(269,611)</u>	<u>585,796</u>
Total liabilities and stockholders' equity	\$ 280,670	491,485	83,252	(269,611)	585,796

102

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2002
(in thousands)

	<u>Restated Parent Company</u>	<u>Restated Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Restated Eliminating Entries</u>	<u>Restated Consolidated</u>
ASSETS					
Cash and cash equivalents	\$ 25,323	180	9,426		34,929
Accounts receivable, net		35,521	17,779	(40)	53,260
Inventories		16,591	4,480	(536)	20,535
Other current assets	10,810	6,988	4,826	30	22,654
Property and equipment, net	3,572	151,366	46,559	(631)	200,866
Investment in subsidiaries	348,585	4,240		(352,825)	
Goodwill	183	179,672	3,915		183,770
Intangible assets		52,892	4,930		57,822
Other assets	47,817	38,693	6,001	(8,525)	83,986
	<u>436,290</u>	<u>486,143</u>	<u>97,916</u>	<u>(362,527)</u>	<u>657,822</u>
Total assets	\$ 436,290	486,143	97,916	(362,527)	657,822
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current installments of long-term debt	\$ 3,281	9	575		3,865
Current liabilities	13,342	49,047	17,970	639	80,998
Long-term debt, excluding current installments	356,418	1	245		356,664
Other non-current liabilities	7,569	28,972	10,845	139	47,525
Intercompany balances	(113,090)	96,751	17,822	(1,483)	
Stockholders' equity	168,770	311,363	50,459	(361,822)	168,770
	<u>436,290</u>	<u>486,143</u>	<u>97,916</u>	<u>(362,527)</u>	<u>657,822</u>
Total liabilities and stockholders' equity	\$ 436,290	486,143	97,916	(362,527)	657,822

103

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended October 31, 2000
(in thousands)

	<u>Restated Parent Company</u>	<u>Restated Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Restated Eliminating Entries</u>	<u>Restated Consolidated</u>
Operating revenues	\$	186,408	60,286	(13,346)	233,348
Operating expenses		122,400	46,766	(13,266)	155,900
Amortization of service contract software		1,765			1,765
		<u>62,243</u>	<u>13,520</u>	<u>(80)</u>	<u>75,683</u>
Gross profit		62,243	13,520	(80)	75,683

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Selling, general and administrative expenses	13,572	16,186	5,917	(11)	35,664
Depreciation and amortization	291	21,119	4,428	(103)	25,735
Operating income (loss)	(13,863)	24,938	3,175	34	14,284
Interest expense	30,535	531	1,037	(872)	31,231
Other (income) deductions	(1,000)	(275)	(198)	1,017	(456)
Income (loss) before equity in income of subsidiaries, and income taxes	(43,398)	24,682	2,336	(111)	(16,491)
Equity in income of subsidiaries	25,259			(25,259)	
Income tax expense		812	791		1,603
Income (loss) before extraordinary items	(18,139)	23,870	1,545	(25,370)	(18,094)
Extraordinary items:					
Write-off of deferred financing fees and debt call premium	12,522	45			12,567
Net income (loss)	\$ (30,661)	23,825	1,545	(25,370)	(30,661)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Two Months Ended December 31, 2000
(in thousands)

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Operating revenues	\$	57,125	22,087	(12,621)	66,591
Operating expenses		41,333	16,425	(12,619)	45,139
Amortization of service contract software		517			517
Gross profit		15,275	5,662	(2)	20,935
Selling, general and administrative expenses	2,872	4,896	2,136	(2)	9,902
Depreciation and amortization	49	6,497	1,224	(15)	7,755
Operating income (loss)	(2,921)	3,882	2,302	15	3,278
Interest expense	8,930	13	477	(630)	8,790
Other (income) deductions	(87)	(458)	(277)	575	(247)
Income (loss) before equity in income of subsidiaries, and income taxes	(11,764)	4,327	2,102	70	(5,265)
Equity in income of subsidiaries	7,176			(7,176)	
Income tax expense (benefit)	212	(1,267)	590		(465)
Net income (loss)	\$ (4,800)	5,594	1,512	(7,106)	(4,800)

Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
-------------------------------	---------------------------------------	-------------------------------	------------------------------------	--------------------------

104

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended December 31, 2001
(in thousands)

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Operating revenues	\$	338,626	115,434	(13,819)	440,241
Operating expenses		211,193	80,728	(13,478)	278,443
Amortization of service contract software		4,366			4,366
Gross profit		123,067	34,706	(341)	157,432
Selling, general and administrative expenses	12,762	32,310	11,664	(41)	56,695
Depreciation and amortization	306	40,867	8,032	(73)	49,132
Operating income (loss)	(13,068)	49,890	15,010	(227)	51,605
Interest expense	49,880	410	2,009	(1,936)	50,363
Other (income) deductions	(596)	(2,545)	1,148	2030	37
Income (loss) before equity in income of subsidiaries, and income taxes	(62,352)	52,025	11,853	(321)	1,205
Equity in income of subsidiaries		63,532		(63,532)	
Income tax expense (benefit)	6,042	(3,122)	3,147		6,067
Net income (loss)	\$ (4,862)	55,147	8,706	(63,853)	(4,862)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended December 31, 2002
(in thousands)

