

SCIENTIFIC GAMES CORP
Form 10-Q
August 05, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

6650 S. El Camino Road, Las Vegas, Nevada 89118
(Address of principal executive offices)
(Zip Code)

(702) 897-7150
(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 ý 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 ý 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 ý Accelerated filer ¨
Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

The registrant has the following number of shares outstanding of each of the registrant's classes of common stock as of August 2, 2016:

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Class A Common Stock: 87,523,669

Class B Common Stock: None

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES
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Glossary of
Terms

The following terms or acronyms used in this Quarterly Report on Form 10-Q are defined below:

Term or Acronym	Definition
2018 Notes	8.125% senior subordinated notes due 2018 issued by Scientific Games Corporation
2020 Notes	6.250% senior subordinated notes due 2020 issued by SGI
2021 Notes	6.625% senior subordinated notes due 2021 issued by SGI
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bally	Bally Technologies, Inc.
Bally acquisition	the acquisition of Bally by the Company on November 21, 2014
Barcrest	Barcrest Group Limited
Coin-in	the amount wagered
Company	refers to Scientific Games Corporation and its consolidated subsidiaries, unless otherwise specified or the context otherwise dictates
CSG	Beijing CITIC Scientific Games Technology Co., Ltd.
CSL	China Sports Lottery
CSP	Cooperative Services Program
D&A	depreciation and amortization
ESPP	employee stock purchase plan
EU	European Union
FASB	Financial Accounting Standards Board
GLB	Beijing Guard Libang Technology Co., Ltd.
Hellenic Lotteries	Hellenic Lotteries S.A.
ITL	International Terminal Leasing
LBO	licensed betting office
LNS	Lotterie Nazionali S.r.l.
Net win	Coin-in less payouts
Northstar Illinois	Northstar Lottery Group, LLC
Northstar New Jersey	Northstar New Jersey Lottery Group, LLC
Note	refers to a note in the Condensed Notes to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q, unless otherwise indicated
Participation	with respect to our Gaming business, refers to gaming machines provided to customers through service or leasing arrangements in which we earn revenues and are paid based on: (1) a percentage of Net win; (2) fixed daily-fees; (3) a percentage of the Coin-in; or (4) a combination of a fixed daily-fee and a percentage of the Coin-in, and with respect to our Lottery business, refers to a contract or arrangement in which we earn revenues and are paid based on a percentage of retail sales
PMA	private management agreement
PTG	Proprietary table games
R&D	research and development
RCN	Roberts Communications Network, LLC
RFP	Request for proposal

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RMG	real-money gaming
RSU	restricted stock unit
SEC	Securities and Exchange Commission
Secured Notes	7.00% senior secured notes due 2022 issued by SGI
Securities Act	Securities Act of 1933, as amended
SG&A	selling, general and administrative
SGI	Scientific Games International, Inc., a wholly-owned subsidiary of Scientific Games Corporation
SHFL	SHFL entertainment, Inc.
Shufflers	various models of automatic card shufflers, deck checkers and roulette chip sorters

Unsecured Notes 10.00% senior unsecured notes due 2022 issued by SGI
U.K. United Kingdom of Great Britain and Northern Ireland
U.S. United States of America
U.S. GAAP accounting principles generally accepted in the U.S.
VLT video lottery terminal
WAP wide-area progressive
WMS WMS Industries, Inc.
WMS acquisition the acquisition of WMS by the Company on October 18, 2013

Intellectual Property Rights

® and ™ indicate U.S. trademarks. Marks are owned by their respective owners.

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," "plan," "continue," "believe," "expect," "anticipate," "target," "should," "could," "potential," "opportunity," "goal" or similar terminology. The forward-looking statements contained in this Quarterly Report on Form 10-Q are generally located in the material set forth under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" but may be found in other locations as well. These statements are based upon management's current expectations, assumptions and estimates and are not guarantees of timing, 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;

•U.S. and international economic and industry conditions, including declines in or slow growth of gross gaming revenues or lottery retail sales, reductions in or constraints on capital spending by gaming or lottery operators and bankruptcies of, or credit risk relating to, customers;

•limited growth from new gaming jurisdictions, slow addition of casinos in existing jurisdictions and declines in the replacement cycle of existing gaming machines;

