

INTERNATIONAL GAME TECHNOLOGY
Form 10-Q
August 12, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended: June 28, 2003

OR

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

For the transition period from _____ to _____

Commission File Number 001-10684

INTERNATIONAL GAME TECHNOLOGY

(Exact name of registrant as specified in charter)

Nevada
(State of Incorporation)

88-0173041
(IRS Employer Identification No.)

9295 Prototype Drive, Reno, Nevada 89521
(Address of principal executive offices)

(775) 448-7777
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

OR

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

Yes No

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

<u>Class</u>	<u>Outstanding at July 26, 2003</u>
Common Stock par value \$.00015625 per share	345,063,060

International Game Technology

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements**Unaudited Condensed Consolidated Statements of Income**

	Quarters Ended		Nine Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
<i>(Amounts in thousands, except per share amounts)</i>				
Revenues				
Product sales	\$ 300,068	\$ 222,429	\$ 795,847	\$ 628,359
Gaming operations	261,853	261,190	784,795	618,039
Lottery systems	35,749	32,570	111,349	67,299
Total revenues	597,670	516,189	1,691,991	1,313,697
Costs and expenses				
Cost of product sales	156,556	128,140	414,506	362,864
Cost of gaming operations	126,322	119,489	369,818	283,241
Cost of lottery systems	23,478	22,476	73,057	46,377
Selling, general and administrative	73,013	64,701	214,379	170,380
Depreciation and amortization	13,177	13,108	40,619	32,134
Research and development	23,844	18,390	68,124	56,421
Provision for bad debts	2,537	3,974	9,550	14,988
Total costs and expenses	418,927	370,278	1,190,053	966,405
Earnings (losses) of unconsolidated affiliates	(152)	(345)	(497)	32,772
Income from operations	178,591	145,566	501,441	380,064
Other income (expense)				

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	Quarters Ended		Nine Months Ended	
Interest income	14,154	14,030	38,827	37,880
Interest expense	(31,281)	(31,074)	(87,573)	(88,428)
Loss on the sale of assets	(51)	(213)	(113)	(73)
Minority interest	(225)	--	(562)	--
Other	1,165	49	1,671	(1,509)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Other expense, net	(16,238)	(17,208)	(47,750)	(52,130)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income from continuing operations before tax	162,353	128,358	453,691	327,934
Provision for income taxes	59,392	48,460	169,227	123,619
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income from continuing operations	102,961	79,898	284,464	204,315

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Unaudited Condensed Consolidated Statements of Income

	Quarters Ended		Nine Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
<i>(Amounts in thousands, except per share amounts)</i>				
Income from discontinued operations, net of tax	\$ 1,891	\$ 2,730	\$ 5,834	\$ 4,003
Loss on sale of discontinued operations, net of tax	(1,167)	--	(7,912)	--
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income (loss) from discontinued operations, net of tax of \$390, \$1,655, \$(1,241) and \$2,555	724	2,730	(2,078)	4,003
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 103,685	\$ 82,628	\$ 282,386	\$ 208,318
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Basic earnings per share				
Continuing operations	\$ 0.30	\$ 0.22	\$ 0.83	\$ 0.61
Discontinued operations	0.00	0.01	(0.01)	0.01
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 0.30	\$ 0.23	\$ 0.82	\$ 0.62
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted earnings per share				
Continuing operations	\$ 0.30	\$ 0.22	\$ 0.81	\$ 0.60
Discontinued operations	0.00	0.01	(0.01)	0.01
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 0.30	\$ 0.23	\$ 0.80	\$ 0.61
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Weighted average common shares outstanding	342,367	357,960	344,009	335,557

	<u>Quarters Ended</u>		<u>Nine Months Ended</u>	
Weighted average common and potential shares outstanding	349,755	363,329	350,978	341,607

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Unaudited Condensed Consolidated Balance Sheets

	<u>June 28, 2003</u>	<u>September 28, 2002</u>
<i>(Amounts in thousands, except shares and par value)</i>		
Assets		
Current assets		
Cash and cash equivalents	\$ 1,139,260	\$ 421,405
Investment securities, at market value	4,057	13,493
Accounts receivable, net of allowances for doubtful accounts of \$23,500 and \$18,272	376,082	311,936
Current maturities of long-term notes and contracts receivable, net of allowances	85,647	60,710
Inventories, net of allowances for obsolescence of \$26,809 and \$24,677		
Raw materials	77,703	65,028
Work-in-process	7,415	5,267
Finished goods	59,773	69,552
	<u>144,891</u>	<u>139,847</u>
Total inventories	144,891	139,847
Investments to fund liabilities to jackpot winners	41,322	39,932
Deferred income taxes	42,738	3,511
Prepaid expenses and other	32,304	47,018
Assets of discontinued operations held for sale	13,993	172,758
Other assets held for sale	4,523	--
	<u>1,884,817</u>	<u>1,210,610</u>
Total current assets	1,884,817	1,210,610
Long-term notes and contracts receivable, net of allowances and current maturities	<u>152,056</u>	<u>136,629</u>
Property, plant and equipment, at cost		
Land	20,109	21,557
Buildings	83,816	85,784
Gaming operations equipment	320,574	285,155
Manufacturing machinery and equipment	191,942	168,985
Leasehold improvements	10,059	9,355
	<u>626,500</u>	<u>571,736</u>

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	June 28,	September 28,
Total	626,500	570,836
Less accumulated depreciation and amortization	(333,992)	(283,000)
	<hr/>	<hr/>
Property, plant and equipment, net	292,508	287,836
	<hr/>	<hr/>
Investments to fund liabilities to jackpot winners	336,485	329,802
Deferred income taxes	72,865	82,916
Intangible assets, net	243,610	271,024
Goodwill, net	980,464	967,424
Other assets	72,758	29,577
	<hr/>	<hr/>
	\$ 4,035,563	\$ 3,315,818
	<hr/>	<hr/>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Unaudited Condensed Consolidated Balance Sheets

	June 28,	September 28,
	2003	2002
<hr/>		
<i>(Amounts in thousands, except shares and par value)</i>		
Liabilities, Minority Interest and Stockholders' Equity		
Current liabilities		
Current maturities of long-term notes payable and capital lease obligations	\$ 406,434	\$ 8,519
Accounts payable	75,494	76,837
Jackpot liabilities	153,617	167,097
Accrued employee benefit plan liabilities	49,181	47,156
Dividends payable	25,796	--
Accrued interest	11,051	29,998
Accrued income taxes	580	45,762
Other accrued liabilities	157,690	121,770
Liabilities of discontinued operations	2,957	13,920
	<hr/>	<hr/>
Total current liabilities	882,800	511,059
	<hr/>	<hr/>
Long-term notes payable and capital lease obligations, net of current maturities	1,151,715	971,375
Long-term jackpot liabilities	387,467	380,567
Other liabilities	13,425	11,010
	<hr/>	<hr/>
	2,435,407	1,874,011
	<hr/>	<hr/>
Minority Interest	9,313	8,663
	<hr/>	<hr/>
Commitments and Contingencies	--	--

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June 28, September 28,

Stockholders' Equity

Common stock, \$.00015625 par value; 1,280,000,000 shares authorized; 701,757,952 and 696,667,752 shares issued	110	109
Additional paid-in capital	1,507,454	1,451,385
Deferred compensation	(6,338)	(10,748)
Retained earnings	1,784,873	1,528,284
Treasury stock; 357,806,048 and 349,362,448 shares, at cost	(1,691,959)	(1,530,434)
Accumulated other comprehensive loss	(3,297)	(5,452)
	<u>1,590,843</u>	<u>1,433,144</u>
	<u>\$ 4,035,563</u>	<u>\$ 3,315,818</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Unaudited Condensed Consolidated Statements of Cash Flows

Nine Months Ended

June 28, 2003 June 29, 2002

(Amounts in thousands, except shares and par value)

Cash flows from operating activities

Net income	\$ 282,386	\$ 208,318
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	117,211	98,667
Discounts and deferred offering costs	8,296	654
Stock-based compensation	2,817	2,421
Provision for bad debts	9,550	14,988
Provision for inventory obsolescence	11,593	11,575
Loss on sale of assets	113	73
Loss on redemption of debt	--	1,459
Loss on sale of discontinued operations	12,622	--
(Increase) decrease in operating assets:		
Receivables	(117,344)	8,454
Inventories	(15,622)	18,190
Prepaid expenses and other	16,909	21,233
Other assets	(40,169)	(3,239)
Net accrued and deferred income taxes, net of tax benefit of employee stock plans	(53,742)	54,383
Increase (decrease) in accounts payable and accrued liabilities	7,548	(49,325)
Earnings of unconsolidated affiliates less than distributions	497	10,578

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	Nine Months Ended	
	<u> </u>	<u> </u>
Total adjustments	(39,721)	190,111
Net cash provided by operating activities	<u>242,665</u>	<u>398,429</u>
Cash flows from investing activities		
Investment in property, plant and equipment	(32,597)	(21,873)
Investment in gaming operations equipment	(70,807)	(44,019)
Proceeds from sale of property, plant and equipment	1,516	804
Proceeds from sale of other assets	--	14,000
Proceeds from sale of discontinued operations	142,507	--
Investment securities:		
Purchases	--	(12,715)
Proceeds	10,000	6,030
Investments to fund liabilities to jackpot winners:		
Purchases	(19,029)	(14,849)
Proceeds	28,296	25,276
Loans receivable:		
Cash advanced	(11,260)	(5,869)
Payments received	19,291	16,834
Investment in unconsolidated affiliates	(400)	(440)
Acquisition of businesses	--	124,060
Net cash provided by investing activities	<u>67,517</u>	<u>87,239</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Unaudited Condensed Consolidated Statements of Cash Flows

	Nine Months Ended	
	<u> </u>	<u> </u>
	June 28, 2003	June 29, 2002
<i>(Amounts in thousands)</i>		
Cash flows from financing activities		
Long-term debt:		
Proceeds	\$ 564,201	\$ 1,173
Principal payments	(4,796)	(143,888)
Premium paid on early redemption	--	(3,797)
Jackpot liabilities:		
Collections from systems	196,966	137,125
Payments to winners	(223,055)	(136,933)
Proceeds from employee stock plans	38,737	67,294
Share repurchases	(161,321)	(249,270)
Net cash provided by (used in) financing activities	<u>410,732</u>	<u>(328,296)</u>

	Nine Months Ended	
	2003	2002
Effect of exchange rate changes on cash and cash equivalents	(3,059)	2,407
Net increase in cash and cash equivalents	717,855	159,779
Cash and cash equivalents at:		
Beginning of period	421,405	364,234
End of period	\$ 1,139,260	\$ 524,013

Supplemental Statements of Cash Flows Information

Depreciation and amortization reflected in the statements of cash flows includes the amounts presented separately on the statements of income, plus depreciation that is classified as a component of cost of product sales, cost of gaming operations and cost of lottery systems.