	Restated Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Restated Consolidated
Operating revenues	\$	347,702	118,762	(11,211)	455,253
Operating expenses		199,209	80,265	(11,024)	268,450
Amortization of service contract software		4,530	400		4,930
Gross profit		143,963	38,097	(187)	181,873
Selling, general and administrative expenses	19,271	32,590	11,283	(12)	63,132

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Restated Consolidated
Depreciation and amortization	550	29,229	8,134	(8)	37,905
Operating income (loss)	(19,821)	82,144	18,680	(167)	80,836
Interest expense	44,112	776	1,291	(1,337)	44,842
Other (income) deductions	(302)	(2,124)	1,841	1,221	636
Income (loss) before equity in income of subsidiaries, and income taxes	(63,631)	83,492	15,548	(51)	35,358
Equity in income of subsidiaries	95,434			(95,434)	
Income tax expense (benefit)	(21,430)	(218)	3,773		(17,875)
Income (loss) before extraordinary items	53,233	83,710	11,775	(95,485)	53,233
Extraordinary items:					
Early retirement of debt, net of tax benefit	13,501				13,501
Net income (loss)	\$ 39,732	83,710	11,775	(95,485)	39,732

105

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended October 31, 2000
(in thousands)

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Net income (loss)	\$ (30,661)	23,825	1,545	(25,370)	(30,661)
Depreciation and amortization	291	22,884	4,428	(103)	27,500
Equity in income of subsidiaries	(25,259)			25,259	
Extraordinary item	12,567				12,567
Non-cash interest expense	8,735				8,735
Other non-cash adjustments	1,762	181	214		2,157
Changes in working capital	7,208	3,323	(5,455)	34	5,110
Net cash provided by (used in) operating activities	(25,357)	50,213	732	(180)	25,408
Cash flows from investing activities:					
Capital and wagering systems expenditures	(1,863)	(27,581)	(5,715)	113	(35,046)
Business acquisition, net of cash acquired	(111,305)	(215,091)	73	10,081	(316,242)
Other assets and investments	(240,221)	230,382	5,190	(1,546)	(6,195)
Net cash provided by (used in) investing activities	(353,389)	(12,290)	(452)	8,648	(357,483)

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Cash flows from financing activities:					
Net borrowing under lines of credit	11,250				11,250
Proceeds from issuance of long-term debt	441,501		1,043	(22)	442,522
Payments on long-term debt	(165,957)	(34,301)	(1,104)		(201,362)
Net proceeds from stock issue	107,525	(547)	993	(479)	107,492
Payment of finance fees	(16,792)				(16,792)
Net cash provided by (used in) financing activities	377,527	(34,848)	932	(501)	343,110
Effect of exchange rate changes on cash		370	(1,228)	64	(794)
Increase (decrease) in cash and cash equivalents	(1,219)	3,445	(16)	8,031	10,241
Cash and cash equivalents, beginning of year	1,598	4,346	7,154	(8,031)	5,067
Cash and cash equivalents, end of year	\$ 379	7,791	7,138		15,308

106

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Two Months Ended December 31, 2000
(in thousands)

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Net income (loss)	\$ (4,800)	5,594	1,512	(7,106)	(4,800)
Depreciation and amortization	49	7,014	1,224	(15)	8,272
Equity in income of subsidiaries	(7,176)			7,176	
Non-cash interest	384				384
Other non-cash adjustments	256	(1,341)	40		(1,045)
Changes in working capital	6,078	(5,643)	(988)	(230)	(783)
Net cash provided by (used in) operating activities	(5,209)	5,624	1,788	(175)	2,028
Cash flows from investing activities:					
Capital and wagering systems expenditures	(13)	(3,608)	(2,136)	(346)	(6,103)
Other assets and investments	(3,060)	(770)	(93)	1,504	(2,419)
Net cash provided by (used in) investing activities	(3,073)	(4,378)	(2,229)	1,158	(8,522)
Cash flows from financing activities:					
Net borrowing under lines of credit	(2,250)				(2,250)
Payments on long-term debt	(1,304)		(20)		(1,324)
Other, principally intercompany balances	12,324	(10,288)	(851)	(983)	202

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Net cash provided by (used in) financing activities	8,770	(10,288)	(871)	(983)	(3,372)
Effect of exchange rate changes on cash		1,199	(153)		1,046
Increase (decrease) in cash and cash equivalents	488	(7,843)	(1,465)		(8,820)
Cash and cash equivalents, beginning of period	379	7,792	7,137		15,308
Cash and cash equivalents, end of period	\$ 867	(51)	5,672		6,488

107

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2001
(in thousands)

