ALLIANCE GAMING CORP
Form 10-Q
February 09, 2005

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 December 31, 2004

OR

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

For the transition period from to

Commission File Number 0-4281

ALLIANCE GAMING CORPORATION

(Exact name of registrant as specified in its charter)

NEVADA	**88-0104066**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6601 S. Bermuda Rd.

Las Vegas, Nevada	**89119**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number: **(702) 270-7600**

Registrant s internet: www.alliancegaming.com

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12B-2 of the Exchange Act).

Yes ý No o

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.

ý Yes o No

The number of shares of Common Stock, $0.10 par value, outstanding as of January 31, 2005, according to the records of the registrant s registrar and transfer agent was 51,088,700.

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PART I.	**FINANCIAL INFORMATION**

PART I

ALLIANCE GAMING CORPORATION

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

($ In 000 s except share and per share data)

	As of December 31, 2004		As of June 30, 2004	
ASSETS				
Current assets:				
Cash and cash equivalents	$	27,964	$	172,726
Accounts and notes receivable, net of allowance for doubtful accounts of $14,399 and $9,722		103,601		129,779
Inventories		72,462		61,135
Deferred tax assets, net		19,982		20,054
Other current assets		19,580		12,420
Total current assets		243,589		396,114
Long-term investments (restricted)		8,542		2,528
Long-term receivables, net of allowance of $12 and $12		8,757		12,518
Net investment in leases		12,626		5,614
Leased gaming equipment, net of accumulated depreciation of $40,814 and $31,105		44,273		46,634
Property, plant and equipment, net of accumulated depreciation and amortization of $30,164 and $23,127		76,654		75,838
Goodwill, net		177,961		136,989
Intangible assets, net of accumulated amortization of $14,968 and $12,489		59,474		63,623
Assets of discontinued operations held for sale				4,442
Other assets, net		15,286		6,354
Total assets	$	647,162	$	750,654
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Accounts payable	$	30,478	$	37,515
Accrued liabilities		60,991		51,469
Jackpot liabilities		10,076		12,075
Income taxes payable				7,233
Current maturities of long-term debt		5,040		5,866
Liabilities of discontinued operations held for sale				4,337
Total current liabilities		106,585		118,495
Long-term debt, net of current maturities		348,540		423,089
Deferred tax liabilities		90		849
Other liabilities		6,985		6,092
Minority interest		1,163		1,326
Total liabilities		463,363		549,851
Stockholders equity:				
Special stock, 10,000,000 shares authorized: Series E, $100 liquidation value; 115 shares issued and outstanding		12		12
Common stock, $.10 par value; 100,000,000 shares authorized; 51,552,000 and 51,426,000 shares issued		5,158		5,145
Treasury stock at cost, 526,600 and 513,000 shares		(665)		(501)
Deferred compensation		(7,858)		(6,500)
Additional paid-in capital		196,872		194,040
Accumulated other comprehensive income		1,518		1,524
Retained earnings (accumulated deficit)		(11,238)		7,083
Total stockholders equity		183,799		200,803
Total liabilities and stockholders equity	$	647,162	$	750,654

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE GAMING CORPORATION AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