	Nine Months Ended	
	June 28, 2003	June 29, 2002
<i>(Amounts in thousands)</i>		
Payments of interest	\$ 80,848	\$ 94,140
Payments of income taxes	217,208	59,748
Non-cash items:		
Tax benefit of employee stock plans	17,912	31,430
Increase in notes receivable from sale of Pala management contract, asset held for sale	--	63,000
Dividends declared, but not yet paid	25,796	--
Acquisitions:		
Fair value of assets acquired	--	1,546,478
Fair value of liabilities assumed	--	701,161
Fair value of equity issued, net	--	969,377

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Organization and Significant Accounting Policies

Organization

International Game Technology is recognized as one of the world leaders in the development and production of computerized gaming products. We operate in three lines of business: product sales, proprietary gaming and lottery systems. Founded in 1980, IGT principally served the gaming industry in the United States (US). In 1986, we began expanding our business internationally. In addition to our US production, we currently manufacture our products in the United Kingdom and through third party manufacturers in Japan, Canada, and Germany. We also maintain sales offices in selected legalized gaming jurisdictions globally, including Australia, Europe, Japan, Latin America, New Zealand and South Africa.

Unless the context indicates otherwise, references to International Game Technology, IGT, we, our, or the Company includes International Game Technology and our wholly-owned subsidiaries and their subsidiaries. Our principal executive offices are located at 9295 Prototype Drive, Reno, Nevada 89521; our telephone number is (775) IGT-7777; our Internet address is www.IGT.com. Through our Internet website, we make available free of charge, as soon as reasonably practical after such information has been filed or furnished to the Securities and Exchange Commission (SEC), our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act. Italicized text indicates trademarks of IGT or its licensors. For a complete list of trademark and copyright ownership information, please visit our website.

Significant Accounting Policies

Basis of Presentation and Consolidation

Our consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC and include all adjustments necessary to fairly present our consolidated results of operations, financial position, and cash flows for each period presented. Results for interim periods are not necessarily indicative of results for the full year. This quarterly report should be read in conjunction with our Annual Report on Form 10-K for the year ended September 28, 2002. Certain prior period amounts have been reclassified to conform to our current presentation.

Our consolidated financial statements include the accounts of International Game Technology and all of its wholly-owned and majority-owned subsidiaries, as well as a 24% interest in a company where we have effective control because we maintain 50.1% of the voting power through 2005. All appropriate intercompany accounts and transactions have been eliminated. We account for investments in 50% or less owned joint ventures using the equity method. For strategic marketing alliances where no separate legal entity exists, we recognize all assets, liabilities, revenues and expenses that we own, owe, earn and incur based on the activities that we perform on behalf of the alliance.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, the seller's price to the buyer is fixed or determinable, collectibility is reasonably assured and delivery has occurred.

Product Sales

We generally recognize revenue upon delivery of our products to customers, upon fulfillment of acceptance terms, if any, when no significant contractual obligations remain and collection of the related receivable is reasonably assured. Revenue is reported net of incentive rebates or discounts. Revenue related to customized research and development contracts is recognized as the related work is delivered. We recognize license fee revenue from business affiliates over the term of the associated agreement unless the fee is in exchange for products delivered or services performed that represent the culmination of a separate earnings process. Amounts received prior to revenue recognition are recorded as deferred revenue. Our sales credit terms are normally 90 days or less. We also grant extended payment terms under contracts of sale secured by the related equipment sold, generally for terms of one to five years with interest recognized at prevailing rates.

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Revenue from the sale of software and license fee agreements is generally recognized based on basic and key conditions of each agreement. If software does not require substantial customization, modification, or production, then as any other product, revenue can be recognized based on our general revenue recognition policy. We generally defer recognition of revenue for software license agreements that include multiple elements until the fair value of the delivered elements can be fairly established or all essential elements of the arrangement have been delivered. Software license agreements with post-contract customer support terms are recognized ratably over the term of the contract including a proportionate amount of any discount given.

Proprietary Gaming

Our proprietary gaming segment is comprised of our wholly-owned gaming operations, which includes activities that we perform on behalf of our strategic marketing alliances for which no separate legal entities exist, as well as our unconsolidated joint venture activities reported as earnings of unconsolidated affiliates. Because our joint venture operations are an integral part of our business and the nature of the products and management are the same, our earnings of unconsolidated affiliates are included as a component of income from operations. IGT and Anchor Gaming (Anchor) were 50% partners in our largest joint venture, The Spin For Cash Wide Area Progressive Joint Venture (JV). Subsequent to the acquisition of Anchor on December 30, 2001, the activities of the JV have been consolidated.

We place games in both casinos and government-sponsored gaming markets under a broad spectrum of recurring revenue pricing arrangements, including wide area progressive (WAP) systems, stand-alone participation and flat fee, equipment leasing and rental, as well as hybrid pricing or premium products that include a product sale and a recurring fee. WAP games differ from stand-alone and hybrid games in that they are electronically linked, inter-casino systems that connect gaming machines to a central computer, allowing the system to build a progressive jackpot with every wager until a player hits the top award winning combination. WAP game revenues are recognized based on a percentage of coin-in generated by the game. Revenues from stand-alone games are recognized based on a percentage of the net win that the game generates or on a flat fee basis with the passage of time. The operation of linked progressive systems varies among jurisdictions as a result of different gaming regulations. Participating casinos pay a percentage of the coin-in either directly to IGT, an administrator, or a trust to oversee and fund the progressive jackpot. Funding of the jackpots also differs by jurisdiction but is generally administered by IGT.

Our linked progressive systems in Iowa are operated under a trust consisting of one member from each Iowa casino operating multi-linked games related to the trust. As administrator, IGT provides all of the services associated with the operation of the trust. Fees paid to IGT consist of funds generated by the trust in excess of the amount necessary to fund the jackpot liabilities. IGT recognizes revenue based on the trust profits. In Atlantic City, New Jersey, our linked progressive slot system operations are administered by several trusts managed by representatives of the participating casinos. Separate trusts exist for each system linked by a progressive meter. Fees paid to IGT are a function of each trust's adequate cash flow. We recognize revenues from these trusts based on estimated collectibility.

Lottery and Pari-mutuel Systems

Revenue from the sale of lottery and pari-mutuel gaming systems equipment and related parts is generally recognized upon delivery to the customer. Revenues from sales of lottery and video gaming central site systems (including customized software and equipment) are recognized using the percentage of completion method for long-term construction type contracts where costs to complete the contract can reasonably be estimated. Prior to revenue recognition on central site systems, costs incurred are applied against progress billings and recorded as a net accrued liability or other current asset as appropriate. Systems contract services revenue is recognized as the services are performed. These long-term contracts require installation and operation of lottery and pari-mutuel wagering networks and the related revenue is generally based on a percentage of sales volume, which may fluctuate over the lives of the contracts. See Note 2 regarding discontinued pari-mutuel operations.

Casino Operations

In accordance with industry practice, we recognize casino gaming revenue as the net win from casino operations, which is the difference between amounts wagered and payments made to casino players. Slot route revenue is recognized based on our share of coins wagered or on our share of net winnings. Revenue excludes the retail value of complimentary food and beverage furnished gratuitously to customers. Revenue is also reported net of cash rebates accrued to customers as part of the casino loyalty programs. See Note 2 regarding discontinued casino operations.

Stock-based Compensation

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On October 1, 1996, we adopted Statement of Financial Accounting Standards (SFAS) 123, Accounting for Stock-Based Compensation, which establishes a fair value based method of accounting for stock compensation plans with employees and others. As permitted by SFAS 123, we continue to account for stock-based compensation plans in accordance with the Accounting Principles Board (APB) Opinion 25 intrinsic value method, which determines the compensation cost of stock options issued for non-variable plans such as ours as the difference between the quoted market value at the measurement date and the amount, if any, required to be paid by employees. Our stock-based compensation plans are predominantly non-compensatory plans where the option price is equal to or greater than the trading price of our stock on the date of the option grant and therefore, no compensation cost is recorded. Our reported results include stock-based compensation under APB 25 resulting from the modification of outstanding options, including acquisition conversion modifications, and the issuance of restricted stock awards. See Note 12 for pro forma stock-based compensation costs that would have been charged to operations had the SFAS 123 fair value method been applied.

