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INTERLOTT TECHNOLOGIES INC

Form 10-K/A

August 06, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

(AMENDMENT NO. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

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 001-12986

INTERLOTT TECHNOLOGIES, INC.  
(Exact name of Registrant as specified in its charter)

DELAWARE  
(State of incorporation)

31-1297916  
(IRS Employer Identification Number)

7697 INNOVATION WAY, MASON, OHIO 45040  
(Address of principal executive offices, including zip code)

(513) 701-7000  
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, \$.01 Par Value	American Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant on June 28, 2002, the last business day of the Registrant's most recently completed second fiscal quarter, was \$16,175,411. There were 6,459,718 shares of Common Stock outstanding as of March 20, 2003.

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INTERLOTT TECHNOLOGIES, INC.  
ANNUAL REPORT ON FORM 10-K  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

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PART I

ITEM 1. BUSINESS

Interlott Technologies, Inc. (the "Company" or "Interlott") is engaged primarily in the design, manufacture, sale, lease and service of instant-winner lottery ticket vending machines ("ITVMs"). ITVMs are used by public lotteries operated by states and international public entities to dispense instant winner lottery tickets primarily in retail locations such as supermarkets and convenience stores. An instant lottery commonly is played by players scratching off a latex coating from a pre-printed ticket or tearing pull-tabs from a pre-printed ticket to determine the outcome of the game. The Company's ITVMs dispense instant lottery tickets directly to players, thereby permitting the retailer or agent to sell tickets without disrupting the normal duties of its

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employees.

The Company's ITVMs dispense scratch-off instant lottery tickets using a dispensing process that incorporates the Company's patented "burster technology." The Company believes that this burster technology is superior to any other ITVM scratch-off dispensing technology on the market and considers it to be a key to its marketing efforts and the ITVM procurement decisions of the various lotteries. The Company is unaware of any competitor that incorporates a substantially equivalent or superior scratch-off dispensing mechanism in its ITVMs. To dispense pull-tab instant lottery tickets, the Company has developed an ITVM that incorporates a patented dispensing technology which is different than the burster technology but that is also believed by the Company to be superior to any other currently available pull-tab dispensing technology. ITVMs that dispense pull-tab tickets are sometimes referred to herein as "pull tab vending machines" or "PTVMs." The term "ITVM" includes both scratch-off vending machines and PTVMs unless the context indicates otherwise.

As of December 31, 2002, the Company had sold or leased over 30,000 ITVMs through agreements with 29 different state lotteries and the District of Columbia and 14 international jurisdictions, or their licensees or contractors.

Taking advantage of its expertise in dispensing technology, the Company introduced a prepaid phone card dispensing machine ("PCDM") in 1995 that enables providers of long distance telephone service to dispense prepaid telephone calling cards in retail locations without the assistance of an employee of the retailer. The dispensing process used in the Company's PCDM incorporates the same patented technology used in the Company's PTVM, and the Company believes that this dispensing technology is superior to any other PCDM dispensing technology on the market. Although PCDM revenues in 2002 represented less than 1% of total revenues, the Company continues to believe that PCDMs may be a source of future sales growth.

The Company has entered into an Agreement and Plan of Merger dated as of March 17, 2003 with GTECH Holdings Corporation and a subsidiary of GTECH, pursuant to which the Company will merge into the subsidiary and become a wholly-owned subsidiary of GTECH. Upon the merger, each share of the Company's Common Stock will be changed into the right to receive \$9.00 in cash, GTECH common stock or a combination of the two, with 51.5% of the aggregate merger consideration to be paid in GTECH common stock and the balance in cash.

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Consummation of the merger is subject to satisfaction of various conditions, including the approval of the Company's stockholders, the making of various regulatory filings, the absence of any injunction or certain litigation challenging the merger, the receipt of tax and other legal opinions, the accuracy of the parties' representations and warranties and performance of their agreements, and the receipt of consents to the merger from customers representing 85% of the Company's projected business for 2003 and certain other parties to material contacts. GTECH may terminate the merger agreement if its stock price declines by 18% unless the Company elects to convert the merger consideration into all cash.

The Company has agreed not to solicit a competing offer, but may terminate the merger agreement to accept an unsolicited superior proposal. If it does so, the Company will be required to pay GTECH a termination fee of \$2.75 million and reimburse GTECH's expenses up to \$750,000.

In connection with the Merger Agreement, GTECH also entered into a Stockholder Voting and Option Agreement and a Noncompetition Agreement with L.

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Rogers Wells, Jr. Under the Voting and Option Agreement, Mr. Wells agreed to vote in favor of the merger and granted GTECH the option to purchase his Company Common Stock at \$9.00 if the Merger Agreement terminates for specified reasons. The Voting and Option Agreement terminates if the Company terminates the Merger Agreement to accept a superior proposal. If GTECH exercises the option, it is required to make a cash tender offer for the remaining Common Stock of the Company at \$9.00 per share.

Pursuant to the Noncompetition Agreement, Mr. Wells has agreed not to engage in the lottery business for five years after consummation of the merger. As compensation for this agreement, GTECH will pay him \$250,000 per year during that five-year period.

