INTERNATIONAL GAME TECHNOLOGY
Form 10-Q
February 03, 2006

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United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended December 31, 2005

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 001-10684

International Game Technology
(Exact name of registrant as specified in its charter)

Nevada	**88-0173041**
(State of Incorporation)	(I.R.S. Employer Identification No.)

9295 Prototype Drive
Reno, Nevada 89521
(Address of principal executive offices)
(775) 448-7777
(Registrant s telephone number, including area code)
www.IGT.com
(Registrant s website)

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at February 2, 2006
Common Stock par value $.00015625 per share	337,181,710

INTERNATIONAL GAME TECHNOLOGY

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DEFINITIONS

Abbreviation or acronym	**Meaning as used in this report**
Acres	Acres Gaming Incorporated
Anchor	Anchor Gaming
APB	Accounting Principles Board
ARB	Accounting Research Bulletin
ARDU	average revenue per day per unit
ARPU	average revenue per unit
ARS	Auction Rate Securities
ASP	average sales price per machine
CAD$	Canadian dollars
CCSC	Colorado Central Station Casino
CDS	central determination system
CEO	Chief Executive Officer
CFO	Chief Financial Officer
Debentures	Senior Convertible Debentures due January 29, 2033
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
EPS	earnings per share
ERP	enterprise resource planning
ESPP	Employee Stock Purchase Plan
FAS	Financial Accounting Standard
FASB	Financial Accounting Standards Board
FIN	FASB Interpretations
FSP	FASB Staff Position
NDT	The Nevada Department of Taxation
OSHA	Occupational Safety & Health Administration
PGIC	Progressive Gaming International Corporation
pp	percentage points
R&D	research and development
RFID	radio frequency identification
SAB	Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SIP	Stock Incentive Plan
SMI	Shuffle Master, Inc.
SG&A	selling, general and administrative
TRO	temporary restraining order
UK	United Kingdom
US	United States
VIE	variable interest entity
WW or WagerWorks	WagerWorks, Inc.
WAP	wide area progressive
*	not meaningful (in tables)
IGT, we our, management, Company	International Game Technology, consolidated

PART I FINANCIAL INFORMATION
Item 1. Unaudited Condensed Consolidated Financial Statements
CONSOLIDATED INCOME STATEMENTS

Quarters ended December 31,	**2005**	2004
(In millions, except per share amounts)		
Revenues		
Product sales	**$ 324.5**	$ 354.3
Gaming operations	**291.7**	286.9
Total revenues	**616.2**	641.2
Costs and operating expenses		
Cost of product sales	**158.0**	190.7
Cost of gaming operations	**126.2**	137.5
Selling, general and administrative	**84.4**	74.3
Depreciation and amortization	**20.4**	16.6
Research and development	**41.2**	31.7
Bad debt provisions	**0.2**	0.7
Total costs and operating expenses	**430.4**	451.5
Operating income	**185.8**	189.7
Other income (expense)		
Interest income	**15.8**	15.4
Interest expense	**(13.6)**	(14.9)
Other	**0.5**	1.1
Total other income (expense)	**2.7**	1.6
Income before tax	**188.5**	191.3
Income tax provisions	**67.9**	68.9
Net income	**$ 120.6**	$ 122.4
Basic earnings per share	**$ 0.36**	$ 0.35
Diluted earnings per share	**$ 0.34**	$ 0.33
Cash dividends declared per share	**$ 0.125**	$ 0.120
Weighted average shares outstanding		
Basic	**337.1**	345.9
Diluted	**362.7**	374.1

See accompanying notes.

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CONSOLIDATED BALANCE SHEETS

(In millions, except par value)	**December 31, 2005**	September 30, 2005
Assets		
Current assets		
Cash and equivalents	**$ 411.4**	$ 288.9
Investment securities, at market value	**198.2**	268.3
Restricted cash and investments	**116.7**	130.9
Accounts receivable, net of allowances for doubtful accounts of $18.0 and $20.4	**346.0**	327.8
Current maturities of notes and contracts receivable, net	**86.3**	98.2
Inventories	**137.8**	142.3
Jackpot annuity investments	**46.1**	52.2
Deferred income taxes	**54.1**	50.0
Prepaid expenses and other	**88.2**	78.6
Total current assets	**1,484.8**	1,437.2
Notes and contracts receivable, net	**68.0**	49.3
Property, plant and equipment, net	**404.1**	385.2
Jackpot annuity investments	**347.3**	469.4
Deferred income taxes	**40.3**	43.2
Intangible assets, net	**274.3**	286.3
Goodwill, net	**1,091.8**	1,090.9
Other assets	**93.2**	102.9
	$ 3,803.8	$ 3,864.4
Liabilities and Stockholders Equity		
Liabilities		
Current liabilities		
Current maturities of notes payable	**$ 605.0**	$ 611.0
Accounts payable	**96.6**	96.7
Jackpot liabilities	**189.0**	203.9
Accrued employee benefit plan liabilities	**22.6**	60.2
Dividends payable	**42.1**	42.6
Accrued income taxes	**55.1**	14.5
Other accrued liabilities	**161.6**	188.7
Total current liabilities	**1,172.0**	1,217.6
Notes payable, net of current maturities	**200.0**	200.0
Non-current jackpot liabilities	**382.3**	501.9
Other liabilities	**39.5**	39.2
	1,793.8	1,958.7

Commitments and Contingencies		
Stockholders Equity		
Common stock: $.00015625 par value; 1,280.0 shares authorized; 713.6 and 712.8 shares issued	**0.1**	0.1
Additional paid-in capital	**1,710.8**	1,623.6
Treasury stock at cost: 377.1 and 374.6 shares	**(2,250.0)**	(2,176.9)
Deferred compensation		(11.4)
Retained earnings	**2,550.0**	2,471.1
Accumulated other comprehensive loss	**(0.9)**	(0.8)
	2,010.0	1,905.7
	$ 3,803.8	$ 3,864.4

See accompanying notes.