($ In 000s, except share and per share amounts)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2004	**2003**	**2004**	**2003**
Revenues:				
Gaming equipment and systems	$ 100,933	$ 96,319	$ 205,010	$ 184,787
Casino operations	12,769	12,312	25,605	25,067
	113,702	108,631	230,615	209,854
Costs and expenses:				
Cost of gaming equipment and systems	53,337	38,780	104,173	72,017
Cost of casino operations	4,589	4,884	9,391	9,887
Selling, general and administrative	41,051	21,548	84,706	50,613
Research and development	10,358	9,440	22,130	15,403
Restructuring charge			1,435	
Depreciation and amortization	12,020	6,445	22,861	12,467
	121,355	81,097	244,696	160,387
Operating income (loss)	(7,653)	27,534	(14,081)	49,467
Other income (expense)				
Interest income	318	83	798	126
Interest expense	(3,750)	(3,869)	(7,712)	(9,598)
Minority interest	(1,145)	(541)	(1,644)	(1,027)
Refinancing / bank amendment charges	(564)		(564)	(12,293)
Other, net	375	(545)	528	(899)
Income (loss) from continuing operations before income taxes	(12,419)	22,662	(22,675)	25,776
Income tax expense (benefit)	(4,879)	8,444	(8,730)	9,710
Income (loss) from continuing operations	(7,540)	14,218	(13,945)	16,066
Income (loss) from discontinued operations	15	4,526	(4,376)	8,706
Net income (loss)	$ (7,525)	$ 18,744	$ (18,321)	$ 24,772
Basic earnings (loss) per share:				
Continuing operations	$ (0.15)	$ 0.29	$ (0.27)	$ 0.32
Discontinued operations		0.09	(0.09)	0.18
Total	$ (0.15)	$ 0.38	$ (0.36)	$ 0.50
Diluted earnings (loss) per share:				
Continuing operations	$ (0.15)	$ 0.28	$ (0.27)	$ 0.32
Discontinued operations		0.09	(0.09)	0.17
Total	$ (0.15)	$ 0.37	$ (0.36)	$ 0.49
Weighted average common shares outstanding	51,010	49,741	50,988	49,660
Weighted average diluted common and common share equivalents outstanding	51,010	50,930	50,988	50,814

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE GAMING CORPORATION AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

($ In 000s)

	Common Stock Shares	Common Stock Dollars	Series E Special Stock	Treasury Stock	Deferred Compen-sation	Additional Paid-In Capital	Accum-ulated Other Compre-hensive Income (Loss)	Retained Earnings (Accum-ulated Deficit)	Total Stock-holders Equity
Balances at June 30, 2004	51,426	$ 5,145	$ 12	$ (501)	$ (6,500)	$ 194,040	$ 1,524	$ 7,083	$ 200,803
Net loss								(18,321)	(18,321)
Foreign currency translation adjustment							(6)		(6)
Total comprehensive income									(18,327)
Restricted stock units issued					(1,900)	1,900			
Restricted stock units amortization					542				542
Repurchase of common stock for treasury				(164)					(164)
Shares issued upon exercise of stock options	126	13				696			709
Tax benefit of employee stock option exercises						236			236
Balances at December 31, 2004	51,552	$ 5,158	$ 12	$ (665)	$ (7,858)	$ 196,872	$ 1,518	$ (11,238)	$ 183,799

See accompanying notes to unaudited condensed consolidated financial statements.

ALLIANCE GAMING CORPORATION AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

($ In 000s)

	Six Months Ended December 31, 2004	Six Months Ended December 31, 2003
Cash flows from operating activities of continuing operations:		
Net income (loss)	$ (18,321)	$ 24,772
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities of continuing operations:		
(Income) loss from discontinued operations	4,376	(8,706)
Depreciation and amortization	22,861	12,467
Stock-based compensation	542	
Refinancing / bank amendment charges	564	12,293
Deferred income taxes	(687)	10,433
Provision for losses on receivables	5,154	526
Inventory and other discontinued asset write-downs	14,088	
Other	(11,605)	(1,099)
Change in operating assets and liabilities, net of effects of business acquired:		
Accounts and notes receivable	17,138	(2,019)
Inventories	(17,456)	(2,493)
Other current assets	(4,336)	(1,023)
Accounts payable	(7,169)	(2,072)
Accrued liabilities and jackpot liabilities	(12,853)	(2,924)
Net cash provided by (used in) operating activities of continuing operations	(7,704)	40,155
Cash flows from investing activities of continuing operations:		
Advances of notes receivable due from Sierra Design Group		(61,025)
Additions to property, plant and equipment	(5,531)	(3,815)
Additions to leased gaming equipment	(18,183)	(15,957)
Additions to other long-term assets	(1,521)	(10,414)
Acquisitions, net of cash acquired	(12,000)	(3,879)
Proceeds from sale of net assets of discontinued operations	1,911	16,500
Net cash used in investing activities of continuing operations	(35,324)	(78,590)
Cash flows from financing activities of continuing operations:		
Capitalized debt issuance costs	(1,038)	(6,954)
Premium paid on early redemption of debt		(5,399)
Proceeds from the issuance of long-term debt		350,000
Net change in revolving credit facility		70,000
Payoff of debt due to sale of net assets of discontinued operations	(101,618)	(337,625)
Reduction of long-term debt	(2,050)	(1,349)
Re-purchase of treasury shares	(164)	
Proceeds from exercise of stock options	945	2,907
Net cash provided by (used in) financing activities of continuing operations	(103,925)	71,580
Effect of exchange rates changes on cash	487	130
Cash provided by discontinued operations	1,704	95
Cash and cash equivalents:		
Increase for the period	(144,762)	33,370
Balance, beginning of period	172,726	38,884
Balance, end of period	$ 27,964	$ 72,254