Interlott is a Delaware corporation. The Company's Common Stock trades on the American Stock Exchange under the symbol "ILI."

### PRODUCTS

#### The ITVM

In 1987, Edmund F. Turek, a director of and consultant to the Company, led the team that developed the technology for what the Company believes was the first automated ITVM. The burster dispensing technology is a key component of the Company's ITVM for scratch-off instant lottery tickets and is protected by a patent that the Company acquired from Mr. Turek's family-owned corporation. See "Patents, Trademarks and Copyrights" below.

The Company's ITVMs automatically dispense instant lottery tickets upon payment from the user. The burster technology in the Company's ITVMs automatically separates one scratch-off instant ticket from another along the perforations between tickets to help prevent tearing of the tickets or scarring of the latex on the tickets. This technology also enables the Company's ITVMs to dispense and account for virtually any known type of scratch-off instant lottery ticket, allowing the use of a wide range of sizes, shapes, paper stocks or perforations, without the intervention of a lottery retailer or agent. This feature allows a lottery to purchase

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virtually all types of scratch-off instant tickets from its instant ticket manufacturer without having to request from the manufacturer major alterations in the ticket perforations. For example, the Company's ITVM can dispense recyclable scratch-off tickets without tearing or scarring the tickets. This feature also is particularly beneficial to international lottery jurisdictions that may use non-standard sizes, shapes and paper stocks. In addition, the ITVM for scratch-off tickets is faster than manual sales of scratch-off tickets as the ITVM's entire dispensing process is completed in less than 1.5 seconds once the ticket selector button has been pushed.

The Company's ITVMs for scratch-off tickets have a record of reliability. The Company believes that the mean time between failure of its ITVMs is approximately 3.75 years and that the mean time to repair is approximately 15 minutes.

Since the introduction of the Company's modular Expandable Dispensing System (EDS) in 2000, the Company's ITVM for scratch-off tickets has had the capacity to dispense tickets from one to 24 different bins. Because each bin can dispense tickets of different sizes, paper stocks and price levels, lotteries can sell scratch-off tickets for up to 24 different instant-winner games with a single ITVM. The ITVM can accommodate up to 24,000 tickets in the 24-game unit

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and can dispense all tickets in the bin without manual intervention. When all of the tickets in a bin have been dispensed, tickets can be easily reloaded by an employee of the retailer or agent. The ability of the Company's ITVM to dispense every ticket in each bin not only facilitates the ticket reloading process but also enhances the accuracy of the inventory and accounting functions.

All of the Company's ITVMs accept bills in \$1, \$2, \$5, \$10 and \$20 denominations and, in some applications, accept international currency. The size of the Company's ITVM for scratch-off tickets varies from 69 inches tall, 28 inches wide and 33.5 inches deep for a 24-game unit to 19.75 inches tall, 15.5 inches wide and 20.5 inches deep for a countertop unit.

The Company's Instant Ticket Management System ("ITMS") also known as GameGuard, addresses the specific needs of convenience store and grocery check-out lanes. The GameGuard may be installed in a variety of configurations, including on the counter or under-the-counter. This technology reduces ticket shrinkage and increases sales volume of instant tickets and also may be tied into the Point of Service register.

All models are anchored to the floor or counter. The ITVMs typically are custom designed to meet any color and other appearance specifications requested by a lottery. All models are Underwriters Laboratory ("UL(R)") listed and Federal Communications Commission ("FCC") approved, which ensures that the ITVM has passed nationally recognized safety standards and stringent requirements designed to preclude machine damage and personal injury due to non-approved components, devices, installation or application.

Each ITVM is standardized with an information display that provides the player with easy-to-read instructions on how to use the machine and gives the lottery retailer or agent the ability to read sales reports without printing the report. The ITVM can be ordered with a "BETA BRITE(R)" multi-color LED sign mounted on the top of the ITVM which is intended to increase attention to the machine and thereby increase ticket sales. The BETA BRITE(R) sign is programmed at the Company's manufacturing facility and can display any message the lottery may desire. The BETA BRITE(R) also may be programmed by the retailer or agent or can be

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programmed from the lottery headquarters by utilizing the Company's optional modem communications system.

For security and durability purposes, each of the Company's ITVM cabinets is manufactured with 16 gauge and 11 gauge steel. The surface of the ITVM is coated with durable and fade resistant paints. The display windows are fabricated from a flame resistant, high impact polycarbonate sheet material. This material is shatter resistant and, to date to the knowledge of the Company, none of the Company's installed ITVMs has had a polycarbonate window broken or shattered. Additionally, to the knowledge of the Company, the cabinets have not had any fading, marring, scratching, chipping or rusting. All of the Company's ITVMs are manufactured with high security locks which are coded to prevent unauthorized duplication, and each ITVM is keyed separately, except for ITVMs deployed in Maryland where the Lottery desired a master key system. For further security, each of the Company's bill acceptor units must be accessed with a key unique to the particular acceptor unit.