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CONSOLIDATED CASH FLOWS STATEMENTS

Quarters ended December 31, *(In millions)*	**2005**	2004
Operations		
Net income	**$ 120.6**	$ 122.4
Adjustments:		
Depreciation, amortization, and asset charges	**55.9**	42.5
Debt discounts and deferred offering costs	**4.0**	4.1
Share-based compensation	**9.5**	1.1
Bad debt provisions	**0.2**	0.7
Inventory obsolescence provisions	**3.4**	6.8
Changes in operating assets and liabilities, excluding acquisitions and VIE consolidations/deconsolidations:		
Receivables	**(25.7)**	(40.4)
Inventories	**2.8**	(9.2)
Accounts payable and accrued liabilities	**(50.2)**	(33.7)
Jackpot liabilities	**(12.4)**	(1.8)
Income taxes, net of employee stock plans	**40.9**	53.7
Other current assets	**(4.3)**	(5.5)
Other non-current assets	**14.3**	13.1
Cash from operations	**159.0**	153.8
Investing		
Capital expenditures	**(75.2)**	(44.4)
Restricted cash	**8.9**	(13.3)
Investment securities, net	**63.3**	(59.9)
Jackpot annuity investments, net	**4.7**	0.5
Loans receivable cash advanced	**(0.8)**	
Loans receivable payments received	**1.5**	0.8
Proceeds from assets sold	**0.3**	
Business acquisitions		(3.6)
Cash from investing	**2.7**	(119.9)
Financing		
Debt proceeds (repayments), net	**(12.6)**	32.3
Employee stock plan proceeds	**9.2**	10.3
Excess tax benefits from employee stock plans	**1.3**	
Dividends paid	**(42.3)**	(41.5)
Share repurchases	**(73.1)**	
Structured share repurchase plan	**77.8**	
Cash from financing	**(39.7)**	1.1

Foreign exchange rates effect on cash	**0.5**	2.9
Net change in cash and equivalents	**122.5**	37.9
Beginning cash and equivalents	**288.9**	307.0
Ending cash and equivalents	**$ 411.4**	$ 344.9

See accompanying notes.

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Supplemental Cash Flows Information
Depreciation, amortization and asset charges reflected in the cash flows statements is comprised of amounts presented separately on the income statements, plus depreciation and asset charges included in cost of product sales and cost of gaming operations.

Quarters ended December 31, *(In millions)*	**2005**	2004
Investment securities		
Purchases	**$(142.6)**	$(158.5)
Proceeds from sales	**205.9**	98.6
Net	**$ 63.3**	$ (59.9)
Jackpot funding		
Collections to fund jackpots	**$ 34.7**	$ 65.2
Payments to winners	**(47.1)**	(67.0)
Net change in jackpot liabilities	**(12.4)**	(1.8)
Jackpot annuity purchases	**(5.0)**	(12.1)
Jackpot annuity proceeds	**9.7**	12.6
Net change in jackpot annuity investments	**4.7**	0.5
Net jackpot funding cash flows	**$ (7.7)**	$ (1.3)
Capital expenditures		
Property, plant and equipment	**$ (14.8)**	$ (15.3)
Gaming operations equipment	**(56.1)**	(26.4)
Intellectual property	**(4.3)**	(2.7)
Total capital expenditures	**$ (75.2)**	$ (44.4)
Payments		
Interest	**$ 4.9**	$ 2.1
Income taxes	**27.1**	15.7
Non-cash investing and financing items:		
Tax benefit of employee stock plans	**$ 2.6**	$ 5.6
Capital expenditure accruals	**(1.6)**	
Acquisitions		
Fair value of assets	**$**	$ 5.2

Fair value of liabilities		1.6
VIE deconsolidations		
Fair value of assets	**$ 139.2**	$
Fair value of liabilities	**139.2**	

See accompanying notes.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

We prepare our consolidated financial statements in accordance with SEC requirements and include all adjustments necessary to fairly present consolidated results of operations, financial position, and cash flows for all periods presented. Interim period results are not necessarily indicative of full year results This quarterly report should be read in conjunction with our most recent Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of International Game Technology and all majority-owned or controlled subsidiaries and variable interest entities of which we are the primary beneficiary. All appropriate inter-company accounts and transactions are eliminated.

Our fiscal accounting periods end on the Saturday nearest the last day of the quarter end month. For simplicity, we present all fiscal period endings as the calendar month end date. Accordingly, this report presents the following periods:

	Period End	
	Actual	**Presented as**
Current quarter	December 31, 2005	December 31, 2005
Prior year quarter	January 1, 2005	December 31, 2004
Prior fiscal year end	October 1, 2005	September 30, 2005

We reclassified certain prior period amounts to be consistent with the current period presentation, specifically with respect to restricted cash and Auction Rate Securities (ARS) investments in our cash flows statements.

Restricted Cash

Gaming regulations require us to maintain sufficient reserves in restricted accounts for funding payments to progressive jackpot winners. The net change in restricted cash is reflected as a decrease in investing cash flows of $13.3 million for the quarter ended December 31, 2004, rather than as a component of net change in cash as presented previously. This reclassification had no impact on operating cash flows.

ARS Investments

In the second quarter of fiscal 2005, we determined it appropriate to classify our ARS as short-term investments rather than cash equivalents as previously presented. The reclassification of ARS purchases and proceeds decreased the prior year quarter investing cash flows and net change in cash and equivalents by $59.9 million. This reclassification had no impact on operating cash flows.

WAP Trust VIE Consolidations

We have consolidated our WAP trusts in Iowa and New Jersey since March 31, 2004 under FIN 46 (revised December 2003), *Consolidation of Variable Interest Entities*. Consolidated trust assets equal liabilities and relate primarily to jackpot funding.

On November 4, 2005, because of an earlier change in gaming regulations, IGT assumed direct responsibility for New Jersey WAP jackpot system operations previously under the control of a separate trust administrator, including casino collections and future winner payments. The administration of past winner payments remains the responsibility of the existing separate New Jersey trusts, and IGT has no remaining obligations related to past winner payments. Accordingly, we deconsolidated approximately $139.2 million of New Jersey VIE assets and liabilities related to past winners during the first quarter of fiscal 2006. This deconsolidation had no material impact on consolidated gaming operations revenues or expenses.