See accompanying notes to unaudited condensed consolidated financial statements.

ALLIANCE GAMING CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Principles of presentation and consolidation

The accompanying unaudited interim condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which management believes are necessary to present fairly the financial position, results of operations and cash flows of Alliance Gaming Corporation and its subsidiaries (Alliance or the Company) for the respective periods presented. The results of operations for an interim period are not necessarily indicative of the results that may be expected for any other interim period or the year as a whole. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes in the Company s annual report on Form 10-K for the year ended June 30, 2004.

The accompanying consolidated financial statements include the accounts of Alliance Gaming Corporation and its wholly owned and partially owned, controlled subsidiaries. The Company consolidates Rainbow Casino Vicksburg Partnership (RCVP) and records minority interest expense to reflect the portion of the earnings of RCVP attributable to the minority shareholders.The Company is the general partner of RCVP, the partnership that operates the Rainbow Casino. Pursuant to transactions consummated in March 1995, the Rainbow Corporation, which was the former general partner of RCVP, became a limited partner entitled to receive 10% (which amount increases to 20% of such amount when annual revenues exceed $35.0 million but only on such incremental amount) of the net available cash flows after debt service and other items, as defined, payable quarterly through December 31, 2010. The Company holds the remaining economic interest in the partnership.

For Video Services, Inc. (VSI), the Company owned 100% of the voting stock and was entitled to receive 71% of dividends declared by VSI, if any, at such time that dividends were declared. The sale of VSI was completed during the quarter ended December 31, 2004 for a realized gain of $0.8 million, net of tax (included in discontinued operations).

All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior year financial statements to conform to the current year presentation, and to present Rail City as discontinued operations for all periods presented.

Recently Issue Accounting Pronouncements

In December 2004, the FASB issued Statement 123(R) which revised FASB No. 123. Statement 123(R) requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments granted to employees for reporting periods beginning after June 15, 2005. The first reporting period for the Company will be the quarter ended September 30, 2005, and the Company is currently evaluating the impact of the adoption, however the pro forma impact is reflected in footnote 2.

In November 2004 the FASB issued Statement 151 which revised ARB 43, Chapter 4, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, wasted material (spoilage). This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not believe this accounting pronouncement will have a material impact on its financial condition or results of operations.

2. STOCK-BASED COMPENSATION

The Company accounts for its stock-based employee compensation awards in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Under APB 25, because the exercise price of the Company s employee stock options equals or exceeds the market price on the date of grant, no compensation expense is recognized.

As provided under Financial Accounting Standards Board No. 123 Accounting for Stock-Based Compensation (FASB No. 123), companies may continue to account for employee stock-based compensation under APB 25, but are required to disclose historical pro-forma net income and earnings per share that would have resulted from the use of the fair value method described in FASB No. 123.

In December 2002, the FASB issued FASB No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure . This Statement amends FASB No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of FASB No. 123 and APB Opinion No. 28 Interim Financial Reporting to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Under fair value method, compensation costs are measured using an options pricing model and are amortized over the estimated life of the option, which is generally three to ten years, with option forfeitures accounted for at the time of the forfeiture, and all amounts are reflected net of tax.