Recently Issued Accounting Standards

SFAS 143

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, Accounting for Asset Retirement Obligations. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement applies to all entities and to all legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and the normal operation of a long-lived asset, except for certain obligations of lessees. We adopted SFAS 143 at the beginning of fiscal 2003. The adoption of this statement did not have a material impact on our results of operations or financial position.

SFAS 144

In August 2001, the FASB issued SFAS 144, Accounting for the Impairment and Disposal of Long-Lived Assets. This statement requires one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired and broadens the presentation of discontinued operations to include additional disposal transactions. We adopted SFAS 144 at the beginning of fiscal 2003. The adoption of this statement did not have a material impact on our results of operations or financial position.

SFAS 145

In April 2002, the FASB issued SFAS 145, Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement 13, and Technical Corrections. SFAS 145 rescinds SFAS 4, Reporting Gains and Losses from Extinguishment of Debt. Under SFAS 4, all gains and losses from extinguishment of debt were required to be aggregated, if material, and classified as an extraordinary item, net of related income tax effect, on the statement of income. SFAS 145 requires all gains and losses from extinguishment of debt to be classified as extraordinary only if they meet the criteria of APB Opinion 30. We adopted SFAS 145 at the beginning of fiscal 2003. Accordingly, losses on the extinguishment of debt that were classified as extraordinary items in prior periods have been reclassified to other expense in continuing operations.

SFAS 146

In June 2002, the FASB issued SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. A fundamental conclusion reached by the FASB in this statement is that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. SFAS 146 also establishes that fair value is the objective for initial measurement of the liability. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of this statement did not have a material impact on our results of operations or financial position.

SFAS 148

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In December 2002, the FASB issued SFAS 148, Accounting for Stock-Based Compensation-Transition and Disclosure. This Statement amends SFAS 123, Accounting for Stock-Based Compensation, 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 Statement 123 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. The disclosure requirements of this statement were effective for our interim financial statements for the quarter ended March 2003. See Note 12.

SFAS 149

In April 2003, the FASB issued SFAS 149, Amendments of Statement 133 on Derivative Instruments and Hedging Activities. This Statement amends SFAS 133, Accounting for Derivative and Instruments and Hedging Activities, and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and or hedging activities under SFAS 133. This statement is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. The provisions of this statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. The adoption of this statement is not expected to have a material impact on our results of operations or financial position.

SFAS 150

In May 2003, the FASB issued SFAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Financial instruments that are within the scope of the statement, which previously were often classified as equity, must now be classified as liabilities. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement is not expected to have a material effect on our results of operations or financial position.

FIN 45

In November 2002, the FASB issued FASB Interpretation (FIN) 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 expands the disclosures required by guarantors for obligations under certain types of guarantees. It also requires initial recognition at fair value of a liability for such guarantees. We adopted the disclosure requirements of FIN 45 for the quarter ended December 28, 2002 and the liability recognition requirements to all guarantees issued or modified after December 31, 2002. The adoption of these requirements did not have a material impact on our results of operations or financial position.

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FIN 46

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities (VIEs). FIN 46 establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. FIN 46 also requires disclosures about unconsolidated VIEs in which the Company has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to VIEs created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain disclosure requirements apply to all financial statements issued after January 31, 2003.

We continue to evaluate the impact of this interpretation on our financial condition and results of operations. Based on our analysis, we will be required to consolidate the progressive systems trusts in Iowa and New Jersey when the consolidation requirements become effective for our fourth quarter ending September 2003. Our linked progressive systems in Iowa and New Jersey are administered by trusts that collect contribution fees from participating casinos and manage the jackpot liabilities and payments to winners. At June 28, 2003, these unconsolidated entities collectively recorded total assets of \$198.9 million, total liabilities of \$218.0 million, including \$33.5 million due to IGT that will be eliminated upon consolidation, and total revenues for the nine months ended June 2003 of \$106.5 million. We do not believe that consolidation of these entities will have a material impact to our net income. We are not able to estimate the maximum exposure to loss as a result of our involvement with these entities as it is based on future operations of the linked progressive jackpot systems. Historically, we have incurred no losses as a result of our involvement in these entities since the first trust was formed in 1990.

2. Acquisitions, Divestitures and Discontinued Operations

Acquisitions

Acres

In June 2003, we entered into a definitive merger agreement with Acres Gaming (Acres). Acres specializes in the development of gaming systems technology that enables casino operators to increase patron loyalty. Terms of the agreement call for IGT to pay \$11.50 per share in an all cash transaction, representing an aggregate purchase price of approximately \$130.0 million. The merger is subject to the approval of Acres stockholders, various regulatory approvals, including gaming regulators and Hart-Scott-Rodino antitrust, and other conditions.

Anchor

On December 30, 2001, we completed our acquisition of Anchor in a stock for stock exchange. Anchor shareholders received one share of IGT common stock for each share of Anchor common stock owned. This acquisition afforded us additional opportunities to use our complementary resources to develop new games more effectively for the benefit of our customers. In addition, with Anchor we grew our business presence in the government-operated public gaming sector and expanded our business activities into online lottery systems. We believe our combined resources make us a more effective supplier to the gaming and lottery industries.

The aggregate purchase price paid for Anchor was \$986.9 million, plus the assumption of Anchor's outstanding debt of \$337.0 million, net of discount. The purchase price included 56.9 million shares of IGT common stock valued at \$14.87 per share (adjusted for the four-for-one stock split) exchanged for Anchor common stock, \$93.0 million for Anchor stock options assumed by IGT, \$3.7 million of Anchor shares held by IGT prior to the acquisition, and \$3.5 million of transaction costs. The share price used to determine the purchase price for accounting purposes was based on the average closing market prices of IGT's common stock for the seven trading days ended July 12, 2001, which includes the three trading days before and after the acquisition announcement on July 9, 2001.

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We finalized our allocation of the Anchor acquisition purchase price in December 2002 under the guidance of SFAS 141. See Note 5 for the purchase price allocation to identifiable intangible assets and goodwill. Prior to the Anchor acquisition, the JV activities were accounted for under the equity method and its revenues were reflected, net of expenses, as earnings of unconsolidated affiliates in our statements of income. Subsequent to the acquisition, the JV activities have been consolidated.

The following table presents our final allocation of the Anchor acquisition purchase price, including the consolidation of the JV:

	Total	Discontinued Operations Reclass	Net
<i>(Amounts in thousands)</i>			
Cash acquired	\$ 123,104	\$ --	\$ 123,104
Assets held for sale	77,000	167,621	244,621
Accounts and notes receivable	88,156	(7,588)	80,568
Inventory	18,974	(5,023)	13,951
Property and equipment	153,926	(60,861)	93,065
Investments to fund liabilities to jackpot winners	102,880	--	102,880
Identifiable intangible assets	288,839	(74,769)	214,070
Goodwill	853,614	(16,978)	836,636
Investment in JV	(64,758)	--	(64,758)
Other current assets	27,520	(849)	26,671
Other long-term assets	2,446	(1,553)	893
Total assets	\$ 1,671,701	\$ --	\$ 1,671,701

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		Discontinued	
Accounts payable	\$ 14,370	\$ (1,150)	\$ 13,220
Liabilities of discontinued operations	--	9,439	9,439
Notes payable	377,292	--	377,292
Jackpot liabilities	168,610	--	168,610
Other liabilities	142,052	(8,289)	133,763
	<hr/>	<hr/>	<hr/>
Total liabilities	702,324	--	702,324
	<hr/>	<hr/>	<hr/>
Deferred compensation	(13,973)	--	(13,973)
Common stock and additional paid-in capital	983,350	--	983,350
	<hr/>	<hr/>	<hr/>
Total equity	969,377	--	969,377
	<hr/>	<hr/>	<hr/>
Total liabilities and equity	\$ 1,671,701	\$ --	\$ 1,671,701

The following unaudited pro forma financial information is presented as if the Anchor acquisition had been effective at the beginning of fiscal 2002:

	Nine Months Ended	
	June 2003 (Actual)	June 2002 (Pro Forma)
<hr/>		
<i>(Amounts in thousands, except per share amounts)</i>		
Total revenues	\$ 1,691,991	\$ 1,492,743
Income from continuing operations	284,464	217,530
Income (loss) from discontinued operations	(2,078)	3,977
Net income	282,386	221,507
Earnings per share		
Basic	0.82	0.66
Diluted	0.80	0.65

Divestitures and Discontinued Operations

In June 2002, we determined that the casino and route operations acquired with Anchor were not a strategic fit with our core business and committed to a plan to sell the two Colorado casinos (Colorado Central Station and Colorado Grande Casino) and the Nevada slot route acquired with Anchor. In February 2003, we closed the sale of substantially all of the assets of the Nevada slot route operations of our subsidiary, Anchor Coin, for a cash price of \$60.5 million. In April 2003, we closed the sale of the two Colorado casinos for total proceeds of \$82.0 million. Collectively, we recognized a loss of \$1.1 million on these divestitures.

In March 2003, we additionally committed to a plan to sell the non-strategic pari-mutuel wagering business purchased with Anchor, United Tote (UT). Based on preliminary offers from prospective buyers, we recorded an estimated loss on sale of \$10.8 million or \$6.8 million, net of tax. The UT operations were previously included as a component of our lottery systems segment.

The casino, route and UT operations have been reclassified to discontinued operations and assets held for sale in all periods presented. We ceased depreciation and amortization for our discontinued operations when they were reclassified to held for sale.