We continue to consolidate the Iowa Trust VIEs, with assets and liabilities totaling $4.0 million at December 31, 2005. IGT, as trustee and administrator, will establish and consolidate any future New Jersey WAP trusts required only for periodic payments to winners who decline lump sum payout.

Hurricane Damages

We suffered damages and losses to our US gulf coast operations from the hurricanes Katrina in August 2005 and Rita in September 2005, primarily affecting gaming operations machines destroyed or temporarily shutdown. At December 31, 2005, 600 gaming operations machines remain offline at damaged casinos.

No determination has been made as to the total amount or timing of insurance payments. We carry comprehensive business interruption and property damage insurance. We are working closely with our insurance carriers, claims adjustors, and consultants to ascertain the full amount of insurance proceeds due to IGT because of the damages and losses suffered in the hurricanes. We will record any business interruption insurance recoveries for lost earnings and any property insurance reimbursements over book value when realized and all contingencies are resolved. This may result in periodic fluctuations affecting comparability.

Recently Issued Accounting Standards

SFAS 154

In May 2005, the FASB issued SFAS 154, *Accounting Changes and Error Corrections,* requiring retrospective application to prior-period financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of errors made in fiscal years beginning after December 15, 2005, which will be IGT s fiscal year 2007. Although we have no current application for this statement, the adoption of this statement may affect our future results of operations, financial position or cash flows.

FIN 47

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of FAS 143.* FIN 47 requires recognition of a liability for the fair value of a conditional asset retirement obligation if we can reasonably estimate the fair value of the liability. When sufficient information exists, we should factor uncertainty about the amount and/or timing of future settlement into the liability measurement. The interpretation is effective for the end of fiscal years ending after December 15, 2005, which is IGT s fiscal year 2006. We anticipate no material impact on our results of operations, financial position or cash flows from the adoption of FIN 47.

SFAS 123R and SAB 107

In December 2004, the FASB issued SFAS 123R (revised 2004), *Share-Based Payment*, replacing and superseding both SFAS 123, *Accounting for Stock-Based Compensation*, and APB 25, *Accounting for Stock Issued to Employees*. SFAS 123R requires fair value measurement and recognition in the financial statements for all share-based compensation arrangements. SFAS 123R also requires additional accounting and disclosures related to income tax effects and cash flows resulting from share-based compensation arrangements.

In March 2005, the SEC issued SAB 107, *Share-Based Payment,* providing interpretive guidance on SFAS 123R valuation methods, assumptions used in valuation models, and the interaction of SFAS 123R with existing SEC guidance. The additional SAB 107 requirement for the classification of stock compensation expense to the same financial statement line as cash compensation affected our cost of product sales and gaming operations, related gross profits and margins, R&D, and SG&A expenses.

SFAS 123R is effective for the first annual reporting period that begins after June 15, 2005. Adoption of SFAS 123R in our first quarter ended December 31, 2005 reduced earnings consistent with past pro forma stock based compensation disclosures. See Note 2 for additional information.

SFAS 151

In November 2004, the FASB issued SFAS 151, *Inventory Costs*, *amending ARB 43 Chapter 4*, *Inventory Pricing*. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight and handling costs, and wasted material (spoilage). SFAS 151 introduces the concept of normal capacity requiring allocation of fixed production overheads to inventory based upon normal capacity of production facilities. We must expense unallocated overhead costs in the period incurred. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, which is IGT s fiscal year 2006. The adoption of this statement had no material impact on our results of operations, financial position or cash flows.

2. Share-based Compensation

Our share-based payment arrangements are designed to attract and retain employees. The amount, frequency, and terms of share-based awards may vary based on competitive practices, company operating results, and government regulations. New shares are issued upon option exercise or restricted share grants.

Stock Incentive Plan (SIP)

Under the IGT SIP, our eligible employees and non-employee directors may be granted non-qualified and incentive stock options, nonvested shares (also known as restricted shares), or stock appreciation rights. SIP

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grants may vest over time of service or based on performance. We generally grant stock options at an exercise price equal to the market price at the date of grant, with a 10-year contractual term. Our share-based compensation arrangements typically vest ratably over five years of continuous service. At December 31, 2005, 9.0 million shares remain available for grant under the IGT SIP.

Current year stock options activity as of and for the quarter ended December 31, 2005

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Instrinsic Value
	(thousands)	*(per share)*	*(years)*	*(millions)*
Outstanding at beginning of year	22,774	$22.80		
Granted	932	28.46		
Exercised	(777)	11.81		
Forfeited	(52)	26.02		
Expired	(10)	22.68		
Outstanding at end of period	22,867	$23.39	7.2	$ 202.1
Exercisable at end of period	10,240	$18.66	6.3	$ 133.6

Current year restricted shares activity as of and for the quarter ended December 31, 2005

Restricted Shares	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term	Aggregate Instrinsic Value
	(thousands)	*(per share)*	*(years)*	*(millions)*
Outstanding at beginning of year	514	$26.78		
Granted				
Vested	(49)	35.70		
Forfeited	(2)	35.70		
Outstanding at end of period	463	$25.80	3.8	$ 14.3

Employee Stock Purchase Plan (ESPP)

Under the IGT qualified ESPP, eligible employees may be granted an option with a 12-month term to purchase a limited number of shares, exercisable the last day in February each year. Eligible employees participate in this plan through payroll deductions up to the lesser of 10% of base pay or $21,250. The option price is equal to 85% of the market price of our stock on the grant date or exercise date, whichever is less. No ESPP plan shares were issued during the first quarter of fiscal 2006 or 2005. At December 31, 2005, 3.2 million shares were available for future grants. Based on expected payroll contributions as of December 31, 2005, we expect to issue approximately 247,000 shares in February 2006 under this plan.