The historical and pro forma net income (assuming an after-tax charge for stock-based compensation) and related per share data are as follows (in 000s, except per share data):

	Three Months Ended December 31,				Six Months Ended December 31,			
		2004		2003		2004		2003
Net income (loss)								
As reported	$	(7,525)	$	18,744	$	(18,321)	$	24,772
Stock-based compensation under FASB No. 123, net of tax		(1,701)		(1,021)		(3,263)		(1,893)
Pro forma net income (loss)	$	(9,226)	$	17,723	$	(21,584)	$	22,879
Earnings per share:								
Basic As reported	$	(0.15)	$	0.38	$	(0.36)	$	0.50
Basic Pro forma	$	(0.18)	$	0.36	$	(0.42)	$	0.46
Diluted As reported	$	(0.15)	$	0.37	$	(0.36)	$	0.49
Diluted Pro forma	$	(0.18)	$	0.35	$	(0.42)	$	0.45

On the date of grant using the Black-Scholes option-pricing model, the following assumptions were used to estimate the grant-date fair value of the options in the periods indicated:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2004	2003	2004	2003
Risk-fee interest rate (weighted average)	3.5%	3.5%	3.5%	3.5%
Expected volatility	0.35	0.26	0. 35	0.26
Expected dividend yield	0	0	0	0
Expected life	3-10 years	3-10 years	3-10 years	3-10 years

The resulting fair values applied to the options granted were $4.39 and $3.14 per share for the quarter ended December 31, 2004 and December 31, 2003, respectively and were $5.06 and $3.10 for the six months ended December 31, 2004 and 2003, respectively.

3. DISCONTINUED OPERATIONS

The Company has completed several divestitures in accordance with our plan to sell our non-core businesses, which was a strategy announced in July 2003. In July 2003, we completed the sale of Bally Wulff to a private equity investor. Since the net assets of Bally Wulff were written down to the estimated sale price in June 2003, no additional gain or loss was recorded upon the closing of the sale. In May 2004, we completed the sale of Rail City Casino to The Sands Resort. On June 30, 2004, the Company completed the sale of United Coin Machine Co. (UCMC). On October 15, 2004 the Company completed the sale of its interest in VSI to Churchill Downs Incorporated and received proceeds of approximately $2.0 million and realized a gain of $0.8 million, net of tax.

The results of these discontinued operations are presented net of applicable income taxes in discontinued operations in the accompanying consolidated statements of operations.

Operating results for the discontinued operations for the three and six month periods ended December 31, 2004 include VSI, while the results for the three and six month periods ended December 31, 2003 include UCMC, VSI, and Rail City. Summary operating results are as follows (in 000s):

	Three Months Ended December 31, 2004	Three Months Ended December 31, 2003	Six Months Ended December 31, 2004	Six Months Ended December 31, 2003
Net revenues	$ 559	$ 64,179	$ 4,514	$ 123,533
Operating income (loss)	(129)	7,947	358	14,746
Income tax expense (benefit)	(38)	2,437	(2,516)	4,724
Income (loss) from discontinued operations	$ 15	$ 4,526	$ (4,376)	$ 8,706

4. OTHER CURRENT ASSETS

Other current assets consist of the following (in 000s):

	December 31, 2004	June 30, 2004
Prepaid taxes	$ 3,889	$ 814
Prepaid royalty	3,126	2,623
Refundable deposits	1,883	3,229
Games on trial	3,088	2,608
Deferred cost of revenue	3,974	208
Prepaid licensing and intellectual fees	685	1,090
Prepaid insurance	1,122	592
Prepaid other expense	1,813	1,256
Total current assets	$ 19,580	$ 12,420

The decrease in refundable deposits of $1.3 million is a result of units purchased from other manufacturers for which the deposit has now been applied to the account payable. The increase in deferred costs of $3.7 million is due to shipments of games, primarily to the European market with F.O.B. destination terms, which will not be recognized as revenue until the third quarter of fiscal year 2005.