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
Net income (loss)	\$ (4,862)	55,147	8,706	(63,853)	(4,862)
Depreciation and amortization	306	45,233	8,032	(73)	53,498
Equity in income of subsidiaries	(63,532)			63,532	
Non-cash interest	2,435				2,435
Other non-cash adjustments	7,213	(1,819)	(2)		5,392
Changes in working capital	(8,426)	12,117	1,146	1,111	5,948
Net cash provided by (used in) operating activities	(66,866)	110,678	17,882	717	62,411
Cash flows from investing activities:					
Capital and wagering systems expenditures	(350)	(39,726)	(6,712)	295	(46,493)
Other assets and investments	(624)	(5,273)	(5,202)	1,508	(9,591)
Net cash provided by (used in) investing activities	(974)	(44,999)	(11,914)	1,803	(56,084)
Cash flows from financing activities:					
Net borrowing under lines of credit	5,750				5,750
Payments on long-term debt	(6,007)	(8)	(751)	193	(6,573)
Net proceeds from stock issue	1,046	250	497	(747)	1,046
Other, principally intercompany balances	73,738	(65,779)	(5,993)	(1,966)	
Net cash provided by (used in) financing activities	74,527	(65,537)	(6,247)	(2,520)	223
Effect of exchange rate changes on cash	58	(507)	60		(389)
Increase (decrease) in cash and cash equivalents	6,745	(365)	(219)		6,161
Cash and cash equivalents, beginning of year	867	(50)	5,671		6,488

	Restated Parent Company	Restated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Restated Eliminating Entries	Restated Consolidated
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash and cash equivalents, end of year	\$ 7,612	(415)	5,452		12,649
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

108

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2002
(in thousands)

	Restated Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Restated Consolidated
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 39,732	83,710	11,775	(95,485)	39,732
Depreciation and amortization	550	33,759	8,534	(8)	42,835
Equity in income of subsidiaries	(95,434)			95,434	
Extraordinary items	13,501				13,501
Deferred income taxes	(23,021)	(1,472)	(491)		(24,984)
Non-cash interest expense	2,298				2,298
Other non-cash adjustments	1,541	516	118		2,175
Changes in working capital	(1,385)	(930)	(2,172)	(1,216)	(5,703)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) operating activities	(62,218)	115,583	17,764	(1,275)	69,854
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash flows from investing activities:					
Capital and wagering systems expenditures	(1,755)	(22,900)	(6,583)	221	(31,017)
Business acquisition, net of cash acquired		(4,150)	46		(4,104)
Other assets and investments	(3,983)	(2,913)	1,051	(8,286)	(14,131)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) investing activities	(5,738)	(29,963)	(5,486)	(8,065)	(49,252)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Cash flows from financing activities:					
Net borrowing under lines of credit	(14,750)				(14,750)
Proceeds from issuance of long term debt	291,335				291,335
Payments on long-term debt	(355,816)	(9)	(1,638)		(357,463)
Payment of financing fees	(17,531)				(17,531)
Net proceeds from stock issue	98,398	(11,453)	3,370	8,083	98,398
Other, principally intercompany balances	84,031	(74,255)	(11,033)	1,257	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) financing activities	85,667	(85,717)	(9,301)	9,340	(11)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Effect of exchange rate changes on cash		692	997		1,689
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Increase (decrease) in cash and cash equivalents	17,711	595	3,974		22,280
Cash and cash equivalents, beginning of year	7,612	(415)	5,452		12,649

	Restated Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Restated Consolidated
Cash and cash equivalents, end of year	\$ 25,323	180	9,426		34,929

109

SCHEDULE II

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

Valuation and Qualifying Accounts

Year Ended October 31, 2000, the Two Months Ended December 31, 2000,
and the Years Ended December 31, 2001 and 2002
(in thousands)

	Balance at Beginning of Period	Additions		Deductions(1)	Balance at End of Period
		Charged to Costs and Expenses	Other		
Year ended October 31, 2000					
Allowance for doubtful accounts	\$ 2,789	2,077		558	4,308
Reserve for inventory obsolescence	\$ 1,846	31		311	1,566
Two months ended December 31, 2000					
Allowance for doubtful accounts	\$ 4,308	329		468	4,169
Reserve for inventory obsolescence	\$ 1,566	46		683	929
Year ended December 31, 2001					
Allowance for doubtful accounts	\$ 4,169	1,546		1,826	3,889
Reserve for inventory obsolescence	\$ 929	1,944		393	2,480
Year ended December 31, 2002					
Allowance for doubtful accounts	\$ 3,889	1,704		1,821	3,772
Reserve for inventory obsolescence	\$ 2,480	3,782		1,166	5,096

(1) Amounts written off.

110

PART III

ITEM 14. CONTROLS AND PROCEDURES

(a)
Evaluation of Disclosure Controls and Procedures

As of a date within the 90 days prior to the date of this Form 10-K/A, we performed an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended, or the Exchange Act). Based upon that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the evaluation date in ensuring that all material information required to be included in this Form 10-K/A has been made known to them in a timely fashion.

(b)
Changes in Internal Controls

There have been no significant changes in our internal controls or in other factors that could significantly affect our internal controls subsequent to the evaluation date.