Additionally, eligible UK employees may enroll annually in the Barcrest Savings Related Share Option Scheme established in January 1999. Employees must elect to vest over three, five, or seven years and the option price is equal to 80% of the market price of our stock on the grant date. No shares were issued during the first quarters of fiscal 2006 or 2005 under this plan and approximately 707,200 shares were available for grant at December 31, 2005. Based on enrollment through December 2005, we expect to issue approximately 51,000 shares under this plan.

Expense Measurement and Recognition

On October 1, 2005, IGT adopted the provisions of SFAS 123R and SAB 107 requiring the measurement and recognition of all share-based compensation under the fair value method. We implemented SFAS 123R using

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the modified prospective transition method and adjusted previously recorded deferred compensation back to additional paid-in capital.

Accordingly, for the quarter ended December 31, 2005, we recognized share-based compensation for all current award grants and for the unvested portion of previous award grants based on grant date fair values. Prior to fiscal 2006, we accounted for share-based awards under the APB 25 intrinsic value method, which resulted in compensation expense recorded only for restricted share awards and the modification or acquisition of outstanding unvested options. Prior period financial statements have not been adjusted to reflect fair value share-based compensation expense under SFAS 123R.

With the adoption of SFAS 123R, we changed our method of expense attribution for fair value share-based compensation from the accelerated approach to the straight-line approach for all new awards granted. We anticipate the straight-line method will provide a more meaningful measure of costs incurred. Compensation for share-based awards granted prior to the beginning of fiscal 2006 will continue being recognized under the accelerated method. Unrecognized costs related to all share-based awards outstanding at December 31, 2005 totaled $52.6 million and is expected to be recognized over a weighted average period of 1.83 years.

We use historical data and projections to estimate expected employee behaviors related to option exercises and forfeitures. SFAS 123R requires that forfeitures be included as part of the grant date estimate. The cumulative effect of forfeitures related to previous SFAS 123 pro forma expense was not material. Prior to adopting SFAS 123R, we reduced stock-based compensation expense when forfeitures occurred.

The fair value of restricted share awards is based on the grant date market price of IGT stock. We estimate the fair value of each stock option award on the grant date using the Black-Scholes valuation model incorporating the assumptions noted in the following table. Option valuation models require the input of highly subjective assumptions, and changes in assumptions used can materially affect the fair value estimate. Expected volatility and dividends are based on implied and historical IGT stock factors. Expected term represents the estimated weighted average time between grant and employee exercise. Risk free rate is based on US Treasury rates appropriate for the expected term.

Quarters ended December 31,	**2005**	2004
(In millions, except assumptions, years, and per share amounts)		
Option valuation assumptions:		
Expected volatility	**0.29**	0.34
Expected dividends	**1.62%**	1.43%
Expected term (in years)	**4.5**	3.2
Risk free rate	**4.37%**	3.15%
Weighted average grant date fair value per share:		
Options granted	**$ 7.54**	$ 8.27
Restricted shares granted		$ 35.70
Total intrinsic value of options exercised	**$ 13.6**	$ 16.7
Total fair value of restricted shares vested	**1.4**	0.9
Exercises under all share-based payment arrangements:		
Cash received	**$ 9.2**	$ 10.3
Tax benefit realized for tax return deductions	**3.1**	6.0

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Reported share-based compensation was classified as follows:

Quarters ended December 31,	**2005**	**2004**
(In millions, except per share amounts)		
Cost of product sales	**$ 0.2**	$
Cost of gaming operations	**0.3**	
Selling, general and administrative	**6.7**	1.1
Research and development	**2.3**	
Total share-based compensation	**9.5**	1.1
Tax benefit	**(3.4)**	(0.4)
Total share-based compensation, net of tax	**$ 6.1**	$ 0.7

The following table compares net income reflecting SFAS 123R share-based compensation of $6.1 million reported in the current quarter to prior year pro forma SFAS 123 fair value compensation of $7.2 million and reported APB 25 intrinsic value compensation of $0.7 million.

Quarters ended December 31,	**2005**	**2004**
(In millions, except per share amounts)	*Actual*	*Pro forma*
Reported net income	**$120.6**	$ 122.4
Additional proforma shared-based compensation, net of tax		(6.5)
Comparative net income	**$120.6**	$ 115.9
Basic EPS as reported	**$ 0.36**	$ 0.35
Basic EPS (prior year pro forma)	**$ 0.36**	$ 0.34
Diluted EPS as reported	**$ 0.34**	$ 0.33
Diluted EPS (prior year pro forma)	**$ 0.34**	$ 0.32

3. Inventories

	December 31, 2005	**September 30, 2005**
(In millions)		
Raw materials	**$ 73.2**	$ 69.8
Work-in-process	**5.5**	4.6
Finished goods	**59.1**	67.9
Total inventories	**$ 137.8**	$ 142.3

4. Property, Plant and Equipment

	December 31, 2005	**September 30, 2005**
(In millions)		

Land	**$ 20.3**	$ 20.7
Buildings	**97.9**	102.4
Gaming operations equipment	**520.8**	483.2
Manufacturing machinery and equipment	**221.7**	220.1
Leasehold improvements	**11.3**	10.5
Construction in process	**47.4**	39.3
Total	**919.4**	876.2
Less accumulated depreciation and amortization	**(515.3)**	(491.0)
Property, plant and equipment, net	**$ 404.1**	$ 385.2

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Las Vegas facilities under construction totaled $34.6 million at December 31, 2005 and $25.1 million at September 30, 2005. During the current quarter, we listed our facilities in Rapid City, South Dakota for sale and reclassified net book value of $5.2 million to other assets held for sale.

5. Acquisition

On August 25, 2005, we completed the acquisition of WagerWorks, a provider of internet gaming technology, content and services. We anticipate this business combination will enable us to expand the distribution of IGT game content across remote channels and mediums, including the internet, and interactive television. We have not provided pro forma financial information for this acquisition, as it was not material to our consolidated results.