5. INVENTORIES

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market. Cost elements included for work-in-process and finished goods include raw materials, freight, direct labor and manufacturing overhead. Inventories consist of the following (in 000s):

	December 31, 2004	June 30, 2004
Raw materials	$ 24,377	$ 26,050

Work-in-process		4,956		3,324
Finished goods		43,129		31,761
Total	$	72,462	$	61,135

The Company performs detailed inventory valuation procedures at least quarterly. This process includes examining the carrying values of new and used gaming devices, parts and ancillary equipment in comparison to the current fair market values for such equipment (less costs to sell or dispose). Some of the factors involved in this analysis include the overall levels of our inventories, the current and projected sales levels for such products, the projected markets for such products both domestically and internationally, the costs required to sell the products including refurbishment costs and importation costs for international shipments, and the overall projected demand for products once the next generation of products are scheduled for release.

The Company has faced declining demand for its video products. During the quarter ended September 30, 2004, the Company decided that its legacy V7 video platform would no longer be supported, and the remaining used game inventory for such products was targeted for immediate disposal, resulting in a write down of $3.0 million. The inventory of new games for this product line was targeted for sale at reduced prices, which were still above the carrying value less cost to sell and therefore were not written down.

During the quarter ended December 31, 2004, management completed a three year business planning process. In accordance with this plan, significant development efforts were redirected to the Alpha-based video platform and products. The Company also made its existing EVO video games upgradeable to Alpha when approved in each market. The remaining used EVO inventory has been targeted for sale primarily in non-domestic markets, which traditionally have lower price points for used games and have higher importation and delivery costs, resulting in significantly lower net realizable values. The capitalized regulatory approval costs for the EVO and legacy video platform were determined to no longer be recoverable, and were also written off.

During the quarter ended December 31, 2004, the Company consolidated several warehouses into one central warehouse, with the intent to reduce warehouse rental costs. As part of this consolidation, certain used games and related ancillary equipment including signs, were identified for immediate destruction, scrap, or salvage and this process has continued into the March 2005 period.

As a result of the decision to move to the new video platform, the targeting of used equipment for non-domestic markets, and the consolidation of warehouses leading to accelerated disposals, the Company wrote down its inventory and related assets by a total of $11.1 million during the quarter ended December 31, 2004, and such write downs for the six months ended December 31, 2004 totaled $14.1 million. These charges are included in the cost of gaming equipment and systems in the statement of operations.

The Company continues to take certain used games on trade as part of new game sales, and therefore additional write-downs may be necessary in future periods depending on a number of factors impacting the future demand for such used products and the ultimate net values realized.

6. PROPERTY, PLANT AND EQUIPMENT AND LEASED GAMING EQUIPMENT

Property, plant and equipment is stated at cost and depreciated over the estimated useful lives or lease term, if less, using the straight line method as follows: buildings and improvements, 28-40 years; gaming equipment, 4-7 years; furniture, fixtures and equipment, 3-7 years; and leasehold improvements, 5-10 years. Leased gaming equipment is stated at cost and depreciated over estimated useful life ranging from 3-4 years.

Significant replacements and improvements are capitalized; other maintenance and repairs are expensed. The cost and accumulated depreciation of assets retired or otherwise disposed of are eliminated from the accounts and any resulting gain or loss is credited or charged to income as appropriate.

Property, plant and equipment consist of the following (in 000s):

	December 31, 2004	June 30, 2004
Land and land improvements	$ 12,827	$ 19,086
Buildings and leasehold improvements	37,735	29,937
Gaming equipment	33,160	29,121
Furniture, fixtures and equipment	23,096	20,821
Less accumulated depreciation and amortization	(30,164)	(23,127)
Total property, plant and equipment, net	$ 76,654	$ 75,838
Leased gaming equipment	$ 85,087	$ 77,739
Less accumulated depreciation	(40,814)	(31,105)
Total leased gaming equipment, net	$ 44,273	$ 46,634

7. INTANGIBLE ASSETS AND GOODWILL

In July 2001, the Company adopted FASB No. 142 Goodwill and Other Intangible Assets , which requires companies to cease amortizing goodwill and certain intangible assets with indefinite useful lives. Instead, goodwill and intangible assets deemed to have indefinite useful lives are to be reviewed for impairment annually at the reporting unit level (Gaming equipment and systems, and casino operations). There was no impairment of goodwill upon adoption of FASB No. 142. There was no impairment charged to goodwill in the six months ended December 31, 2004 or 2003.