111

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

- (a)
1. Financial Statements See Index to Consolidated Financial Statements attached hereto.
 2. Financial Statements Schedule See Index to Consolidated Financial Statements attached hereto.
 3. Exhibits The following is a list of exhibits:

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of May 18, 2000, among the Company, ATX Enterprises, Inc. and Scientific Games Holdings Corp. (incorporated by reference to Exhibit 2 to the Company's Current Report on Form 8-K filed on May 26, 2000).
2.2	Stock Purchase Agreement, dated June 5, 2002, among the Company, Scientific Games Chile Limitada, Epicentro S.A. and Inversiones Y Aesorias Iculpe Limitada (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on June 20, 2002).
3.(i)	Restated Certificate of Incorporation of the Company, filed with the Secretary of State of the State of Delaware on March 20, 2003 (incorporated by reference to Exhibit 3.(i) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, filed March 24, 2003 (the "2002 10-K")).
3.(ii)	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2000 (the "2000 10-K")).
4.1	Indenture, dated as of August 14, 2000, among the Company, the Subsidiary Guarantors and The Bank of New York, as trustee, relating to the 12 ¹ / ₂ % senior subordinated notes due 2010 (the "12 ¹ / ₂ % Senior Notes") (incorporated by reference to Exhibit 4.6 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended July 31, 2000 (the "July 2000 10-Q")).
4.2	Form of 12 ¹ / ₂ % Senior Notes (incorporated by reference to Exhibit A to Exhibit 4.6 to the Company's July 2000 10-Q).
4.3	First Supplemental Indenture, dated as of September 6, 2000, among the Company, the Guarantors, the Additional Guarantors and The Bank of New York, as trustee, supplementing the Indenture, dated as of August 14, 2000, among the Company, the Guarantors and the Trustee, relating to the 12 ¹ / ₂ % Senior Notes (incorporated by reference to Exhibit 4.8 to

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Exhibit Number	Description
	the Company's July 2000 10-Q).
4.4	Registration Rights Agreement by and among the Company, the Guarantors and Donaldson, Lufkin & Jenrette Securities Corporation and Lehman Brothers Inc., dated as of August 14, 2000, relating to the Series A 12 ¹ / ₂ % Senior Notes (incorporated by reference to Exhibit 4.9 to the Company's July 2000 10-Q).
10.1	Stockholders' Agreement by and among Cirmatica Gaming, S.A., The Oak Fund, Peconic Fund Ltd., Ramius Securities, LLC, Olivetti International S.A. and the Company, dated September 6, 2000, relating to the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 10.38 to the Company's July 2000 10-Q).
10.2	Supplemental Stockholders Agreement, by and among the Company, Cirmatica Gaming S.A. and such persons as may become a party thereto from time to time, dated as of June 26, 2002 (incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2002 (the "June 2002 10-Q")).
10.3	Purchase Agreement among the Company, Autotote Enterprises, Inc., and the State of Connecticut, Division of Special Revenue, dated June 30, 1993 (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated July 1, 1993).
10.4	Agreement between the Company and Elettronica Ingegneria Sistemi dated February 19, 1998 (incorporated by reference to Exhibit 10.28 to the Company's Quarterly Report on Form 10-Q for the quarter ended April 30, 1998 (the "April 1998 10-Q")).
10.5	General Agreement between the Company and Sisal Sport Italia SpA dated February 19, 1998. (incorporated by reference to Exhibit 10.29 to the Company's April 1998 10-Q).
112	
10.6	Agreement between the Company and Stichting Hippo Toto dated June 29, 1998 relating to purchase of Autotote Nederland B.V. (incorporated by reference to Exhibit 10.31 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 1998).
10.7	Instant Ticket and Associated Products and Services Agreement dated May 4, 1993 by and between Georgia Lottery Corporation and Scientific Games Inc. (incorporated by reference to Scientific Games Holding Corp.'s Registration Statement (No. 33-75168) filed on February 11, 1994).
10.8	Instant Lottery Tickets Supply Agreement between Thomas De La Rue Limited, Scientific Games Inc. and Camelot Group plc, dated June 15, 1995 (incorporated by reference to Scientific Games Holding Corp.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 1995. Portions of this Exhibit deemed confidential by Scientific Games Holdings Corp. have been omitted).
10.9	Supply Agreement for Instant Lottery Computer Management System between La Francais Des Jeux and Scientific Games Inc. (incorporated by reference to Exhibit 10.53 to Scientific Games Holding Corp.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 1999. Portions of this Exhibit deemed confidential by Scientific Games Holdings Corp. have been omitted.)
10.10	Agreement of Purchase and Sale, dated January 19, 1996, between Autotote Systems, Inc. and Fusco Properties, L.P. (incorporated by reference to Exhibit 10.42 to the Company's Annual Report on Form 10-K/A for the fiscal year ended October 31, 1995 (the "1995 10-K/A")).
10.11	Lease Agreement, dated as of January 19, 1996, between Fusco Properties, L.P. and Autotote Systems, Inc. (incorporated by reference to Exhibit 10.43 to the Company's 1995 10-K/A).
10.12	1984 Stock Option Plan, as amended (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Registration No. 33-46594) which became effective on March 20, 1992).*
10.13	1992 Equity Incentive Plan, as amended and restated (incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1998).*