As the business valuation is not yet complete and the final consideration amount is subject to a working capital adjustment, the purchase price allocation is preliminary. As of December 31, 2005, we allocated the aggregate purchase price of $88.1 million to:

- tangible assets of $5.6 million, including $1.4 million in cash
- liabilities of $8.9 million
- identifiable intangibles of $31.0 million, including $10.1 million in patents, $7.0 million in contracts, and $13.9 million in developed technology
- $1.8 million of in-process R&D with no future alternative use, charged to R&D expense
- $58.6 million in goodwill not deductible for tax purposes

6. Allowances for Doubtful Notes and Contracts Receivable

(In millions)	**December 31, 2005**	September 30, 2005
Current	**$ 25.5**	$ 27.6
Long-term	**15.5**	15.2
	$ 41.0	$ 42.8

7. Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash or equivalents, short-term investments, and receivables. We place short-term investments in high credit quality financial institutions or in short duration high quality securities. With the exception of US Government and Agency securities, our investment policy limits the amount of credit exposure in any one financial institution, industry group or type of investment. Cash on deposit may be in excess of Federal Deposit Insurance Corporation limits.

Our revenues and resulting receivables are concentrated in specific legalized gaming regions. The composition of our accounts, contracts, and notes receivable at December 31, 2005 was:

Nevada	21%
California	11
Mississippi	6
Other (5% or less individually)	35
Total North America	**73%**

Europe	12%
Other (5% or less individually)	15
Total International	**27%**
Consolidated	**100%**

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8. Intangible Assets and Goodwill

Intangible additions

Patent additions during the current quarter, including capitalized legal costs, totaled $3.2 million with a weighted average life of 5 years.

Intangible Balances

	December 31, 2005			September 30, 2005		
	Cost	**Accumulated Amortization**	**Net**	**Cost**	**Accumulated Amortization**	**Net**
(In millions)						
Finite lived intangible assets						
Patents	**$322.7**	**$ 96.8**	**$225.9**	$323.3	$ 92.7	$230.6
Contracts	**18.8**	**6.7**	**12.1**	23.4	5.6	17.8
Trademarks	**5.0**	**4.1**	**0.9**	9.8	8.5	1.3
Developed technology	**39.6**	**9.4**	**30.2**	38.9	7.7	31.2
Customer relationships	**6.7**	**1.5**	**5.2**	6.7	1.3	5.4
Backlog				6.1	6.1	
Net carrying amount	**$392.8**	**$ 118.5**	**$274.3**	$408.2	$ 121.9	$286.3

Intangible Amortization

Our aggregate amortization expense totaled $11.3 million in the current quarter versus $9.2 million in the comparable prior year quarter.

	2006	**2007**	**2008**	**2009**	**2010**
(In millions)					
Estimated annual amortization	$ 44.5	$ 41.2	$ 37.3	$ 34.1	$ 30.6

Goodwill Activity by Segment

Quarter ended December 31, 2005	**North America**	**International**	**Total**
(In millions)			
Beginning balance	$ 994.3	$ 96.6	$1,090.9
WagerWorks purchase price adjustments		2.0	2.0
Tax benefit of Anchor options exercised	(0.3)		(0.3)
Foreign currency translation adjustment		(0.8)	(0.8)
Ending balance	$ 994.0	$ 97.8	$1,091.8

In accordance with EITF 00-23, *Issues Related to the Accounting for Stock Compensation under APB 25 and FIN 44*, goodwill was adjusted for the tax benefit of Anchor options exercised subsequent to acquisition.

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9. Credit Facilities & Indebtedness

Outstanding Balance	December 31, 2005	September 30, 2004
(In millions)		
Senior credit facility	**$ 200.0**	$ 208.8
Senior convertible debentures, net of unamortized discount	**605.0**	602.2
Total notes payable, net	**$ 805.0**	$ 811.0

We continue to be in compliance with all applicable debt covenants at December 31, 2005.

Senior Credit Facility

On December 20, 2005, we entered into an amended and restated unsecured $2.5 billion credit facility with a syndicate of banks, replacing the previous credit facility of $1.5 billion. The new five-year credit facility provides a $2.5 billion revolving line of credit, of which up to $100.0 million is available for letters of credit and up to $50.0 million is available for swingline (same day funds) borrowing. Borrowings outstanding totaled $200.0 million at December 31, 2005 and $4.2 million was reserved for letters of credit.

Interest rates and facility fees applicable to the credit facility are based on our public credit ratings and debt to capitalization ratio. Initially, the interest rate is LIBOR plus 37.5 bps with a facility fee of 12.5 bps. The revolver interest rate was 4.88% at December 31, 2005.

Financial covenants (as defined in the new facility agreement) include a minimum ratio of EBITDA to interest expense minus interest on jackpot liabilities and a maximum ratio of Debt to EBITDA. Absence of compliance with required covenants causes an event of default that, if not cured, could cause the entire outstanding borrowings under the credit facility to become immediately due and payable.

The new credit facility agreement also includes certain restrictions on our ability to:

ª incur additional debt, guarantee debt, or enter into swap agreements

ª incur liens

ª enter into business combinations, liquidate, or dissolve

ª sell, transfer, lease or dispose of substantially all assets

ª change the nature of the business

Foreign Credit Facilities

Our foreign credit facilities totaled $41.3 million, with no borrowings at December 31, 2005. Renewals occur annually in January and July.

Senior Convertible Debentures

The market price condition for convertibility was not met during the measurement period ended January 18, 2006. Based on holders rights to redemption on January 29, 2006, we classified the debentures in current liabilities at December 31, 2005. On January 29, 2006, 75 debentures were put to IGT for cash redemption. We will reclassify the Debentures to non-current liabilities in the second quarter of fiscal 2006, because the remaining holders are not able to put debentures to IGT for redemption again until January 29, 2008.

Holders have the right to require IGT to redeem the Debentures for an amount equal to accreted value plus accrued and unpaid cash interest, if any, on January 29, 2008, 2013, 2018, 2023 and 2028. On or after January 29, 2006, IGT may call the Debentures for redemption in cash equal to accreted value plus accrued and unpaid cash interest, if any. If IGT calls the debentures, holders will be notified at least 15 days, but not more than 60 days, prior to the redemption date and will have the right to convert prior to redemption.