The Company evaluates the carrying value of goodwill for impairment annually during the fourth quarter or whenever events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. Indicators that could trigger an impairment review include changes in legal, regulatory, or economic factors, market conditions or operational performance. Impairment is measured as the difference between the carrying amount and the fair value of the intangible assets and is recognized as a component of income from operations.

Intangibles

Intangible assets excluding discontinued operations consist of the following (in 000s):

		December 31, 2004			June 30, 2004		
	Wt. Avg. Useful life (Years)	Gross Carrying Amount	Accum-ulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accum-ulated Amortization	Net Carrying Amount
Computer software	3	$ 8,996	$ (2,622)	$ 6,374	$ 8,963	$ (1,498)	$ 7,465
Computer software from acquisitions	9	11,700	(4,030)	7,670	11,700	(3,380)	8,320
License rights	3-5	1,774	(777)	997	2,745	(1,979)	766
Capitalized regulatory approval costs	3	3,638	(1,043)	2,595	4,767	(833)	3,934
CRM project	5	3,290	(1,237)	2,053	3,039	(1,046)	1,993
PLM project	5	1,843	(102)	1,741	1,585		1,585
Trademarks	5	6,688	(431)	6,257	6,688	(288)	6,400
Patents	13	9,470	(608)	8,862	9,470	(243)	9,227
Non-compete agreements	6	275	(38)	237	275	(15)	260
Customer relationships	5	740	(123)	617	740	(49)	691
Core technology	8	5,445	(567)	4,878	5,445	(227)	5,218
Deferred financing costs	6	7,385	(1,656)	5,729	6,910	(1,017)	5,893
Contracts	10	12,100	(1,016)	11,084	12,100	(411)	11,689
Other intangibles	7	1,098	(718)	380	1,685	(1,503)	182
Total		$ 74,442	$ (14,968)	$ 59,474	$ 76,112	$ (12,489)	$ 63,623

Amortization expense totaled $2.6 million and $1.4 million for the three months ended December 31, 2004 and 2003, respectively. Amortization expense totaled $4.6 million and $2.7 million for the six months ended December 31, 2004 and 2003, respectively. Computer software amortization expense totaled $1.1 million and $0.8 million for the three months ended December 31, 2004 and 2003, respectively. Computer software amortization totaled $1.6 million and $1.4 million for the six months ended December 31, 2004 and 2003, respectively.

Future amortization of intangible assets is scheduled as follows (in 000s):

Period Ending December 31,		**Amount**
2005	$	5,197
2006		10,463
2007		8,919
2008		6,600
2009		5,887
Thereafter		22,408
Total	$	59,474

Goodwill

The changes in the carrying amount of goodwill are as follows (in 000s):

Balance as of June 30, 2004	$	136,989
Acquired goodwill		40,558
Foreign currency translation adjustment		414
Balance as of December 31, 2004	$	177,961

On December 30, 2004 the Company amended the Sierra Design Group (SDG) stock purchase agreement originally dated March 3, 2004. The amendment terminates the contingent consideration payable over the next three years (the earnout) which could have totaled $95 million (payable in cash and stock) depending on the achievement of certain SDG financial performance targets. The consideration for the termination of the earnout consisted of a one-time cash payment of $12 million paid to the group of former SDG stakeholders and the delivery of a $28 million unsecured promissory note to that same group of individuals, payable over five years with interest at LIBOR + 2%. The $40 million of total consideration paid to terminate the earnout, and related expenses has been treated as additional consideration paid for the stock of SDG, and therefore has been recorded as goodwill.

The purchase agreement for MindPlay LLC calls for future contingent consideration (earnouts) to be paid to its former principals, as more fully described in footnote 14. The MindPlay earnout is payable based on future revenues and gross margins from the sale of MindPlay products. No amounts have yet been paid pursuant to this earnout.