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

- 10.14 1995 Equity Incentive Plan, as amended (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1997).*
- 10.15 1997 Incentive Compensation Plan as amended and restated (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 (the "2001 10-K")).*
- 10.16 Form of Option dated March 3, 1992 issued to A. Lorne Weil (incorporated by reference to Exhibit 10.45 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1992 (the "1992 10-K")).*
- 10.17 Key Executive Deferred Compensation Plan (incorporated by reference to Exhibit 10.23 to the Company's 2000 10-K).*
- 10.18 Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.17 to the Company's 2001 10-K).*
- 10.19 2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 to the Company's September 2002 10-Q).
- 10.20 Amended and Restated Employment Agreement, dated as of November 1, 2000, by and between the Company and A. Lorne Weil (as further amended and restated, executed July 25, 2002) (incorporated by reference to the June 2002 10-Q).*
- 10.21 Letter Agreement dated January 11, 2001 between the Company and DeWayne E. Laird (incorporated by reference to Exhibit 10.21 to the 2000 10-K).*
- 10.22 Letter Agreement dated January 11, 2001 between the Company and Martin E. Schloss (incorporated by reference to Exhibit 10.22 to the 2000 10-K).*

113

- 10.23 Letter Agreement dated January 9, 2003 between the Company and Richard M. Weil. (incorporated by reference to Exhibit 10.23 to the Company's 2002 10-K).*
- 10.24 Form of Employment and Severance Benefit Agreement effective September 6, 2000 between Scientific Games International, Inc. and certain executives (including William J. Huntley and Cliff O. Bickell) (incorporated by reference to Exhibit 10.42 to the Company's July 2000 10-Q).*
- 10.25 Form of Letter Agreement dated December 18, 2002 between Scientific Games International and certain executives (including William Huntley and Cliff Bickell), which amended their respective Employment and Severance Benefit Agreements (incorporated by reference to Exhibit 10.25 to Amendment No. 1 on Form 10-K/A, filed March 25, 2003, to the Company's 2002 10-K).*
- 10.26 Form of Change in Control Agreement effective November 1, 1997 between the Company and certain executives (including DeWayne E. Laird, Martin E. Schloss, William J. Huntley, Brooks Pierce and Robert E. Becker) (incorporated by reference to Exhibit 10.27 to the Company's April 1998 10-Q).*
- 10.27 Credit Agreement, dated as of December 19, 2002, among the Company, the several banks and other financial institutions or entities from time to time parties thereto (the "Lenders"), Bear, Stearns & Co., Inc., as sole lead arranger and sole book runner, BNY Capital Markets, Inc., as co-arranger, Bear Stearns Corporate Lending Inc., as syndication agent, and The Bank of New York, as administrative agent (the "Credit Agreement") (incorporated by reference to Exhibit 10.27 to the Company's 2002 10-K).
- 10.28 Guarantee and Collateral Agreement, dated as of December 19, 2002, made by the Company and each of the other signatories thereto in favor of The Bank of New York, as Administrative Agent for the Lenders (the "Guarantee and Collateral Agreement") (incorporated by reference to Exhibit 10.28 to the Company's 2002 10-K).
- 10.29 Supplement No. 1, dated as of December 30, 2002, to the Credit Agreement (incorporated by reference to Exhibit 10.29 to the Company's 2002 10-K).
- 10.30 Supplement No. 1, dated as of December 30, 2002, to the Guarantee and Collateral Agreement (incorporated by reference to Exhibit 10.30 to the Company's 2002 10-K).

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

- 10.31 Warrant Registration Rights Agreement dated October 2, 2000 between the Company and Ramius Securities, LLC (incorporated by reference to Exhibit 10.30 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001 (the "March 2001 10-Q")).
- 21.1 List of Subsidiaries (incorporated by reference to Exhibit 21.1 to the Company's 2002 10-K).
- 23 Consent of KPMG LLP. ()
- 99.1 Certification of the Chief Executive Officer of the Company pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ()
- 99.2 Certification of the Chief Financial Officer of the Company pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ()
- 99.3 Warrant to Purchase Class B Nonvoting Common Stock of the Company dated October 30, 1992 issued to various lenders (incorporated by reference to Exhibit 10.34 to the Company's 1992 10-K).
- 99.4 Warrant Agreement dated as of September 14, 1995 (the "1995 Warrant Agreement") (incorporated by reference to Exhibit 99.8 to the Company's Registration Statement on Form S-4/A (Registration No. 333-34465) which became effective on September 12, 1997 (the "1997 S-4/A")).
- 99.5 Amendment dated January 29, 1997 to the 1995 Warrant Agreement (incorporated by reference to Exhibit 99.10 to the Company's 1997 S-4/A).
- 99.6 Form of Amended and Restated Warrant issued November 2, 1998 to Certain Members of Management and Several Employees (incorporated by reference to Exhibit 10.36 to the Company's Form 10-K for the fiscal year ended October 31, 1999).