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10. Earnings Per Share

The calculation of diluted EPS from continuing operations below reflects our outstanding debenture shares for all periods presented, in conjunction with the adoption of EITF 04-8, *The Effect of Contingently Convertible Debt on Diluted Earnings per Share,* in our first quarter of fiscal 2005.

	Quarters Ended December 31,	
	2005	**2004**
(In millions, except per share amounts)		
Income from continuing operations	**$ 120.6**	$ 122.4
After-tax interest expense on convertible debentures	**2.4**	2.4
Diluted EPS Numerator	**$ 123.0**	$ 124.8
Weighted average common shares outstanding:		
Basic	**337.1**	345.9
Dilutive effect of stock awards	**5.1**	7.7
Dilutive effect of debentures	**20.5**	20.5
Diluted EPS Denominator	**362.7**	374.1
Basic earnings per share	**$ 0.36**	$ 0.35
Diluted earnings per share	**$ 0.34**	$ 0.33
Weighted average antidilutive stock award shares excluded from diluted EPS	**9.1**	4.1

From the end of our first quarter through February 2, 2006, we repurchased 0.9 million additional common shares or approximately less than 1% of outstanding shares. There were no other transactions during this period that would have materially changed the number of basic or diluted shares outstanding.

11. Income Taxes

Our provision for income taxes is based on estimated effective annual income tax rates. The provision differs from income taxes currently payable because certain items of income and expense are recognized in different periods for financial statement purposes than for tax return purposes.

12. Comprehensive Income

	Quarters Ended December 31,	
	2005	**2004**
(In millions)		
Net income	**$ 120.6**	$ 122.4
Currency translation adjustments	**(0.1)**	4.4
Comprehensive income	**$ 120.5**	$ 126.8

13. Commitments and Contingencies

Litigation

IGT has been named in and has brought lawsuits in the normal course of business. We do not expect the outcome of these suits, including the lawsuits described below, to have a material adverse effect on our financial position or results of future operations.

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Alliance

On December 7, 2004, IGT filed a complaint in US District Court for the District of Nevada, alleging that defendants Alliance Gaming Corp., Bally Gaming Int l, Inc., and Bally Gaming, Inc. infringed six US patents held by IGT, US Patent numbers 6,827,646; 5,848,932; 5,788,573; 5,722,891; 6,712,698; and 6,722,985. On January 21, 2005, defendants filed an answer to IGT s complaint raising various affirmative defenses to IGT s asserted claims. Defendants also asserted fourteen counterclaims against IGT, including counterclaims for a declaratory judgment of non-infringement, invalidity, unenforceability of the asserted patents, antitrust violations and for intentional interference with prospective business advantage. IGT denies these allegations. In addition, IGT filed motions to strike portions of defendants answers and affirmative defenses and to dismiss certain of defendants counterclaims which were denied in January 2006. Discovery is ongoing.

Aristocrat

On June 30, 2005, Aristocrat Technologies Australia PTY Ltd. filed a patent infringement lawsuit against IGT. The Complaint was served on IGT on December 13, 2005. Aristocrat alleges that IGT has willfully infringed U.S. Patent No. 6,093,102. Aristocrat contends that the patent covers its Reel Power® video slot technology and IGT s Multiway® video slot games. The lawsuit seeks unspecified damages and an injunction. IGT believes that the patent is invalid and not infringed and intends to vigorously defend the lawsuit.

Brochu v. Loto Quebec

Loto Quebec commenced an action in warranty against VLC, Inc., a wholly-owned subsidiary of IGT, and another manufacturer of video lottery machines in October 2003 in the Superior Court of the Province of Quebec, District of Quebec, seeking indemnification for any damages that may be awarded against Loto Quebec in a class action suit, also filed in the Superior Court of the Province of Quebec. The class action against Loto Quebec, to which neither IGT nor any of its affiliates are parties, was filed by Jean Brochu on behalf of himself and a class of other persons who allegedly developed pathological behaviors through the play of video lottery machines made available by Loto Quebec in taverns and other public locations. In this action, plaintiff seeks to recover on behalf of the class damages of approximately CAD$578.7 million, representing CAD$4,863 per class member, and CAD$119.0 million in punitive damages. Loto Quebec is scheduled to file its Plea in Defense in the main action in February 2006. VLC s Plea in Defense in the warranty action is due in April 2006. The Court has scheduled trial of the entire action against Loto Quebec to commence in early 2007.

Environmental Matters

CCSC, a casino operation sold by IGT in April 2003, is located in an area that has been designated by the EPA as a superfund site as a result of contamination from historic mining activity in the area. The EPA is entitled to proceed against current and prior owners and operators of properties located within the site for remediation and response costs associated with their properties and with the entire site. CCSC is located within the drainage basin of North Clear Creek and is therefore subjected to potentially contaminated surface and ground water from upstream mining related sources. Soil and ground water samples on the site indicate that several contaminants exist in concentrations exceeding drinking water standards. We have applied the guidance in Statement of Position 96-1 Environmental Remediation Liabilities and determined that a liability has not yet been incurred.

Miller

In June 2003, a class action lawsuit was filed in Clark County, Nevada, District Court against Acres and its directors, entitled Paul Miller v. Acres Gaming Incorporated, et al. The complaint alleged that Acres directors breached their fiduciary duties to their stockholders in connection with the approval of the merger transaction between Acres and IGT and sought to enjoin and/or void the merger agreement among other forms of relief. On September 19, 2003, the Court denied plaintiff s motion for a TRO to prevent Acres stockholders from voting on the merger. On September 24, 2003, plaintiff petitioned the Nevada Supreme Court to vacate the denial of the TRO and to enjoin Acres from holding its stockholder vote on the merger. The Nevada Supreme Court denied the petition on September 25, 2003. The plaintiff s action also seeks damages. On December 23, 2003, defendants filed a motion to dismiss plaintiff s second amended complaint for failure to state a claim on which relief may be granted. On April 29, 2004, the Court issued a ruling denying defendant s motion to dismiss the second amended complaint. On May 12, 2004 the Court issued an order denying defendants motion to dismiss. Pursuant to stipulation of the parties on August 13, 2004, plaintiff filed a third amended complaint. Defendants have filed a motion to dismiss the third amended complaint. The Court has not yet ruled on this motion.