8. ACCRUED LIABILITIES AND JACKPOT LIABILITIES

Accrued liabilities consist of the following (in 000s):

		December 31, 2004		June 30, 2004
Payroll and related costs	$	9,754	$	11,905
Interest		1,713		1,265
Professional and consulting fees		4,281		3,102
Deferred revenues, sales and use taxes		10,942		5,113
Regulatory approval cost accruals		1,389		652
Royalties, rebates, direct mail coupons		8,541		7,390
Customer deposits		5,748		9,896
Acquisition related accruals		3,906		3,806
Divestiture related accruals		561		4,377
Litigation accruals		9,360		
Severance accruals		637		
Other		4,159		3,963
Subtotal		60,991		51,469
Jackpots accrued not yet awarded		10,076		12,075
Total accrued liabilities	$	71,067	$	63,544

The Company recognizes liability for jackpot expense for the cost to fund these jackpots in the future. Generally winners may elect to receive a single lump sum payment or may opt to receive payments in equal installments over a specified period of time. The most recent history pattern indicates that approximately 85% of winners will elect the single payment option.

The Company funds jackpot installment payments through qualifying U.S. government or agency securities. The present value of the outstanding progressive jackpot liabilities is computed based upon the payment stream discounted at the applicable discount rate.

The increase in litigation accruals of $9.4 million is primarily a result of the patent litigation discussed in the Commitments and Contingencies section of this report.

9. LONG-TERM INVESTMENTS (RESTRICTED)

Pursuant to various state gaming regulations, certain cash accounts are maintained to ensure availability of funds to pay wide-area progressive jackpot awards, which totaled approximately $12.8 million at December 31, 2004 and which are included in cash and cash equivalents in the accompanying balance sheets. In addition, the Company purchases U.S. Treasury Strip securities for the benefit of jackpot winners who elect to receive annual or weekly installment payments. These securities are presented as restricted investments in the accompanying consolidated balance sheets, and totaled $8.5 million and $2.5 million as of December 31, 2004 and June 30, 2004, respectively.

10. LONG-TERM DEBT

Long-term debt consisted of the following (in 000s):

	December 31, 2004	June 30, 2004
Term Loan facility	$ 317,507	$ 350,000
Revolving credit facility		70,000
Other, generally unsecured	36,073	8,955
	353,580	428,955
Less current maturities	5,040	5,866
Long-term debt, less current maturities	$ 348,540	$ 423,089

In December 2004, the Company amended its senior loan agreement. The amendment provides for an increase in the maximum allowable leverage ratio (currently 4.25x), a reduction in the revolver from $125 million to $75 million which is currently unborrowed, and an increase in the term loan interest rate to LIBOR + 3.00%. The LIBOR rate at December 31, 2004 was 2.65%. The fee incurred for the amendment totaled approximately $1.0 million, which has been capitalized and will be amortized over the life of the amended loan agreement, and the Company recorded a pre-tax charge of $0.6 million to write-off a portion of the previously deferred financing costs.

The Company s bank credit agreement, as amended, contains several financial covenants including maximum leverage ratio, minimum cash flow (as that term is defined in the agreement) and fixed charge coverage ratio. The credit agreement also contains a number of maintenance covenants and other significant covenants that, among other things, restrict the ability of the Company and certain of its subsidiaries to dispose of assets, incur additional indebtedness and issue preferred stock, pay dividends or make other distributions, enter into certain acquisitions, repurchase equity interests or subordinated indebtedness, issue or sell equity interests of the Company s subsidiaries, engage in mergers or acquisitions, or engage in certain transactions with subsidiaries and affiliates, and that otherwise restrict corporate activities. As of December 31, 2004, the Company is in compliance with the covenants, including the leverage ratio which is currently 3.9x. Pursuant to the recent amendment, the leverage ratio maximum is scheduled to increase to 4.50x and to 4.75x as of March 31, 2005 and June 30, 2005, respectively.

The other debt totaling approximately $36.1 million as of December 31, 2004, consists primarily of the debt owed to the former principals of SDG, Micro Clever Consulting, and MindPlay, totaling $28.0 million, $1.3 million and $4.0 million respectively. The loans are due at various dates between 2005 and 2009 and bear rates of interest between LIBOR plus 2% (5.7% as of December 31, 2004) and 6%, and are generally unsecured.