114

-
- 99.7 Form of Warrant issued to Ramius Securities, LLC dated October 2, 2000 (incorporated by reference to Exhibit 10.29 to the Company's March 2001 10-Q).
 - 99.8 Agreement and Plan of Merger, dated as of November 19, 2002, by and among Scientific Games International, Inc., MDI Entertainment, Inc. and Blue Suede Acquisition Corp. (incorporated by reference to Exhibit 99(d)(1) to the Company's Schedule TO-T, filed on November 26, 2002).
 - 99.9 Stock Purchase Agreement, dated as of November 19, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and Steven M. Saferin (incorporated by reference to Exhibit 2.2 to MDI's Current Report on Form 8-K, filed on November 20, 2002).
 - 99.10 Amendment No. 1 to Agreement and Plan of Merger, dated December 13, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and MDI Entertainment, Inc. (incorporated by reference to Exhibit 99(d)(1)-2 to the Company's Schedule TO-T/A-1, filed on December 13, 2002).
 - 99.11 Amendment No. 2 to Agreement and Plan of Merger, dated December 20, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and MDI Entertainment, Inc. (incorporated by reference to Exhibit 99(d)(1)-3 to the Company's Schedule TO-T/A-2, filed on December 20, 2002).

()
Filed herewith.

*
Includes management contracts and compensation plans and arrangements.

(b)
Reports on Form 8-K
None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SCIENTIFIC GAMES CORPORATION

DATED: AUGUST 13, 2003

By: /s/ A. LORNE WEIL

A. Lorne Weil, Chairman of the Board,
President and Chief Executive Officer

116

CERTIFICATIONS

I, A. Lorne Weil, certify that:

1. I have reviewed this Amendment No. 3 on Form 10-K/A to Annual Report on Form 10-K of Scientific Games Corporation;
2. Based on my knowledge, this amendment does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this amendment;
3. Based on my knowledge, the financial statements, and other financial information included in this amendment, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amendment;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this amendment is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this amendment (the "Evaluation Date"); and
 - c) Presented in this amendment our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

weaknesses in internal controls; and

b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officers and I have indicated in this amendment whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 13, 2003

/s/ A. LORNE WEIL

A. Lorne Weil
Chief Executive Officer

CERTIFICATIONS

I, DeWayne E. Laird, certify that:

1.

I have reviewed this Amendment No. 3 on Form 10-K/A to Annual Report on Form 10-K of Scientific Games Corporation;

2.

Based on my knowledge, this amendment does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this amendment;

3.

Based on my knowledge, the financial statements, and other financial information included in this amendment, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amendment;

4.

The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a)

Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this amendment is being prepared;

b)

Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this amendment (the "Evaluation Date"); and

c)

Presented in this amendment our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a)

All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

weaknesses in internal controls; and

b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officers and I have indicated in this amendment whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 13, 2003

/s/ DEWAYNE E. LAIRD

DeWayne E. Laird
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of May 18, 2000, among the Company, ATX Enterprises, Inc. and Scientific Games Holdings Corp. (incorporated by reference to Exhibit 2 to the Company's Current Report on Form 8-K filed on May 26, 2000).
2.2	Stock Purchase Agreement, dated June 5, 2002, among the Company, Scientific Games Chile Limitada, Epicentro S.A. and Inversiones Y Aesorias Iculpe Limitada (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on June 20, 2002).
3.(i)	Restated Certificate of Incorporation of the Company, filed with the Secretary of State of the State of Delaware on March 20, 2003 (incorporated by reference to Exhibit 3.(i) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, filed March 24, 2003 (the "2002 10-K")).
3.(ii)	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2000 (the "2000 10-K")).
4.1	Indenture, dated as of August 14, 2000, among the Company, the Subsidiary Guarantors and The Bank of New York, as trustee, relating to the 12 ^{1/2} % senior subordinated notes due 2010 (the "12 ^{1/2} % Senior Notes") (incorporated by reference to Exhibit 4.6 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended July 31, 2000 (the "July 2000 10-Q")).
4.2	Form of 12 ^{1/2} % Senior Notes (incorporated by reference to Exhibit A to Exhibit 4.6 to the Company's July 2000 10-Q).
4.3	First Supplemental Indenture, dated as of September 6, 2000, among the Company, the Guarantors, the Additional Guarantors and The Bank of New York, as trustee, supplementing the Indenture, dated as of August 14, 2000, among the Company, the Guarantors and the Trustee, relating to the 12 ^{1/2} % Senior Notes (incorporated by reference to Exhibit 4.8 to the Company's July 2000 10-Q).
4.4	Registration Rights Agreement by and among the Company, the Guarantors and Donaldson, Lufkin & Jenrette Securities Corporation and Lehman Brothers Inc., dated as of August 14, 2000, relating to the Series A 12 ^{1/2} % Senior Notes (incorporated by reference to Exhibit 4.9 to the Company's July 2000 10-Q).
10.1	Stockholders' Agreement by and among Cirmatica Gaming, S.A., The Oak Fund, Peconic Fund Ltd., Ramius Securities, LLC, Olivetti International S.A. and the Company, dated September 6, 2000, relating to the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 10.38 to the Company's July 2000 10-Q).
10.2	Supplemental Stockholders Agreement, by and among the Company, Cirmatica Gaming S.A. and such persons as may become a party thereto from time to time, dated as of June 26, 2002 (incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2002 (the "June 2002 10-Q")).
10.3	Purchase Agreement among the Company, Autotote Enterprises, Inc., and the State of Connecticut, Division of Special Revenue, dated June 30, 1993 (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated July 1, 1993).
10.4	Agreement between the Company and Elettronica Ingegneria Sistemi dated February 19, 1998 (incorporated by reference to Exhibit 10.28 to the Company's Quarterly Report on Form 10-Q for the quarter ended April 30, 1998 (the "April 1998 10-Q")).