The results of our discontinued operations are summarized below:

	Quarters Ended	Nine Months Ended
Divestitures and Discontinued Operations		

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	June 2003	June 2002	June 2003	June 2002
<i>(Amounts in thousands)</i>				
Net revenue	\$ 10,277	\$ 35,772	\$ 73,004	\$ 70,135
Income before tax	\$ 2,975	\$ 4,385	\$ 9,303	\$ 6,558
Provision for income taxes	1,084	1,655	3,469	2,555
Income from discontinued operations, net of tax	1,891	2,730	5,834	4,003
Loss on sale of discontinued operations before tax	(1,861)	--	(12,622)	--
Income tax benefit	694	--	4,710	--
Loss on sale of discontinued operations, net of tax	(1,167)	--	(7,912)	--
Income (loss) from discontinued operations, net of tax	\$ 724	\$ 2,730	\$ (2,078)	\$ 4,003

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Assets and liabilities related to discontinued operations were comprised of the following as of:

	June 2003	September 2002
<i>(Amounts in thousands)</i>		
Cash	\$ 4,236	\$ 10,126
Accounts receivable, net	3,017	4,132
Other current assets	3,254	6,475
Property and equipment, net	2,247	59,225
Intangible assets	56	71,952
Goodwill	--	16,978
Other non-current assets	1,183	3,870
Total assets of discontinued operations held for sale	\$ 13,993	\$ 172,758
Current liabilities	\$ 2,957	\$ 12,295
Minority interest	--	1,625
Total liabilities of discontinued operations	\$ 2,957	\$ 13,920
Other balances related to discontinued operations included:		
Deferred compensation	\$ 2,486	\$ 2,939
Deferred tax assets (liabilities)	4,208	(27,513)

As a result of integrating the VLC operations acquired with Anchor into our Reno, Nevada plant, in June 2003 we reclassified \$4.5 million related to the Bozeman, Montana building to other assets held for sale.

3. Notes and Contracts Receivable

The following allowances for doubtful notes and contracts were netted against current and long-term maturities:

	June 2003	September 2002
<i>(Amount in thousands)</i>		
Current	\$ 16,399	\$ 22,067
Long-term	12,959	15,062
	<u>\$ 29,358</u>	<u>\$ 37,129</u>

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4. Concentrations of Credit Risk

The financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and accounts, contracts, and notes receivable. We maintain cash balances at several financial institutions in amounts, which at times, may be in excess of the Federal Deposit Insurance Corporation insurance limits.

Our revenues and resulting receivables are concentrated in specific legalized gaming regions. The table below shows the composition of our accounts, contracts, and notes receivable as of June 28, 2003. The receivable related to the sale of the Pala management contract acquired with Anchor was included in the California region.

Domestic Regions

California	27%
Nevada	22
Eastern region	10
Canada	5
New Jersey	5
Other US regions, 4% or less individually	21
	<u>90</u>
Total domestic	<u>90</u>

International Regions

Europe	6
Other international, 4% or less individually	4
	<u>10</u>
Total international	<u>10</u>
Total	<u>100%</u>

5. Intangible Assets and Goodwill

With our commitment in March 2003 to sell UT, we reclassified the final Anchor purchase price allocation to identifiable intangible assets and goodwill as shown in the table below to reflect the intangible assets of UT in discontinued operations. In-process research and development

5. Intangible Assets and Goodwill

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(R&D) was charged to expense immediately subsequent to the acquisition because no future alternative use existed. The goodwill related to Anchor is not deductible for tax purposes. Accumulated amortization on intangible assets of discontinued operations totaled \$3.5 million when reclassified to assets held for sale.

Anchor Acquired Intangible Assets and Goodwill

	Continuing Operations	Discontinued Operations	Total
<i>(Amounts in thousands)</i>			
Finite Lived Intangible Assets			
Patents	\$ 166,400	\$ --	\$ 166,400
Contracts	29,560	50,294	79,854
Developed Technology	9,888	127	10,015
Trademarks	7,222	--	7,222
In-Process R&D	1,000	--	1,000
	<u>214,070</u>	<u>50,421</u>	<u>264,491</u>
Indefinite Lived Intangible Asset			
Trademarks	--	24,348	24,348
	<u>214,070</u>	<u>74,769</u>	<u>288,839</u>
Total Intangible Assets	\$ 214,070	\$ 74,769	\$ 288,839
Goodwill	\$ 836,636	\$ 16,978	\$ 853,614

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In addition to adjustments related to the final Anchor purchase price allocation, we capitalized \$4.0 million of purchased patents and \$3.2 million of patent legal and registration costs with an average life of 9.4 years during the nine months ended June 28, 2003. The following table identifies our intangible asset balances by category, excluding discontinued operations, as of:

	June 2003			September 2002		
	Cost	Accumulated Amortization	Carrying Amount Net	Cost	Accumulated Amortization	Carrying Amount Net
<i>(Amounts in thousands)</i>						
Finite Lived Intangible Assets						
Patents	\$ 249,450	\$ 35,093	\$ 214,357	\$ 242,268	\$ 19,178	\$ 223,090
Contracts	29,560	11,010	18,550	29,712	7,035	22,677
Developed technology	7,135	2,023	5,112	7,660	731	6,929
Trademarks	10,018	4,427	5,591	10,583	1,955	8,628
	<u>296,163</u>	<u>52,553</u>	<u>243,610</u>	<u>290,223</u>	<u>28,899</u>	<u>261,324</u>
Indefinite Lived Assets						
Trademarks	--	--	--	9,700	--	9,700
	<u>296,163</u>	<u>52,553</u>	<u>243,610</u>	<u>299,923</u>	<u>28,899</u>	<u>271,024</u>
Total Intangible Assets	\$ 296,163	\$ 52,553	\$ 243,610	\$ 299,923	\$ 28,899	\$ 271,024

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Aggregate amortization expense totaled \$7.6 million and \$8.2 million for the current and prior year quarters and \$23.7 million and \$17.4 million for the current and prior nine month periods. Estimated amortization expense for fiscal 2003 and for each of the four succeeding fiscal years is as follows:

Fiscal Year	Amount
<i>(Amounts in thousands)</i>	
2003	\$30,972
2004	31,126
2005	29,183
2006	25,693
2007	23,935

Changes to our goodwill allocation by segment since our last annual report are reflected in the table below. Adjustments related to our final Anchor purchase price allocations. No goodwill was allocated to the lottery systems segment acquired from Anchor.

Goodwill	Product Sales	Proprietary Gaming	Total
<i>(Amounts in thousands)</i>			
Balance as of September 28, 2002	\$ 94,574	\$ 872,850	\$967,424
Adjustments	11,353	(670)	10,683
Foreign currency translation adjustment	2,357	--	2,357
	\$108,284	\$ 872,180	\$980,464

6. Zero-Coupon Senior Convertible Debentures

In a private offering on January 29, 2003, we issued approximately \$969.8 million principal amount at maturity of zero-coupon senior convertible debentures due January 29, 2033 (Debentures) for gross proceeds of approximately \$575.0 million. Absent a yield adjustment, the Debentures have a yield to maturity of 1.75%. The yield adjustment feature may require IGT to pay contingent cash interest on the Debentures at prevailing market rates to be determined during any six month period commencing on or after January 29, 2006, if the average closing sale prices of our common stock for specified measurement periods is less than or equal to 60% of the accreted conversion price of the Debentures during such specified periods.

The Debentures are convertible into 21.1704 shares of our common stock per \$1,000 principal amount at maturity, provided one of the enumerated conversion events has occurred. The conversion events are: (i) during the specified conversion periods, the closing price of our common stock is more than 120% of the accreted conversion price (initially \$33.61 per share, adjusted for the four-for-one stock split) for a specified period; (ii) the average trading price of the Debentures is less than 95% of the average closing price of our common stock multiplied by the conversion rate for a specified period; (iii) our long-term senior debt ratings (or the ratings on the Debentures, if rated) are reduced to below Ba2 by Moody's and below BB by Standard & Poors or ceases to be rated by both rating agencies; (iv) the Debentures have been called for redemption; and (v) upon the occurrence of specified corporate events.

On or after January 29, 2006, IGT may repurchase the Debentures for cash equal to their accreted value plus accrued and unpaid cash interest, if any. Holders have the right to require IGT to redeem the Debentures for an amount equal to their accreted value plus accrued and unpaid cash interest, if any, on January 29, 2006, 2008, 2013, 2018, 2023 and 2028. IGT must settle any repurchases on January 29, 2006 in cash. On any subsequent repurchase dates, IGT may elect to settle in cash or shares of common stock or a combination thereof.

IGT may also be required to repurchase the Debentures upon the occurrence of specified change of control events at the accreted value plus accrued and unpaid cash interest, if any. Upon a change of control, we may elect to settle the repurchase price in cash or common stock valued at 95% of its average closing sale price for the five day trading period ending on the third trading day prior to the repurchase date. IGT's right to pay the repurchase price for Debentures in common stock upon a repurchase date or upon a change of control is subject to certain conditions, including the registration under applicable federal and state securities laws of the shares of common stock to be issued.

IGT entered into a registration rights agreement for the benefit of the holders of the Debentures agreeing to file and keep effective a registration statement covering the resale of the Debentures and underlying common stock by the holders for specified periods of time. Our registration statement on Form S-3 relating to the resale of our Zero-Coupon Convertible Debentures due January 29, 2033 became effective with the Securities and Exchange Commission on June 16, 2003. If IGT fails to maintain an effective registration statement for the time periods specified, subject to permitted exceptions, IGT will be required to pay certain additional cash interest as liquidated damages until the default under the registration rights agreement is cured. Such liquidated damages range from 0.25% to 0.50% of the accreted value of the Debentures plus accrued and unpaid cash interest, if any.

7. Earnings Per Share

On June 4, 2003, the Board of Directors approved a four-for-one stock split to shareholders of record on June 18, 2003. All references to common shares and per share amounts have been restated to reflect the stock split for all periods presented. In addition, the Board of Directors declared a cash dividend on post-split shares of \$.075 per share, payable on July 28, 2003 to shareholders of record on July 14, 2003.