In September 2003, the Company refinanced its senior bank debt credit facility and recorded a pre-tax charge totaling $12.3 million. This charge includes a $5.0 million charge for the early extinguishment of the Company s subordinated notes, $7.0 million for the non-cash write-off of deferred financing costs and $0.3 million in fees and expenses.

11. EARNINGS PER SHARE

The following computation of basic and diluted earnings (loss) per share from continuing operations, and income (loss) applicable to common shares are as follows (in 000s except per share amounts):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2004	2003	2004	2003
Net income (loss) from continuing operations	$ (7,540)	$ 14,218	$ (13,945)	$ 16,066
Net income (loss) from discontinued operations	15	4,526	(4,376)	8,706
Net income (loss)	$ (7,525)	$ 18,744	$ (18,321)	$ 24,772
Weighted average common shares outstanding	51,010	49,741	50,988	49,660
Effect of dilutive securities		1,189		1,154
Weighted average common and dilutive shares outstanding	51,010	50,930	50,988	50,814
Earnings (loss) per basic share:				
Income (loss) from continued operations	$ (0.15)	$ 0.29	$ (0.27)	$ 0.32
Income (loss) from discontinued operation	0.00	0.09	(0.09)	0.18
	$ (0.15)	$ 0.38	$ (0.36)	$ 0.50
Earnings (loss) per diluted share:				
Income (loss) from continued operations	$ (0.15)	$ 0.28	$ (0.27)	0.32
Income (loss) from discontinued operation	0.00	0.09	(0.09)	0.17
	$ (0.15)	$ 0.37	$ (0.36)	$ 0.49

Diluted earnings per share represent the potential dilution that could occur if all dilutive securities outstanding were exercised. Certain securities do not have a dilutive effect because their exercise price exceeds the fair market value of the underlying stock. Such securities are excluded from the diluted earnings per share calculation and consist of the following (in 000s):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2004	2003	2004	2003
Stock options	3,519	3	3,378	56
Warrants	100		100	
	3,619	3	3,478	56

For the three and six month periods ended December 31, 2004, a total of 1.2 million in-the-money options and 0.5 million restricted stock units were also excluded from the dilutive earnings per share calculation as they are antidilutive given the reported net loss for these periods.

During the quarter ended December 31, 2004 the Company granted an additional 156,507 restricted stock units valued at $1.9 million. The restricted stock units vest on October 1, 2010; however, vesting could be accelerated under certain circumstances. The $1.9 million has been deferred, and will be amortized as compensation expense over three years.

12. SEGMENTS AND GEOGRAPHICAL INFORMATION

The Company currently operates in two business segments (exclusive of the business segments included in discontinued operations): (i) Gaming Equipment and Systems which designs, manufactures and distributes gaming machines and computerized monitoring systems for gaming machines, and (ii) Casino Operations which currently owns and operates a casino in Vicksburg, Mississippi. The accounting policies of these segments are consistent with Company s policies for the Consolidated Financial Statements.

The table below presents information as to the Company s revenues and operating income by segment (in 000s):

	Three Months Ended December 31, 2004	2003	Six Months Ended December 31, 2004	2003
Revenues:				
Gaming Equipment and Systems	$ 100,933	$ 96,319	$ 205,010	$ 184,787
Casino Operations	12,769	12,312	25,605	25,067
Total revenues	$ 113,702	$ 108,631	$ 230,615	209,854
Intersegment revenues:				
Gaming Equipment and Systems	$ 84	$ 212	$ 256	$ 341
Operating income (loss):				
Gaming Equipment and Systems	$ (6,840)	$ 27,217	$ (11,327)	$ 48,575
Casino Operations	4,082	3,814	7,878	7,828
Corporate/other	(4,895)	(3,497)	(10,632)	(6,936)
Total operating income (loss)	$ (7,653)	$ 27,534	$ (14,081)	$ 49,467

The Company has operations based primarily in the United States with sales and distribution offices in Europe and South America.

The table below presents information as to the Company s revenues, operating income, identifiable assets, capital expenditures and depreciation and amortization by geographic region (in 000s):

	Three Months Ended December 31, 2004	2003	Six Months Ended December 31, 2004	2003