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

Exhibit Number	Description
10.5	General Agreement between the Company and Sisal Sport Italia SpA dated February 19, 1998. (incorporated by reference to Exhibit 10.29 to the Company's April 1998 10-Q).
10.6	Agreement between the Company and Stichting Hippo Toto dated June 29, 1998 relating to purchase of Autotote Nederland B.V. (incorporated by reference to Exhibit 10.31 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 1998).
10.7	Instant Ticket and Associated Products and Services Agreement dated May 4, 1993 by and between Georgia Lottery Corporation and Scientific Games Inc. (incorporated by reference to Scientific Games Holding Corp.'s Registration Statement (No. 33-75168) filed on February 11, 1994).
10.8	Instant Lottery Tickets Supply Agreement between Thomas De La Rue Limited, Scientific Games Inc. and Camelot Group plc, dated June 15, 1995 (incorporated by reference to Scientific Games Holding Corp.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 1995. Portions of this Exhibit deemed confidential by Scientific Games Holdings Corp. have been omitted).
10.9	Supply Agreement for Instant Lottery Computer Management System between La Francais Des Jeux and Scientific Games Inc. (incorporated by reference to Exhibit 10.53 to Scientific Games Holding Corp.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 1999. Portions of this Exhibit deemed confidential by Scientific Games Holdings Corp. have been omitted).
10.10	Agreement of Purchase and Sale, dated January 19, 1996, between Autotote Systems, Inc. and Fusco Properties, L.P. (incorporated by reference to Exhibit 10.42 to the Company's Annual Report on Form 10-K/A for the fiscal year ended October 31, 1995 (the "1995 10-K/A")).
10.11	Lease Agreement, dated as of January 19, 1996, between Fusco Properties, L.P. and Autotote Systems, Inc. (incorporated by reference to Exhibit 10.43 to the Company's 1995 10-K/A).
10.12	1984 Stock Option Plan, as amended (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Registration No. 33-46594) which became effective on March 20, 1992).*
10.13	1992 Equity Incentive Plan, as amended and restated (incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1998).*
10.14	1995 Equity Incentive Plan, as amended (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1997).*
10.15	1997 Incentive Compensation Plan as amended and restated (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 (the "2001 10-K")).*
10.16	Form of Option dated March 3, 1992 issued to A. Lorne Weil (incorporated by reference to Exhibit 10.45 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1992 (the "1992 10-K")).*
10.17	Key Executive Deferred Compensation Plan (incorporated by reference to Exhibit 10.23 to the Company's 2000 10-K).*
10.18	Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.17 to the Company's 2001 10-K).*
10.19	2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 to the Company's September 2002 10-Q).
10.20	Amended and Restated Employment Agreement, dated as of November 1, 2000, by and between the Company and A. Lorne Weil (as further amended and restated, executed July 25, 2002) (incorporated by reference to the June 2002 10-Q).*
10.21	Letter Agreement dated January 11, 2001 between the Company and DeWayne E. Laird (incorporated by reference to Exhibit 10.21 to the 2000 10-K).*
10.22	Letter Agreement dated January 11, 2001 between the Company and Martin E. Schloss (incorporated by reference to Exhibit 10.22 to the 2000 10-K).*
10.23	Letter Agreement dated January 9, 2003 between the Company and Richard M. Weil (incorporated by reference to Exhibit 10.23 to the Company's 2002 10-K).*
10.24	Form of Employment and Severance Benefit Agreement effective September 6, 2000 between Scientific Games International, Inc. and certain executives (including William J. Huntley and Cliff O. Bickell) (incorporated by reference to Exhibit 10.42 to the Company's July 2000 10-Q).*
10.25	Form of Letter Agreement dated December 18, 2002 between Scientific Games International and certain executives (including William Huntley and Cliff Bickell), which amended their respective Employment and Severance Benefit Agreements (incorporated by reference to Exhibit 10.25 to Amendment No. 1 on Form 10-K/A, filed March 25, 2003, to the Company's 2002 10-K).*
10.26	Form of Change in Control Agreement effective November 1, 1997 between the Company and certain executives (including DeWayne E. Laird, Martin E. Schloss, William J. Huntley, Brooks Pierce and Robert E. Becker) (incorporated by reference to Exhibit 10.27 to the Company's April 1998 10-Q).*
10.27	Credit Agreement, dated as of December 19, 2002, among the Company, the several banks and other financial institutions or entities from time to time parties thereto (the "Lenders"), Bear, Stearns & Co., Inc., as sole lead arranger and sole book runner, BNY Capital Markets, Inc., as co-arranger, Bear Stearns Corporate Lending Inc., as syndication agent, and The