The following table shows the reconciliation of basic earnings per share (EPS) for income from continuing operations to diluted EPS:

	Quarters Ended		Nine Months Ended	
	June 2003	June 2002	June 2003	June 2002
<i>(Amounts in thousands, except per share amounts)</i>				
Income from continuing operations	\$102,961	\$ 79,898	\$284,464	\$204,315
Weighted average common shares outstanding	342,367	357,960	344,009	335,557
Dilutive effect of stock options outstanding	7,388	5,369	6,969	6,050
Weighted average common and potential shares outstanding	349,755	363,329	350,978	341,607
Basic earnings per share	\$ 0.30	\$ 0.22	\$ 0.83	\$ 0.61
Diluted earnings per share	\$ 0.30	\$ 0.22	\$ 0.81	\$ 0.60
Common shares excluded from diluted EPS because the effect of option exercise was antidilutive	816	7,708	864	5,452
Common shares excluded from diluted EPS because the debentures conversion event has not occurred	20,531	--	20,531	--

There were no transactions since the end of the current quarter that would have materially changed the number of common shares or potential common shares outstanding.

8. 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 than for tax return purposes.

9. Comprehensive Income

Items of other comprehensive income include cumulative foreign currency translation adjustments and net unrealized gains and losses on investment securities. Our total comprehensive income is presented below:

	Quarters Ended		Nine Months Ended	
	June 2003	June 2002	June 2003	June 2002
<i>(Amounts in thousands)</i>				
Net income	\$103,685	\$82,628	\$282,386	\$208,318
Net change in other comprehensive income	2,953	3,765	2,155	3,791
Comprehensive income	<u>\$106,638</u>	<u>\$86,393</u>	<u>\$284,541</u>	<u>\$212,109</u>

10. 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.

Acres

In February 1999, the JV and Anchor filed an action in US District Court, District of Nevada against Acres Gaming, Inc. (Acres). The complaint alleges, among other things, infringement of certain secondary event (bonus features) patents owned by Anchor and licensed to the JV. Acres responded by filing an answer and counterclaim against the JV and Anchor. Additionally, Acres filed an action in Oregon against the JV and Anchor alleging wrongful use of Acres' intellectual property. On April 21, 2003, the parties reached a confidential out-of-court settlement resolving the claims and counterclaims. Concurrent with the settlement of the matter, Acres agreed to license certain of its bonus patents to IGT and IGT paid a royalty advance of \$10.0 million to Acres for these patents as well as other licensing fees. A trial on the remaining issue of inventorship is tentatively scheduled for October 2003.

Bally

On October 31, 2002, Bally Gaming, Inc. filed a complaint in U.S. District Court for the District of Nevada against IGT and Anchor for declaratory relief seeking a non-monetary judgment that Bally had not infringed certain patents owned by IGT or Anchor. IGT moved to dismiss the complaint on January 27, 2003, and that motion was granted on May 16, 2003.

Collins

In 1994, a lawsuit was filed in South Carolina, against IGT by Collins Music Co. (Collins), a distributor for IGT in South Carolina. In the action, Collins alleged that IGT agreed, but subsequently failed, to renew a Distributorship Agreement with Collins. Collins also alleged that equipment sold to it was not the latest IGT product available to the marketplace. IGT counterclaimed for the unpaid invoices for machines delivered to Collins, for violations of the South Carolina Unfair Trade Practices Act, for breach of the Distributorship Agreement accompanied by fraudulent acts and denied all the other allegations. In August 2001, a jury found that IGT breached its agreement with Collins and awarded Collins \$15.0 million in compensatory damages.

IGT filed motions for post-trial relief that were denied by the trial court. IGT timely filed its Notice of Appeal. In May 2002, Collins filed a Motion to Dismiss the IGT appeal. Oral arguments on the motion were held in August 2002 and in September 2002 the Motion to Dismiss was granted by a three-judge panel of the Court. IGT timely filed a Petition for Rehearing *en banc*. Rather than consider the Petition, the South Carolina Court of Appeals requested that the South Carolina Supreme Court take the case on certification. On February 7, 2003, IGT filed its Petition For A Writ Of Certiorari with the South Carolina Supreme Court, which was denied on April 24, 2003. On April 29, 2003, IGT filed a Petition with the South Carolina Court of Appeals seeking further relief that was denied on May 12, 2003. As a result, on June 11, 2003, IGT filed a second Petition For A Writ Of Certiorari with the South Carolina Supreme Court that was dismissed by that Court on June 25, 2003. On July 22, 2003, IGT filed its Petition For Writ of Certiorari with the US Supreme Court. Through June 2003, we have accrued the \$15.0 million judgment plus accrued interest of \$3.4 million.

Kraft

In July 2001, an individual, Mary Kraft, filed a complaint against IGT, Anchor and the three operators of casinos in Detroit, Michigan. IGT was never served with the complaint and was voluntarily dismissed from the litigation. In September 2001, IGT filed a motion to intervene as a party defendant. The plaintiff claimed the bonus wheel feature of the *Wheel of Fortune*® and *I Dream of Jeannie* slot machines, which are manufactured, designed and programmed by IGT and/or Anchor, are deceptive and misleading. Specifically, the plaintiff alleged that the bonus wheels on these games do not randomly land on a given dollar amount but are programmed to provide a predetermined frequency of payouts. The complaint alleged violations of the Michigan Consumer Protection Act, common law fraud and unjust enrichment and asked for unspecified compensatory and punitive damages, disgorgement of profits, injunctive and other equitable relief, and costs and attorney's fees. The Michigan Gaming Control Board, the administrative agency responsible for regulating the Detroit casinos, approved the machines and their programs for use. In April 2002, the Court granted the Summary Disposition filed by IGT and Anchor and dismissed the Plaintiff's complaint. In May 2002, the plaintiff filed an appeal.

Poulos

Along with a number of other public gaming corporations, IGT is a defendant in three class action lawsuits: one filed in the US District Court of Nevada, entitled *Larry Schreier v. Caesars World, Inc., et al.*, and two filed in the US District Court of Florida, entitled *Poulos v. Caesars World, Inc., et al.* and *Ahern v. Caesars World, Inc., et al.*, which have been consolidated into a single action. The Court granted the defendants' motion to transfer venue of the consolidated action to Las Vegas. The actions allege that the defendants have 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 constitute violations of the Racketeer Influenced and Corrupt Organizations Act, and also give 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. The defendants filed their consolidated answer to the Consolidated Amended Complaint in February 1998. In March 2002, the Court directed that certain merits discovery could proceed. 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. On April 30, 2003, the appellants (class plaintiffs) timely filed their opening brief. The respondent's opposition brief was filed timely on July 31, 2003.

Environmental Matters

Colorado Central Station Casino (CCSC), a casino operation sold by IGT in April 2003, is located in an area that has been designated by the Environmental Protection Agency (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 been incurred.

Guarantees and Other Contingencies

Liquidated Damages

Our online lottery contracts typically permit termination of the contract by the lottery authority at any time for material breach or for other specified reasons and generally contain demanding implementation and performance schedules. Failure to perform under such contracts may result in substantial monetary damages. Some of our US lottery contracts contain provisions for significant liquidated damages related to various incidents such as implementation delays, system downtime, supply downtime, supply shortages, or degraded systems performance. Many of our lottery contracts also permit the lottery authority to terminate the contract upon notice for convenience or upon a State's cessation, in whole or in part, of lottery operations and do not specify the compensation, if any, to which we would be entitled should such termination occur. Some of our international customers similarly reserve the right to assess monetary damages in the event of contract termination or breach. Although such liquidated damages provisions are customary in the lottery industry and the actual liquidated damages imposed are sometimes subject to negotiation, such provisions in our lottery contracts present an ongoing potential for additional expense. At June 28, 2003, we had \$1.5 million accrued for liquidated damages.

Performance Bonds

We had performance bonds outstanding, primarily related to our operation of several lottery systems and gaming operations, totaling \$70.2 million at June 28, 2003. We are liable to reimburse the bond issuer in the event the bond is exercised as a result of our nonperformance.

Progressive Systems Trusts

Our linked progressive systems in Iowa and New Jersey are administered by trusts consisting of participating casino members. We have agreed to loan to these trusts, upon request, and subject to certain limitations, amounts necessary to meet substantially all obligations of the trusts. Trust obligations are primarily related to jackpot liabilities. We are not able to estimate the maximum potential amount of future payments under this guarantee because it is based on future operations of the linked progressive jackpot systems. Loans to the trusts have historically been infrequent and short-term in nature. There were no outstanding loans to the trusts at June 28, 2003.

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. We are not able to estimate the maximum potential amount of future payments under this guarantee because it depends on the occurrence of future events.

Product Warranties

We accrue for warranty costs based on historical trends in product failure rates and the expected material and labor 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. The following table summarizes the activity related to our product warranty liability.

	Nine Months Ended June 2003
<i>(Amounts in thousands)</i>	
Beginning balance	\$ 3,332
Reduction for payments made	(1,522)
Accrual for new warranties issued	4,950
Adjustments for pre-existing warranties	(229)
Ending balance	<u>\$ 6,531</u>

Self-Insurance

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

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, no assurance can be given that taxing authorities will not propose adjustments that will increase our tax liabilities. We do not currently expect that the outcome of these tax audits and proceedings will, either individually or in the aggregate, have a material adverse effect on our financial position or results of operations.