Nevada Sales/Use Tax Matter

In February 2003, an IGT employee, presently on administrative leave, filed a sealed complaint under Nevada s False Claims Act (State of Nevada ex rel. James McAndrews v. International Game Technology, Anchor Coin and Spin for Cash Wide Area Progressive) alleging that IGT failed to pay requisite Nevada sales/use taxes on certain Wheel of Fortune® games placed in Nevada since 1997 and in connection with royalties received under intellectual property licensing agreements related to the placement of Action Gaming games in Nevada since 1997. The Attorney General and IGT both filed motions to dismiss the complaint in January 2004, and the Court unsealed the action in February 2004. The Court denied both motions to dismiss the complaint on July 1, 2004. A Petition for Writ of Mandamus was filed with the Nevada Supreme Court in September 2004. The Court granted the petition. A stay of the lower court proceedings pending action by the Nevada Supreme Court was granted by the trial court in September 2004. The matter was argued and submitted to the Nevada Supreme Court in June 2005.

In October 2004 and again in July 2005, NDT advised us that we had a good-faith legal basis for our position that no sales tax was payable on royalties received, but that NDT believed that sales tax may be payable on some amount of the royalties. IGT disagrees with NDT s position that sales tax may be payable on any part of the royalties and continues to correspond with NDT on this issue.

OSHA Matter

On July 8, 2004, two former employees filed a complaint with the US Department of Labor, OSHA, alleging retaliatory termination in violation of the Sarbanes-Oxley Act of 2002. The former employees allege that they were terminated in retaliation for questioning whether Anchor and its executives failed to properly disclose information allegedly affecting the value of Anchor s patents in connection with IGT s acquisition of Anchor in 2001. The former employees also allege that the acquired patents are overvalued on the financial statements of IGT. Outside counsel, retained by an independent committee of our Board of Directors, reviewed the allegations and found them to be entirely without merit.

On November 10, 2004, the employees withdrew their complaint filed with OSHA and filed a notice of intent to file a complaint in federal court. On December 1, 2004, a complaint was filed under seal in the US District Court for Nevada. IGT filed a motion to dismiss the complaint in December 2004. The court denied the motion on May 2, 2005. IGT has appealed this denial to the US Court of Appeals for the Ninth Circuit. IGT believes that the allegations are without merit and intends to vigorously defend this matter.

In the purchase price allocation, IGT used the relief of royalty valuation methodology to estimate the fair value of the patents at $164.4 million, which is being amortized over the useful economic life. The carrying value of the patents at December 31, 2005 totaled $106.3 million, with a remaining life of approximately 10.25 years.

Poulos

Along with a number of other public gaming corporations, IGT was a defendant in three class action lawsuits, later consolidated into a single action. Plaintiffs alleged that the defendants engaged in fraudulent and misleading conduct by inducing people to play video poker machines and electronic slot machines, based on false beliefs concerning how the machines operate and the extent to which there is an opportunity to win on a given play. The amended complaint alleges that the defendants acts constituted violations of the Racketeer Influenced and Corrupt Organizations Act, giving rise to claims for common law fraud and unjust enrichment, and seeks compensatory, special, incidental and punitive damages of several billion dollars.

In December 1997, the Court denied the motions that would have dismissed the Consolidated Amended Complaint or that would have stayed the action pending Nevada gaming regulatory action. In June 2002, the Court denied the plaintiffs motion for class certification. An appeal of that denial was filed timely with the US Court of Appeals for the Ninth Circuit. The class plaintiffs did not appeal the decision and proceeded with only their individual claims. Prior to the scheduled trial date on September 7, 2005, the US District Court of Nevada granted the defendants pending motions for summary judgment. The plaintiffs timely filed a Notice of Appeal to the US Ninth Circuit Court.

Arrangements with Off-Balance Sheet Risks

In the normal course of business, we are party to financial instruments with off-balance sheet risk, such as performance bonds, guarantees and product warranties not reflected in our balance sheet. We do not expect any material losses to result from these arrangements, and we are not dependent on off-balance sheet financing arrangements to fund our operations.

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Performance Bonds

Performance bonds outstanding related to gaming operations totaled $29.1 million at December 31, 2005. We are liable to reimburse the bond issuer in the event of exercise due to nonperformance.

Letters of Credit

Outstanding letters of credit issued under our line of credit to ensure payment to certain vendors and governmental agencies totaled $4.2 million at December 31, 2005.

IGT Licensor Arrangements

Our sales agreements that include software and intellectual property licensing arrangements may provide a clause whereby IGT indemnifies the third party licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement. Should such a claim occur, we could be required to make payments to the licensee for any liabilities or damages incurred. Historically, we have not incurred any significant costs due to infringement claims. As we consider the likelihood of recurring future costs to be remote, no liability has been recorded.

Product Warranties

Our warranty costs in the table below are accrued based on historical trends in product failure rates and expected costs to provide warranty services. The majority of our products are generally covered by a warranty for periods ranging from 90 days to one year.

Quarters ended December 31,	**2005**	**2004**
(In millions)		
Balance at beginning of year	**$ 6.0**	$ 6.9
Reduction for payments made	**(1.6)**	(2.6)
Accrual for new warranties issued	**3.5**	3.0
Adjustments for pre-existing warranties	**(0.3)**	(1.5)
Balance at end of period	**$ 7.6**	$ 5.8

Self-Insurance

We are self-insured for various levels of workers compensation, directors and officers liability, electronic errors and omissions liability, as well as employee medical, dental, prescription drug, and disability coverage. We purchase stop loss coverage to protect against unexpected claims. Accrued insurance claims and reserves include estimated settlements for known claims, and actuarial estimates of claims incurred but not reported.

