

SCIENTIFIC GAMES CORP
Form 10-Q
May 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
{Mark One}

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

For the quarterly period ended March 31, 2013

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

For the transition period from to

Commission file number: 0-13063
SCIENTIFIC GAMES CORPORATION
(Exact name of registrant as specified in its charter)
Delaware
(State or other jurisdiction of
incorporation or organization)

81-0422894
(I.R.S. Employer Identification No.)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The registrant has the following number of shares outstanding of each of the registrant's classes of common stock as of May 3, 2013:

Class A Common Stock: 85,005,388

Class B Common Stock: None

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Forward-Looking Statements

Throughout this Quarterly Report on Form 10-Q, we make "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements describe future expectations, plans, results or strategies and can often be identified by the use of terminology such as "may," "will," "estimate," "intend," "continue," "believe," "expect," "anticipate," "should," "could," "potential," "opportunity," or similar terminology. The forward-looking statements contained in this Quarterly Report on Form 10-Q are generally located under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" but may be found in other locations as well. These statements are based upon management's current expectations, assumptions and estimates and are not guarantees of future results or performance. Actual results may differ materially from those contemplated in these statements due to a variety of risks and uncertainties and other factors, including, among other things: competition; material adverse changes in economic and industry conditions; technological change; retention and renewal of existing contracts and entry into new or revised contracts; availability and adequacy of cash flows to satisfy obligations and indebtedness or future needs; protection of intellectual property; security and integrity of software and systems; laws and government regulation, including those relating to gaming licenses, permits and operations; inability to identify, complete and integrate future acquisitions; inability to benefit from, and risks associated with, strategic equity investments and relationships; failure of our Northstar Illinois joint venture to meet the net income targets or otherwise to realize the anticipated benefits under its private management agreement with the Illinois Lottery; failure of our Northstar New Jersey joint venture to enter into an agreement to provide marketing and sales services to the New Jersey Lottery (including as a result of the pending protest) or to meet the net income targets or other requirements under any such agreement or otherwise to realize the anticipated benefits under any such agreement; the seasonality of our business; inability to obtain the approvals required to complete the pending merger with WMS Industries Inc. ("WMS"); failure to complete the pending merger with WMS or, if completed, failure to achieve the intended benefits of the merger or disruption of our current plans and operations; inability to identify and capitalize on trends and changes in the lottery and gaming industries, including the potential expansion of regulated gaming via the internet; inability to enhance and develop successful gaming concepts; dependence on suppliers and manufacturers; liability for product defects; fluctuations in foreign currency exchange rates and other factors associated with international operations; influence of certain stockholders; dependence on key personnel; failure to perform on contracts; resolution of pending or future litigation; labor matters; and stock price volatility. Additional information regarding risks and uncertainties and other factors that could cause actual results to differ materially from those contemplated in forward-looking statements is included from time to time in our filings with the Securities and Exchange Commission ("SEC"), including under the heading "Risk Factors" in our most recent Annual Report on Form 10-K. Forward-looking statements speak only as of the date they are made and, except for our ongoing obligations under the U.S. federal securities laws, we undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise.

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

(Unaudited, in thousands, except per share amounts)

	Three Months Ended	
	March 31,	
	2013	2012
Revenue:		
Instant tickets	\$122,813	\$123,324
Services	81,767	86,905
Sales	15,008	20,965
Total revenue	219,588	231,194
Operating expenses:		
Cost of instant tickets (1)	68,194	69,963
Cost of services (1)	46,233	43,303
Cost of sales (1)	10,291	16,927
Selling, general and administrative expenses	50,641	45,298
Employee termination and restructuring costs	331	2,304
Depreciation and amortization	32,769	28,468
Operating income	11,129	24,931
Other income (expense):		
Interest expense	(25,008)	(24,898)
Earnings from equity investments	6,136	8,845
Other (expense) income, net	(998)	522
Total other expense	(19,870)	(15,531)
Net (loss) income from continuing operations before income taxes	(8,741)	9,400
Income tax expense	3,546	5,532
Net (loss) income from continuing operations	\$(12,287)	\$3,868
Discontinued operations		
Loss from discontinued operations	(1,911)	(2,670)
Other expense	(45)	(44)
Gain on sale of assets	828	—
Income tax benefit	262	665
Net loss from discontinued operations	\$(866)	\$(2,049)
Net (loss) income	\$(13,153)	\$1,819
Other comprehensive (loss) income:		
Foreign currency translation (loss) gain	(39,355)	26,016
Pension gain (loss), net of tax	514	(371)
Gain on derivative financial instruments, net of tax	5	120
Gain (loss) on foreign currency forward contracts	725	(343)