11. Derivatives and Hedging Activities

With the adoption of SFAS 133 on October 1, 2000, we recognize all derivatives as either assets or liabilities on the balance sheet at the fair value of the instruments. Accounting for changes in the fair value of derivatives depends on the intended use and resulting designation. We use derivative financial instruments to minimize our market risk exposure resulting from fluctuations in foreign exchange rates and interest rates. The primary business objective of our hedging program, as defined in our corporate risk management policy, is to minimize the impact of transaction, remeasurement, and specified economic exposures to our net income and earnings per share. The counter parties to these instruments are major commercial banks and we believe that losses related to credit risk are remote. We are not party to leveraged derivatives and do not hold or issue financial instruments for speculative purposes.

Foreign Currency Hedging

We routinely use derivative financial instruments to hedge our net exposure, by currency, related to our monetary assets and liabilities denominated in nonfunctional foreign currency. These hedging instruments are subject to fluctuations in value that are generally offset by the value of the underlying exposures being hedged. These forward exchange contracts are not designated as hedging instruments under SFAS 133 and resulting gains or losses are recognized in current earnings.

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From time to time, we enter into sales commitments denominated in foreign currencies. Our policy is to hedge significant firm commitments denominated in foreign currency with forward exchange contracts to protect the US dollar value of the revenues. These forward exchange contracts have been designated as fair value hedges under SFAS 133 and related gains or losses are included as a component of the hedged transaction when recorded. Gains and losses related to the hedge ineffectiveness are recorded in other income or expense. Time value is excluded from effectiveness testing.

At June 28, 2003, our net foreign currency exposure totaled \$52.7 million related to our monetary assets and liabilities denominated in nonfunctional foreign currency and \$6.5 million for a firm sales commitment denominated in Canadian dollars. These exposures were hedged with \$51.7 million in forward currency contracts. The hedge for the firm commitment was designated a fair value hedge under SFAS 133 and there was no hedge ineffectiveness for the nine months ended June 28, 2003. At September 28, 2002, we had net foreign currency exposure of \$31.2 million related to our monetary assets and liabilities denominated in nonfunctional foreign currency and \$52.6 million for a firm sales commitment denominated in Canadian dollars. These exposures were hedged with \$86.5 million in forward contracts.

Interest Rate Swap

In July 2003, we entered into two interest rate swap agreements with a combined notional amount of \$200.0 million, primarily to strategically diversify a portion of our debt portfolio between fixed and variable rate instruments. Under the terms of the interest rate swaps, we will make payments based on a specific spread over six-month LIBOR, and receive payments equal to the interest rate on our fixed rate senior notes due in 2009.

Convertible Debentures Yield Adjustment

The yield adjustment feature of our convertible Debentures due January 29, 2033 (See Note 6) requires contingent cash interest payments based on interest rates that are indexed to, or 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 or the holder could exercise its right to require IGT to purchase the debentures. 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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12. Pro Forma Stock-Based Compensation Costs

We have provided the following pro forma financial information reflecting the difference between stock compensation costs charged to operations under the APB 25 intrinsic value method and pro forma stock compensation cost that would have been charged to operations had the SFAS 123 fair value method been applied to all awards granted, modified, or settled since the beginning of fiscal 1996, using a Black-Scholes option pricing model. This valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. IGT's employee stock-based compensation has characteristics significantly different from those of traded options, and changes in the assumptions used can materially affect the fair value estimate.

	Quarters Ended		Nine Months Ended	
	June 2003	June 2002	June 2003	June 2002
<i>(Amounts in thousands, except per share amounts)</i>				
Reported net income	\$ 103,685	\$ 82,628	\$ 282,386	\$ 208,318
Reported stock compensation, net of tax	618	744	1,766	1,508
Pro forma stock compensation, net of tax	(5,771)	(5,084)	(15,789)	(13,774)
	\$ 98,532	\$ 78,288	\$ 268,363	\$ 196,052

	Quarters Ended		Nine Months Ended	
Basic earnings per share:				
As reported	\$ 0.30	\$ 0.23	\$ 0.82	\$ 0.62
Pro forma	\$ 0.29	\$ 0.22	\$ 0.78	\$ 0.58
Diluted earnings per share:				
As reported	\$ 0.30	\$ 0.23	\$ 0.80	\$ 0.61
Pro forma	\$ 0.28	\$ 0.22	\$ 0.76	\$ 0.57

13. Business Segments

We currently operate principally in the following three lines of business:

- * Product sales encompass the development, manufacturing, marketing, distribution and sales of computerized gaming products and systems.
- * Proprietary gaming operations includes the development, marketing and placement of Wide Area Progressive (WAP) systems, stand-alone games, and gaming equipment leasing. This segment is comprised of our wholly-owned gaming operations, which includes activities that we perform on behalf of our strategic marketing alliances, as well as our joint venture activities reported as earnings of unconsolidated affiliates. Subsequent to the Anchor acquisition, the JV activities have been consolidated.

* Lottery systems consist of the development, manufacturing, operation and sale of online lottery systems. There have been no material changes during the current period in the basis of measuring the amount of identifiable assets by segment since our last annual report. See Note 5 for changes to the allocation of goodwill by segment since our last annual report. The following table presents information on our lines of business for the current and prior comparable periods. The prior period amounts were restated to conform to the current period presentation, including the reclassification of the casino, route and pari-mutuel operations to discontinued operations. IGT's segment profit reflects income from continuing operations before tax, including an applicable allocation of operating expenses, as well as other income and expenses.

Lines of Business	Product Sales	Proprietary Gaming	Lottery Systems	Unallocated Corporate	Consolidated
<i>(Amounts in thousands)</i>					
Quarter Ended June 2003					
Total revenues	\$ 300,068	\$ 261,853	\$ 35,749	\$ --	\$ 597,670
Losses of unconsolidated affiliates	--	(152)	--	--	(152)
Segment profit (loss)	88,746	94,218	3,297	(23,908)	162,353
Nine Months Ended June 2003					
Total revenues	\$ 795,847	\$ 784,795	\$ 111,349	\$ --	\$ 1,691,991
Losses of unconsolidated affiliates	--	(497)	--	--	(497)
Segment profit (loss)	221,549	286,079	12,226	(66,163)	453,691
Quarter Ended June 2002					
Total revenues	\$ 222,429	\$ 261,190	\$ 32,570	\$ --	\$ 516,189
Losses of unconsolidated affiliates	--	(345)	--	--	(345)
Segment profit (loss)	50,570	100,473	530	(23,215)	128,358
Nine Months Ended June 2002					
Total revenue	\$ 628,359	\$ 618,039	\$ 67,299	\$ --	\$ 1,313,697
Earnings of unconsolidated affiliates	--	32,772	--	--	32,772

	Product	Proprietary	Lottery	Unallocated	
Segment profit (loss)	131,228	259,546	2,318	(65,158)	327,934

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

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (US). Accordingly, we are required to make estimates, judgments and assumptions that we believe are reasonable based on our historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect the reported amounts and related disclosures. Actual results may differ from initial estimates. IGT's critical accounting policies that require management to make particularly difficult, subjective or complex judgments about matters that are inherently uncertain relate to our jackpot liabilities and expenses, intangible assets, and income taxes. These areas of our accounting estimates are the most sensitive to material change from external factors.

Jackpot Liabilities and Expenses

IGT, or the trust, recognizes a liability for jackpots not yet won and jackpot expense for the cost to fund these jackpots in the future. Jackpots are generally payable in equal installments over a 20 to 26 year period or immediately in the case of our instant win progressive jackpots. Winners may elect to receive the present value of jackpots discounted at applicable interest rates (lump sum) in lieu of annual installments. Interest rates eligible for use in the lump sum payment calculation vary by jurisdiction and are impacted by market forces and other economic conditions. Historically, approximately 80% of winners have elected the lump sum payment option. Winners that do not elect the lump sum payment generally receive equal annuity payments over 20 to 26 years. We fund jackpot annuity payments through qualifying US government or agency securities. To calculate the present value of our outstanding progressive jackpot liabilities to be paid to future winners, we use current market prime, treasury, and agency rates weighted based on the 80% historical lump sum election ratio. We believe this calculation provides the best estimate of our cost to fund jackpots.

Additionally, we estimate the current portion of our liabilities for jackpots not yet won based on our historical experience with winners' lump sum elections, as well as the theoretical projected number of jackpots for the current and non-current periods. Based on this, we have classified 80% of our jackpot liabilities as current and 20% as non-current. Changes in future winners' elections of installment or lump sum payments could impact the allocation of our jackpot liabilities between current and non-current liabilities.

Our jackpot expense totaled \$198.8 million for the nine months ended June 28, 2003. Although the majority of material changes to jackpot expense relate to market interest rate trends (see Item 3, Market Risk) and the volume of slot play, changes in our estimates and assumptions regarding the number of jackpot winners who may elect lump sum payments in the future could impact our gaming operations jackpot expense and gross profit. Because current year lump sum rates have been essentially the same as installment funding rates over the first nine months of fiscal 2003, if we changed our estimate of winners expected to elect the lump sum payment option by 10%, our jackpot expense for the nine months just ended would not change materially.

Intangible Assets and Goodwill

We assign estimated useful lives to our intangible assets based on the period of time the asset is expected to contribute directly or indirectly to future cash flows. We consider certain factors when assigning useful lives such as legal, regulatory and contractual provisions, as well as the effects of obsolescence, demand, competition, and other economic factors. We are required to use judgment and make estimates to determine the useful lives of intangible assets.

We amortize our intangible assets with finite lives to reflect the pattern in which the economic benefits for the assets will be consumed based on projected revenues. Intangible assets with an increasing revenue stream are amortized using the straight-line method. Intangible assets with a declining revenue stream are amortized on an accelerated basis.