•ownership changes and consolidation in the casino industry, including by casino operators;

•opposition to legalized gaming or the expansion thereof;

•inability to adapt to, and offer products that keep pace with, evolving technology;

•inability to develop successful gaming concepts and content;

•laws and government regulations, including those relating to gaming licenses and environmental laws;

•inability to identify and capitalize on trends and changes in the gaming, lottery and interactive gaming industries;

•dependence upon key providers in our social gaming business;

•inability to retain or renew, or unfavorable revisions of, existing contracts, and the inability to enter into new contracts;

•level of our indebtedness, higher interest rates, availability or adequacy of cash flows and liquidity to satisfy indebtedness, other obligations or future cash needs;

•inability to reduce or refinance our indebtedness;

•restrictions and covenants in debt agreements, including those that could result in acceleration of the maturity of our indebtedness;

•protection of intellectual property, inability to license third party intellectual property and the intellectual property rights of others;

•security and integrity of our products and systems and reliance on or failures in information technology and other systems;

•natural events that disrupt our operations or those of our customers, suppliers or regulators;

•inability to benefit from, and risks associated with, strategic equity investments and relationships, including (1) the inability of our joint venture to realize the anticipated benefits under its PMA with the Illinois lottery or from the disentanglement services performed in connection with the termination thereof, (2) the inability of our joint venture to meet the net income targets or other requirements under its agreement to provide marketing and sales services to the New Jersey Lottery or otherwise to realize the anticipated benefits under such agreement and (3) the failure to realize the anticipated benefits related to our consortium's instant lottery game concession in Greece;

failure to achieve the intended benefits of the Bally acquisition, the WMS acquisition, our other recent acquisitions, or future acquisitions, including due to the inability to successfully complete or integrate such acquisitions or realize synergies in the anticipated amounts or within the contemplated time frames or cost expectations, or at all; disruption of current plans and operations in connection with our recent acquisitions (including in connection with the integration of Bally and WMS), including departure of key personnel or inability to recruit additional qualified personnel or maintain relationships with customers, suppliers or other third parties; incurrence of employee termination or restructuring costs and impairment or asset write-down charges; changes in estimates or judgments related to our impairment analysis of goodwill or other intangible assets; implementation of complex revenue recognition standards; fluctuations in our results due to seasonality and other factors; dependence on suppliers and manufacturers; risks relating to foreign operations, including fluctuations in foreign currency exchange rates (including those fluctuations related to the affirmative vote in the U.K. to withdraw from the EU), restrictions on the payment of dividends from earnings, restrictions on the import of products and financial instability, including the potential impact to our business resulting from the affirmative vote in the U.K. to withdraw from the EU and the potential impact to our instant lottery game concession or VLT lease arrangements resulting from the recent economic and political conditions in Greece; dependence on key employees; litigation and other liabilities relating to our business, including litigation and liabilities relating to our contracts and licenses, our products and systems, our employees (including labor disputes), intellectual property and our strategic relationships; influence of certain stockholders; 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 SEC, including under Item 1A "Risk Factors" in our 2015 Annual Report on Form 10-K filed with the SEC on February 29, 2016 and under Item 1A "Risk Factors" in this Quarterly Report on Form 10-Q. Forward-looking statements speak only as of the date they are made and, except for our ongoing obligations under the U.S. federal securities laws, we undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise.

You should also note that this Quarterly Report on Form 10-Q may contain references to industry market data and certain industry forecasts. Industry market data and industry forecasts are obtained from publicly available information and industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of that information is not guaranteed. Although we believe industry information to be accurate, it is 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 gaming, lottery and interactive gaming industries than the same industries in the U.S.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SCIENTIFIC GAMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited, in millions, except per share amounts)

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Revenue:				
Services	\$363.5	\$337.9	\$713.8	\$668.3
Product sales	214.8	218.1	412.4	417.5
Instant games	150.9	135.5	285.0	264.4
Total revenue	729.2	691.5	1,411.2	1,350.2
Operating expenses:				
Cost of services ⁽¹⁾	101.4	98.6	196.3	189.1
Cost of product sales ⁽¹⁾	100.7	107.9	195.1	205.8
Cost of instant games ⁽¹⁾	74.1			