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Other comprehensive (loss) income	(38,111)	25,422
Comprehensive (loss) income	\$(51,264)	\$27,241

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited, in thousands, except per share amounts)

	Three Months Ended	
	March 31,	
	2013	2012
Basic and diluted net (loss) income per share:		
Basic from continuing operations	\$ (0.15) \$ 0.04
Basic from discontinued operations	(0.01) (0.02)
Total net (loss) income per share	\$ (0.16) \$ 0.02
Diluted from continuing operations	\$ (0.15) \$ 0.04
Diluted from discontinued operations	(0.01) (0.02)
Total diluted net (loss) income per share	\$ (0.16) \$ 0.02
Weighted average number of shares used in per share calculations:		
Basic shares	84,607	92,484
Diluted shares	84,607	94,224

(1) Exclusive of depreciation and amortization.

See accompanying notes to consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$90,019	\$109,015
Restricted cash	28,543	30,398
Accounts receivable, net of allowance for doubtful accounts of \$10,558 and \$11,182 as of March 31, 2013 and December 31, 2012, respectively	182,503	209,915
Inventories	70,780	71,255
Notes receivable	10,373	10,298
Deferred income taxes, current portion	6,643	6,800
Prepaid expenses, deposits and other current assets	46,448	46,982
Total current assets	435,309	484,663
Property and equipment, at cost	839,031	848,622
Less: accumulated depreciation	(458,347)	(471,745)
Net property and equipment	380,684	376,877
Goodwill	782,762	801,328
Intangible assets, net	99,375	84,291
Equity investments	312,069	316,234
Other assets	124,027	\$123,515
Total assets	\$2,134,226	\$2,186,908
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Debt payments due within one year	\$16,895	\$16,458
Accounts payable	76,248	80,872
Accrued liabilities	141,772	159,017
Total current liabilities	234,915	256,347
Deferred income taxes	62,315	62,265
Other long-term liabilities	69,999	51,797
Long-term debt, excluding current installments	1,450,847	1,451,708
Total liabilities	1,818,076	1,822,117
Commitments and contingencies		
Stockholders' equity:		
Class A common stock, par value \$0.01 per share, 199,300 shares authorized, 100,119 and 99,301 shares issued and 84,987 and 84,395 shares outstanding as of March 31, 2013 and December 31, 2012, respectively	1,001	993
Additional paid-in capital	720,490	715,910
Accumulated loss	(219,371)	(206,218)
Treasury stock, at cost, 15,132 and 14,906 shares held as of March 31, 2013 and December 31, 2012, respectively	(144,882)	(142,917)
Accumulated other comprehensive loss	(41,088)	(2,977)
Total stockholders' equity	316,150	364,791

Total liabilities and stockholders' equity	\$2,134,226	\$2,186,908
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See accompanying notes to consolidated financial statements.

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STATEMENT OF CASH FLOWS

(Unaudited, in thousands, except per share amounts)

	Three Months Ended	
	March 31,	
	2013	2012
Cash flows from operating activities:		
Net (loss) income	\$(13,153)	\$1,819
Adjustments:		
Depreciation and amortization	33,366	30,518
Change in deferred income taxes	780	263
Stock-based compensation	5,862	5,771
Non-cash interest expense	1,705	1,996
Earnings from equity investments	(6,136)	(8,845)
Distributed earnings from equity investments	2,239	—
Allowance for doubtful accounts	13	195
Changes in current assets and liabilities, net of effects of acquisitions		
Accounts receivable	24,690	7,045
Inventories	772	919
Accounts payable	(12,646)	(11,428)
Accrued liabilities	(17,926)	(5,968)
Other current assets and liabilities	1,566	(706)
Other	2,103	345
Net cash provided by operating activities	23,235	21,924
Cash flows from investing activities:		
Capital expenditures	(7,346)	(1,958)
Lottery and gaming systems expenditures	(16,856)	(7,393)
Other intangible assets and software expenditures	(12,078)	(12,446)
Proceeds from asset disposals	886	84
Change in other assets and liabilities, net	(195)	(152)
Equity method investments	—	—
Restricted cash	965	—
Distributions of capital on equity investments	—	2,407
Business acquisitions, net of cash acquired	(287)	(344)
Net cash used in investing activities	(34,911)	(19,802)
Cash flows from financing activities:		
Proceeds from the issuance of long-term debt		