We evaluate the carrying value of our intangible assets and goodwill for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value of these assets 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.

While we believe that our estimates of future revenues and cash flows are reasonable, different assumptions could materially effect our assessment of useful lives and fair values. Changes in assumptions may cause modifications to our estimates for amortization or impairment, thereby impacting our results of operations. If the estimated lives of our intangible assets were to decrease based on the factors mentioned above, the most significant impact would be on amortization expense. Amortization expense totaled \$23.7 million for the first nine months of fiscal 2003. We estimated that a 10% decrease in the estimated remaining useful lives would have increased amortization expense by \$2.5 million for the nine months ended June 2003 and \$2.3 million for the comparable prior year period.

Income Taxes

For financial reporting, we use estimates and judgments to determine our current tax liability, as well as those taxes deferred until future periods. Net deferred and accrued income taxes represent significant assets and liabilities to IGT. In accordance with the liability method of accounting for income taxes as specified in Statement of Financial Accounting Standards 109, *Accounting for Income Taxes*, we recognize the amount of taxes payable or refundable for the current year and deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns.

Adjustments to deferred taxes are determined based upon the changes in differences between the book basis and tax basis of our assets and liabilities, measured by future tax rates we estimate will be applicable when these differences are expected to reverse. This process also involves estimating our current tax position in each jurisdiction, as well as making judgments as to whether our taxable income in future periods will be sufficient to fully recover any deferred tax assets. We establish a valuation allowance to the extent recovery of deferred tax assets is not likely, based on our estimation of future taxable income in each jurisdiction.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize potential tax liabilities for anticipated tax audit issues in the US and other jurisdictions based on our estimate of whether and the extent to which additional taxes will be due. If payment of these amounts proves to be unnecessary, the reversal of liabilities could result in tax benefits being recognized in the current period. If our estimate of tax liabilities is understated, a charge to our tax provision would result.

Changes in current tax laws, enacted tax rates, geographic mix or the estimated level of annual taxable income could change the valuation of deferred tax assets and liabilities and affect the overall effective tax rate and impact the tax provision. Accordingly, we believe that the estimate related to our provision for income taxes is critical to our financial results.

Allowances For Doubtful Accounts and Obsolete Inventory Reserve

We maintain an allowance for doubtful accounts related to our accounts, contracts, and notes receivable that we have deemed to have a high risk of collectibility. We analyze historical collection trends, customer concentrations, customer creditworthiness, current economic trends and changes in our customer payment patterns when evaluating the adequacy of our allowance for doubtful accounts. While we believe we can make reliable estimates for these matters, if we changed our assumptions and estimates, our bad debt expense could change, which would impact our income from operations.

We regularly review inventory quantities on hand and record reserves for excess and obsolete inventory, based primarily on our estimated forecast of product demand and production requirements. The determination of obsolete or excess inventory requires us to estimate the future demand for our products within specific time horizons, generally, one year or less. If our demand forecast for specific products is greater than actual demand and we fail to reduce manufacturing output accordingly, we may need to record additional provisions for inventory obsolescence, which would have a negative impact on our gross profit.

ACRES MERGER AGREEMENT

In June 2003, we announced the signing of a definitive merger agreement with Acres Gaming. Acres specializes in the development of gaming systems technology that enables casino operators to increase patron loyalty. The terms of the agreement call for IGT to pay \$11.50 per share in an all cash transaction, representing an aggregate purchase price of approximately \$130.0 million. The merger is subject to the approval of Acres stockholders, various regulatory approvals, including gaming regulators and Hart-Scott-Rodino antitrust, and other conditions.

ANCHOR ACQUISITION

On December 30, 2001, we completed our acquisition of Anchor Gaming (Anchor), which resulted in the addition of one new line of business, lottery systems. The casino, route, and pari-mutuel operations acquired with Anchor have been reclassified to discontinued operations. The most notable change to our financial results following the acquisition was the consolidation of the Spin for Cash Joint Venture (JV). IGT and Anchor had worked together since 1996 as partners in the JV, which we accounted for under the equity method prior to the acquisition. Under the equity method, revenues were previously reflected net of expenses in earnings of unconsolidated affiliates.

Discontinued Operations

In June 2002, we determined that the casino and route operations acquired with Anchor were not a strategic fit with our core business and committed to a plan to sell the two Colorado casinos (Colorado Central Station and Colorado Grande Casino) and the Nevada slot route. In February 2003, we closed the sale of substantially all of the assets of the Nevada slot route operations of our subsidiary, Anchor Coin, for a cash price of \$60.5 million. In April 2003, we closed the sale of the two Colorado casinos for total cash proceeds of \$82.0 million. Collectively, we recognized a loss of \$1.1 million on these divestitures.

In March 2003, we additionally committed to a plan to sell the non-strategic pari-mutuel wagering business, acquired with Anchor, United Tote (UT). Based on preliminary offers from prospective buyers, we recorded an estimated loss on sale of \$6.8 million, net of tax. We expect to close the sale of UT by the end of September 2003. The UT operations were previously included as a component of our lottery systems segment.

The casino, route and UT operations have been reclassified to discontinued operations and assets held for sale until sold for all periods presented. We ceased depreciation and amortization for discontinued operations upon reclassification to assets held for sale.

RESULTS OF OPERATIONS

We currently operate principally in the following three lines of business:

- * Product sales encompass the development, manufacturing, marketing, distribution and sales of computerized gaming products and systems.
- * Proprietary gaming operations includes the development, marketing and placement of wide area progressive (WAP) systems, stand-alone games, and gaming equipment leasing. This segment is comprised of our wholly-owned gaming operations, which includes activities that we perform on behalf of our strategic marketing alliances, as well as our joint venture activities reported as earnings of unconsolidated affiliates. Subsequent to the Anchor acquisition, the JV activities have been consolidated.

* Lottery systems consist of the development, manufacturing, operation and sale of online lottery systems.

Comparison of Quarters Ended June 28, 2003 and June 29, 2002

<i>Revenues, earnings of unconsolidated affiliates and gross profit</i>	Quarters Ended			
	June 2003	June 2002	Increase (Decrease)	% Change
<i>(Amounts in thousands)</i>				
Consolidated:				
Revenues and earnings of unconsolidated affiliates	\$ 597,518	\$ 515,844	\$ 81,674	16%
Gross profit	291,162	245,739	45,423	18%
Gross profit margin	49%	48%	1%	2%

Total consolidated revenues and earnings of unconsolidated affiliates, gross profit, and gross margin for the three months ended June 2003 increased over the same period last year as a result of record replacement sales volumes in product sales, as well as improved performance in lottery systems.

<i>Product sales</i>	Quarters Ended			
	June 2003	June 2002	Increase (Decrease)	% Change
<i>(Amounts in thousands, except units)</i>				
Domestic:				
Revenues	\$ 242,577	\$ 169,352	\$ 73,225	43%
Gross profit	119,709	76,384	43,325	57%
Gross margin	49%	45%	4%	9%
Units shipped	24,166	17,597	6,569	37%
International:				
Revenues	\$ 57,491	\$ 53,077	\$ 4,414	8%
Gross profit	23,803	17,905	5,898	33%
Gross margin	41%	34%	7%	21%
Units shipped	13,360	13,662	(302)	(2%)
Total product sales:				
Revenues	\$ 300,068	\$ 222,429	\$ 77,639	35%
Gross profit	143,512	94,289	49,223	52%
Gross margin	48%	42%	6%	14%
Units shipped	37,526	31,259	6,267	20%

Current third quarter consolidated product sales revenues grew 35% and gross profit was up 52% over the comparable prior year quarter. These improvements were driven by the following:

- * Consolidated domestic replacement shipments increased 68% over the prior year quarter to 17,500 units.
- * Average sales prices improved 12% over the third quarter last year related to a greater mix of domestic games, as well as increased parts and systems revenues.
- * The growth in gross margins over the prior year also related to:

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- >> a higher mix of domestic units, comprising 64% of consolidated units in the current quarter versus 56% in the same quarter last year;
- >> a greater mix of our spinning reel products (\$2000) sold;
- >> more significant systems revenues;
- >> improved operating efficiencies related to higher volumes.

We estimate our consolidated gross profit margin will range between 45% and 48% for the remainder of fiscal 2003 depending on the mix of geography and products.

Domestic

Total domestic units shipped increased 37% during the current quarter, due to strong growth in replacement sales. Replacement units grew to 17,500 in the third quarter of fiscal 2003, up from 10,400 units in the prior year quarter. This growth related to the following factors:

- * An increase in EZ Pay™ orders were primarily responsible for the increase in units shipped during the quarter.
- * Replacement shipments into the Nevada, Atlantic City and Midwestern riverboat casino markets were also up from the same quarter last year.
- * We shipped an additional 3,300 replacement units during the current quarter into the Canadian government-operated public gaming market under our 8,400 unit contract with the Quebec Lottery Board. Approximately 1,000 units remain to be shipped on this contract. In fiscal 2004, we expect to benefit from replacement programs announced in Alberta and Manitoba, but they will not be of the same magnitude as Quebec.

Our *EZ Pay* technology continues to stimulate replacement demand for our gaming machines as existing slot machines are replaced with our ticket-in ticket-out (TITO) equipped machines throughout major casino resorts. Several major casino resorts have committed to replace existing slot machines with our *EZ Pay* systems and TITO equipped machines throughout their properties. We believe this will encourage broader adoption of cashless technology and continue to stimulate replacement demand.

New and expansion unit sales for the current quarter were concentrated primarily in the California market, including shipments of:

- * 1,500 units to the new Thunder Valley Casino, and
- * 1,000 units to the Chukchansi Gold Resort & Casino.