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

- Bank of New York, as administrative agent (the "Credit Agreement") (incorporated by reference to Exhibit 10.27 to the Company's 2002 10-K).
- 10.28 Guarantee and Collateral Agreement, dated as of December 19, 2002, made by the Company and each of the other signatories thereto in favor of The Bank of New York, as Administrative Agent for the Lenders (the "Guarantee and Collateral Agreement") (incorporated by reference to Exhibit 10.28 to the Company's 2002 10-K).
- 10.29 Supplement No. 1, dated as of December 30, 2002, to the Credit Agreement (incorporated by reference to Exhibit 10.29 to the Company's 2002 10-K).
- 10.30 Supplement No. 1, dated as of December 30, 2002, to the Guarantee and Collateral Agreement (incorporated by reference to Exhibit 10.30 to the Company's 2002 10-K).
- 10.31 Warrant Registration Rights Agreement dated October 2, 2000 between the Company and Ramius Securities, LLC (incorporated by reference to Exhibit 10.30 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001 (the "March 2001 10-Q")).
- 21.1 List of Subsidiaries (incorporated by reference to Exhibit 21.1 to the Company's 2002 10-K).
- 23 Consent of KPMG LLP. ()
- 99.1 Certification of the Chief Executive Officer of the Company pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ()
- 99.2 Certification of the Chief Financial Officer of the Company pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ()
- 99.3 Warrant to Purchase Class B Nonvoting Common Stock of the Company dated October 30, 1992 issued to various lenders (incorporated by reference to Exhibit 10.34 to the Company's 1992 10-K).
- 99.4 Warrant Agreement dated as of September 14, 1995 (the "1995 Warrant Agreement") (incorporated by reference to Exhibit 99.8 to the Company's Registration Statement on Form S-4/A (Registration No. 333-34465) which became effective on September 12, 1997 (the "1997 S-4/A")).
- 99.5 Amendment dated January 29, 1997 to the 1995 Warrant Agreement (incorporated by reference to Exhibit 99.10 to the Company's 1997 S-4/A).
- 99.6 Form of Amended and Restated Warrant issued November 2, 1998 to Certain Members of Management and Several Employees (incorporated by reference to Exhibit 10.36 to the Company's Form 10-K for the fiscal year ended October 31, 1999).
- 99.7 Form of Warrant issued to Ramius Securities, LLC dated October 2, 2000 (incorporated by reference to Exhibit 10.29 to the Company's March 2001 10-Q).
- 99.8 Agreement and Plan of Merger, dated as of November 19, 2002, by and among Scientific Games International, Inc., MDI Entertainment, Inc. and Blue Suede Acquisition Corp. (incorporated by reference to Exhibit 99(d)(1) to the Company's Schedule TO-T, filed on November 26, 2002).
- 99.9 Stock Purchase Agreement, dated as of November 19, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and Steven M. Saferin (incorporated by reference to Exhibit 2.2 to MDI's Current Report on Form 8-K, filed on November 20, 2002).
- 99.10 Amendment No. 1 to Agreement and Plan of Merger, dated December 13, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and MDI Entertainment, Inc. (incorporated by reference to Exhibit 99(d)(1)-2 to the Company's Schedule TO-T/A-1, filed on December 13, 2002).
- 99.11 Amendment No. 2 to Agreement and Plan of Merger, dated December 20, 2002, by and among Scientific Games International, Inc., Blue Suede Acquisition Corp. and MDI Entertainment, Inc. (incorporated by reference to Exhibit 99(d)(1)-3 to the Company's Schedule TO-T/A-2, filed on December 20, 2002).

()

Filed herewith.

*

Includes management contracts and compensation plans and arrangements.

(b)

Reports on Form 8-K

None

Edgar Filing: SCIENTIFIC GAMES CORP - Form 10-K/A

EXPLANATORY NOTE

EXHIBIT INDEX APPEARS ON PAGE 112

PART I FORWARD-LOOKING STATEMENTS

U.S. Instant Ticket and On-line Lottery Sales

U.S. Thoroughbred Industry Pari-Mutuel Wagering: Remote and Live Handle

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

PART II

FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA (in thousands, except per share amounts)

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

INDEPENDENT AUDITORS' REPORT

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS December 31, 2001 and 2002 (in thousands, except per share amounts)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS Year Ended October 31, 2000, the Two Months Ended December 31, 2000, and the Years Ended December 31, 2001 and 2002 (in thousands, except per share amounts)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS) Year Ended October 31, 2000, the Two Months Ended December 31, 2000, and the Years Ended December 31, 2001 and 2002 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS Year Ended October 31, 2000, the Two Months Ended December 31, 2000, and the Years Ended December 31, 2001 and 2002 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands, except per share amounts)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET December 31, 2001 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET December 31, 2002 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS Year Ended October 31, 2000 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS Two Months Ended December 31, 2000 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS Year Ended December 31, 2001 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS Year Ended December 31, 2002 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS Year Ended October 31, 2000 (in thousands)

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS Two Months Ended December 31, 2000 (in thousands)

SCHEDULE II

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES Valuation and Qualifying Accounts Year Ended October 31, 2000, the Two Months Ended December 31, 2000, and the Years Ended December 31, 2001 and 2002 (in thousands)

PART III

ITEM 14. CONTROLS AND PROCEDURES

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K SIGNATURES

EXHIBIT INDEX