State and Federal Taxes

We are subject to sales, use, income and other tax audits and administrative proceedings in various federal, state, and local jurisdictions. While we believe we have properly reported our tax liabilities in each jurisdiction, we can give no assurance that taxing authorities will not propose adjustments that increase our tax liabilities.

14. Derivatives

Foreign Currency Hedging

At December 31, 2005, we hedged $139.4 million of net foreign currency exposure with $129.8 million in forward currency contracts versus $138.8 million of exposure hedged with $127.2 million in forward currency contracts at September 30, 2005.

Debentures Yield Adjustment

The yield adjustment feature of our debentures requires contingent cash interest payments that are triggered by our stock price and is thus considered an embedded derivative under SFAS 133 requiring bifurcation. However, if an upward adjustment were anticipated to go into effect, IGT could exercise its redemption right. Therefore, an investor could be expected to attribute no economic value to the yield adjustment feature. Accordingly, we have ascribed no value and recorded no derivative asset or liability for this embedded derivative.

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15. Business Segments

We view our business in two regional operating segments, each incorporating all types of revenues:

- The North America Division aggregates our operations in the US and Canada, including the IGT Systems Group.
- The International Division aggregates our operations in Asia, Australia, New Zealand, Europe, Japan, Latin America, Russia, South Africa, and the UK.

Our business segments are designed to allocate resources within a framework of management responsibility. Operating costs from one segment may benefit other segments. We continually evaluate the alignment of our business development and administrative functions for reporting purposes, which may result in changes to segment allocations. Prior year amounts are reclassified to conform to the current management view and presentation.

The Corporate Division administers certain unallocated income and expenses related to company-wide initiatives, including capital deployment, treasury and cash management, as well as administrative and oversight functions such as human resources, information systems, and legal counsel. The Corporate Division includes all income and expenses related to debt, certain investment securities, hedging and other corporate assets.

We do not recognize inter-company revenues or expenses upon the transfer of gaming products between divisions. The North America Division includes revenues from Canada totaling $18.7 million in the first quarter of fiscal 2006, versus $17.6 million in comparable prior period. IGT s segment profit reflects income before tax.

	Quarters Ended December 31,	
	2005	**2004**
(In millions)		
North America Division		
Revenues	**$483.5**	$463.4
Product sales	**206.7**	182.1
Gaming operations	**276.8**	281.3
Segment profit	**184.8**	169.3
International Division		
Revenues	**$132.7**	$177.8
Product sales	**117.8**	172.2
Gaming operations	**14.9**	5.6
Segment profit	**32.4**	48.7
Corporate Division		
Segment profit	**$ (28.7)**	$ (26.7)
Consolidated		
Revenues	**$616.2**	$641.2
Product sales	**324.5**	354.3
Gaming operations	**291.7**	286.9
Segment profit	**188.5**	191.3

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

COMPANY OVERVIEW

The following discussion is intended to enhance the reader s understanding of changes in the financial condition and results of operations of International Game Technology. It should be read in conjunction with our Annual Report on Form 10-K for the year ended September 30, 2005. Throughout this section, table amounts are presented in millions, except units, ASP, ARPU, ARDU, and EPS.

Italicized text with an attached superscript trademark or copyright notation in this document indicates trademarks of IGT or its licensors. For a complete list of trademark and copyright ownership information, please visit our website at www.IGT.com.

Our management s discussion and analysis is organized into the following sections:

- OUR BUSINESS a general description of our business and operating segments
- OUR FOCUS a summary of our strategies and opportunities
- RECENTLY ISSUED ACCOUNTING STANDARDS a discussion of recently issued accounting standards with significance to our business
- CRITICAL ACCOUNTING ESTIMATES a discussion of accounting policies that require critical judgments and estimates
- CONSOLIDATED OPERATING RESULTS a first quarter year-over-year comparative analysis of net income
- BUSINESS SEGMENT RESULTS a first quarter year-over-year comparative analysis of business segment results
- LIQUIDITY AND CAPITAL RESOURCES a first quarter year-over-year comparative analysis of cash flows and capital resources
- FINANCIAL CONDITION - analysis of significant changes in our financial position

OUR BUSINESS

International Game Technology is a global company specializing in the design, development, manufacturing, distribution and sales of computerized gaming machines and systems products. We strive to maintain a diverse portfolio of gaming products that span a wide range of categories and target customer markets with a variety of games, platforms and systems offered across gaming jurisdictions worldwide.

We had annual revenues of $2.4 billion in fiscal 2005. We derive our revenues in two ways, either from the sale (product sales) or placement (gaming operations) of our gaming products, services and/or intellectual property. Operating results reviewed by our chief decision makers encompass all revenue sources within each geographical customer region. We view our business in two regional operating segments, each incorporating all types of revenues:

- The North America Division, encompasses our operations in the US and Canada, including the IGT Systems group
- The International Division oversees our efforts abroad in Asia, Australia, New Zealand, Europe, Japan, Latin America, Russia, South Africa, and the UK

Additionally, our Corporate Division administers certain unallocated income and expenses related to company-wide initiatives. See the BUSINESS SEGMENT RESULTS below and Note 15 of our Unaudited Condensed Consolidated Financial Statements for additional segment information and financial results.

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OUR FOCUS

Product Demand

Demand for our products is driven principally by:

ª technological innovations that create new, more sophisticated games and/or customer cost savings

ª new or expanding gaming properties

ª establishment or expansion of legalized gaming jurisdictions

ª entertainment value to the player

ª manufacturer s reputation and reliability

Our product demand can fluctuate based on a number of variables and particularly the timing of product shipments and play levels of our gaming operations machines. We expect that future replacement sales of our machines will be driven by customer desire to update their floor with new games and technology. We anticipate an acceleration of this trend as we transition to server-based technology.

We see opportunities to grow our business through increased profit contributions from our international operations, new domestic markets and through growth in the installed base of our gaming operation machines. We also see margin expansion opportunities generated by our diversified product mix and increased revenues from non-machine products. Non-machine sales include systems, parts, con