Offsetting these increases over the prior year quarter, were lower new and expansion unit sales across other casino and government-operated public gaming markets, primarily in West Virginia.

Domestic average sales prices per unit were up compared to the prior year quarter due to increased *EZ Pay*™ and related systems revenues, part sales, and game conversion and content fees.

International

International machine shipments declined over the prior year period, due primarily to decreased sales in Australia and Japan, offset by strong sales in the United Kingdom (UK) related to the popularity of new games. We continued to experience difficult business conditions in Australia due to restrictive government anti-gaming regulations, known as *harm minimization*, impacting both operators and suppliers across this market.

International average sales prices increased over the prior year quarter due to:

- * favorable foreign exchange rates impacting the translation of international product sales, and
- * higher margin parts and conversions sales.

Quarters Ended

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	June 2003	June 2002	Increase (Decrease)	% Change
Proprietary gaming operations				
<i>(Amounts in thousands, except units)</i>				
Revenues and earnings of unconsolidated affiliates	\$ 261,701	\$ 260,845	\$ 856	--
Gross profit	135,379	141,356	(5,977)	(4%)
Gross margin	52%	54%	(2%)	(4%)
Installed base	33,601	31,658	1,943	6%
Casinos	29,066	28,285	781	3%
Racinos	4,535	3,373	1,162	34%

Proprietary gaming operations revenues increased over the prior year third quarter, while gross margins declined 2%. These fluctuations were driven by the following:

- * Revenues and gross profit for the current quarter ended June 2003 were unfavorably impacted by a decline in play following a record jackpot payout, which we refer to as "jackpot fatigue". Revenues per unit in Nevada declined in the current quarter after the record \$39.7 million jackpot hit in late March 2003.
- * Although our installed base of proprietary games grew 1,900 units compared to the third quarter of fiscal 2002, a larger share of the unit growth was in racinos and alliance placed games which provide lower average revenues per unit. Additionally, half of the casino additions in the current quarter were placed in the last few weeks of the period, not allowing for the full quarter revenue impact. Casino game placements increased over the prior year quarter, primarily related to additions in California, New York, Canada and Atlantic City markets, partially offset by the continued managed removal of end-of-life former Anchor stand-alone units in Nevada. Racino game placements increased in Delaware and Rhode Island government-operated public gaming markets.
- * Gross profit and margin declines during the current quarter resulted primarily from lower interest rates, which increased the cost of funding jackpots, and to a lesser extent, higher operating costs.

	Quarters Ended			
	June 2003	June 2002	Increase (Decrease)	% Change
Lottery systems				
<i>(Amounts in thousands)</i>				
Revenues	\$ 35,749	\$ 32,570	\$ 3,179	10%
Gross profit	12,271	10,094	2,177	22%
Gross margin	34%	31%	3%	10%

Increased lottery systems revenues and gross profit in the current third quarter over the prior year quarter were primarily the result of:

- * contributions from the Korean Lottery which went live in December 2002,
- * partially offset by the loss of the Minnesota contract.

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	Quarters Ended					
	June 2003	% of Revenue	June 2002	% of Revenue	Increase (Decrease)	% Change
Operating expenses						
<i>(Amounts in thousands)</i>						

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	Quarters Ended					
	June 2003		June 2002		Change	
Selling, general and administrative	\$ 73,013	12%	\$ 64,701	13%	\$ 8,312	13%
Depreciation and amortization	13,177	2%	13,108	3%	69	1%
Research and development	23,844	4%	18,390	4%	5,454	30%
Provision for bad debts	2,537	--	3,974	1%	(1,437)	(36%)
Total	\$ 112,571	19%	\$ 100,173	19%	\$ 12,398	12%

Operating expenses for the three months ended June 2003 increased by 12% primarily related to the following factors:

- * higher employee benefit costs, primarily performance based incentives;
- * increased salaries and wages, predominantly in sales and product development; and
- * our on-going investment in research and development.

Provision for bad debts was partially offset in the current quarter by the recovery of Argentine receivables previously reserved with the devaluation of the Argentine Peso.

	Quarters Ended			
	June 2003	June 2002	Increase (Decrease)	% Change
Income from operations				
<i>(Amounts in thousands)</i>				
Total revenues and earnings of unconsolidated affiliates	\$ 597,518	\$ 515,844	\$ 81,674	16%
Income from operations	178,591	145,566	33,025	23%
Operating margin	30%	28%	2%	7%

Income from operations improved 23% in the third quarter of fiscal 2003 compared to the third quarter of fiscal 2002. This growth was attributable to increased product sales and lottery systems revenues and gross profit, partially offset by the decline in proprietary gaming operations gross profit and higher operating expenses.

	Quarters Ended					
	June 2003	% of Revenue	June 2002	% of Revenue	Increase (Decrease)	% Change
Other income (expense) and taxes						
<i>(Amounts in thousands)</i>						
Interest income	\$ 14,154	2%	\$ 14,030	3%	\$ 124	1%
Interest expense	(31,281)	(5%)	(31,074)	(6%)	(207)	(1%)
Other	889	--	(164)	--	1,053	642%
Other expense, net	\$ (16,238)	(3%)	\$ (17,208)	(3%)	\$ 970	6%
Provision for income taxes	\$ 59,392	10%	\$ 48,460	9%	\$ 10,932	23%

Other expense, net, decreased from the same quarter last year predominantly due to favorable changes in foreign currency rates. Additional interest expense in the current quarter related to the issuance of our zero-coupon convertible debentures in January 2003 was offset by decreased interest expense due to the partial repurchase of senior notes in April 2002.

Operation of our WAP systems games resulted in interest income accretion from annuity investments purchased to fund jackpot payments and interest expense accrued on jackpot liabilities at the rate earned on the investments. Therefore, interest income and expense related to funding jackpot winners are similar and increase at approximately the same rate based on the growth in total jackpot winners. Interest income and expense related to our progressive systems winner jackpot liabilities totaled \$5.8 million in both the current and prior year quarter.

During the current quarter, we adjusted our estimated annual income tax provision rate to 37.3%, resulting in the current quarter rate of 36.6% compared to the prior year quarter rate of 37.7%. Our current period effective tax rate was adjusted based on changes to the geographic mix of estimated annual taxable income. We expect our fourth quarter and fiscal year 2003 rate to remain at the 37.3% rate.

<i>Net income</i>	Quarters Ended		Increase (Decrease)	% Change
	June 2003	June 2002		
<i>(Amounts in thousands, except per share data)</i>				
Income from continuing operations	\$ 102,961	\$ 79,898	\$ 23,063	29%
Income from discontinued operations	724	2,730	(2,006)	(73%)
Net Income	103,685	82,628	21,057	25%
Earnings per diluted share				
Continuing operations	\$ 0.30	\$ 0.22	\$ 0.08	36%
Discontinued operations	0.00	0.01	(0.01)	(100%)
Net Income	0.30	0.23	0.07	30%

Net income and income from continuing operations improved for the third quarter of fiscal 2003 compared to the same quarter last year, primarily related to higher revenues and gross profits, offset by the increase in operating expenses, as discussed above. Earnings per share reflects the four-for-one common stock split approved by IGT's Board of Directors on June 4, 2003 for shareholders of record on June 18, 2003.

<i>Business segments operating profit</i>	Quarters Ended		Increase (Decrease)	% Change
	June 2003	June 2002		
<i>(Amounts in thousands)</i>				
Product sales:				
Revenues	\$ 300,068	\$ 222,429	\$ 77,639	35%
Gross profit	143,512	94,289	49,223	52%
Operating expenses	60,954	48,884	12,070	25%
Other income (expense), net	6,188	5,165	1,023	20%
Segment profit	88,746	50,570	38,176	75%
Segment profit margin	30%	23%	7%	30%
Proprietary gaming:				
Revenues and earnings of unconsolidated affiliates	\$ 261,701	\$ 260,845	\$ 856	--
Gross profit	135,379	141,356	(5,977)	(4%)
Operating expenses	42,737	42,252	485	1%
Other income (expense), net	1,576	1,369	207	15%
Segment profit	94,218	100,473	(6,255)	(6%)
Segment profit margin	36%	39%	(3%)	(8%)

Lottery systems:

	<u>Quarters Ended</u>			
	\$	\$	\$	
Revenues	35,749	32,570	3,179	10%
Gross profit	12,271	10,094	2,177	22%
Operating expenses	8,880	9,037	(157)	(2%)
Other income (expense), net	(94)	(527)	433	82%
Segment profit	3,297	530	2,767	522%
Segment profit margin	9%	2%	7%	350%

IGT's operating profit by segment reflects income from continuing operations before tax, including an applicable allocation of operating expenses, as well as other income and expenses. Our proprietary gaming segment includes both our wholly-owned gaming operations and our unconsolidated joint venture activities reported as earnings of unconsolidated affiliates. See Note 13 of our Unaudited Condensed Consolidated Financial Statements.

- * Product sales segment profit for the third quarter of fiscal 2003 increased over the third quarter of fiscal 2002 related primarily to volume growth and increased gross profit margins, partially offset by increased operating expenses.
- * Segment profit from our proprietary gaming operations decreased in the current quarter compared to the prior year quarter primarily due to the decline in gross profit as discussed above.
- * Current quarter segment profit from lottery systems grew from the same quarter last year related to increased revenues and gross profit.

Comparison of Nine Months Ended June 28, 2003 and June 29, 2002

	<u>Nine Months Ended</u>			
	June 2003	June 2002	Increase (Decrease)	% Change
<i>Revenues, earnings of unconsolidated affiliates and gross profit</i>				

(Amounts in thousands)

Consolidated:

Revenues and earnings of unconsolidated affiliates