All of the Company's ITVMs for scratch-off tickets utilize copyrighted software that can supply up to 12 different reports for accounting and inventory purposes. These reports can provide to the lottery and its retailers or agents a complete summary of daily sales, weekly sales, total sales, sales by game, current status of the machine, inventory of the product currently in the ITVM,

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the last three transactions of the ITVM and other types of information. The software system allows for a simple diagnostic test to identify any malfunction of the ITVM. The diagnostic mode communicates various information such as ticket size setting, status of electronics, status of each game and other information concerning the system software. The Company's ITVM software system may be programmed to the detail specifications of the specific lottery.

To dispense pull-tab instant lottery tickets, the Company's PTVM uses the same technology, design and specifications as are incorporated in the Company's PCDM, described below.

The PCDM

Like the Company's ITVM for scratch-off tickets, the key component of the Company's PCDM is the dispensing technology. The Company has the exclusive right to the use of this patented dispensing technology, which it acquired from a company owned by Kazmier J. Kasper, a director of the Company.

Similar to the Company's ITVM for scratch-off tickets, the Company's PCDM automatically dispenses prepaid telephone calling cards upon payment from the user. The dispensing technology in the Company's PCDM automatically pulls one prepaid telephone calling card from the bottom of the stack of cards without the jamming that is associated with other dispensing processes. The Company's dispensing technology also enables the Company's PCDM to dispense and account for virtually any known thickness of calling card without the intervention of the retailer. In addition, the PCDM is faster than manual sales of prepaid telephone calling cards as the PCDM's entire dispensing process is completed in less than three seconds once the selector button has been pushed.

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The Company's PCDMs have the capacity to dispense cards from two to six different bins. The PCDM can accommodate up to 3,600 cards in the six-bin unit and can dispense all prepaid telephone calling cards in the bin without manual intervention. When all of the cards in a bin have been dispensed, cards easily can be reloaded by an employee of the retailer. The ability of the Company's PCDM to dispense every card in each bin not only facilitates the card reloading process but also enhances the accuracy of the inventory and accounting functions.

All of the Company's PCDMs accept bills in \$1, \$2, \$5, \$10 and \$20 denominations and, in some applications, accept international currency. The size of the Company's PCDMs varies from 66 inches tall, 26 inches wide and 19 inches deep for a six-bin dispenser unit to 22 inches tall, 14 inches wide and 10 inches deep for a countertop unit. All models are anchored to the floor or counter, except that the two bin model may be mounted on an optional pedestal. All models are UL(R) listed and FCC approved. Each PCDM is standardized with an information display that provides the user with easy-to-read instructions on how to use the machine and gives the retailer the ability to read sales reports without printing the report.

For security and durability purposes, each of the Company's PCDM cabinets is manufactured with 16 gauge and 11 gauge steel. The surface of the PCDM is coated with durable and fade resistant paints. The display windows are fabricated from a flame resistant, high impact polycarbonate sheet material. To the knowledge of the Company, the cabinets have not had any fading, marring, scratching, chipping or rusting. All of the Company's PCDMs are manufactured with high security locks that are coded to prevent unauthorized duplication, and each PCDM is keyed separately. For further security, each of the Company's bill acceptor units must be accessed with a key unique to the particular acceptor unit.

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All of the Company's PCDMs utilize copyrighted software that can supply up to twelve different reports for accounting and inventory purposes. These reports can provide retailers a complete summary of daily sales, weekly sales, total sales, sales by bin, current status of the machine, inventory of the product currently in the PCDM, the last three transactions of the PCDM and other types of information. The software system allows for a simple diagnostic test to identify any malfunction of the PCDM.

### MARKETING AND SALES

#### ITVMs

The Company markets its ITVMs to both domestic and international lotteries and their licensees or prime contractors. The Company attends lottery and gaming trade shows, maintains personal contact with lottery officials through its sales force and advertises in trade publications to increase its presence in the lottery industry.

The focus of the Company's marketing strategy is on the superior performance and reliability of its ITVMs, as well as continued competitive pricing. Information developed through actual field use and product field tests demonstrates that a significant factor in increasing instant ticket sales is the reliability of the ITVM. Increased maintenance visits impair an ITVM's "uptime," which in turn reduces ticket sales. The Company believes that its ITVMs, based on actual field performance and product testing, are the most reliable and technologically superior in

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the industry. The Company's ITVMs require preventive maintenance only twice a year. The ITVM "downtime" resulting from this semi-annual preventive maintenance averages approximately 20 minutes.

To further increase the likelihood of receiving ITVM orders from lotteries, the Company offers flexible financing alternatives to the lotteries. The Company believes that many state lotteries, due to budget considerations, cannot afford the high capital costs required to purchase ITVMs. However, if the Company can provide attractive variations of its standard and percentage lease financing options for the lotteries, the lotteries can more affordably deploy ITVMs.

The Company is expanding its marketing presence with the retail grocers associations, convenience store operators associations, retail stores at both the corporate and store levels, and other types of corporate or association member entities to familiarize these groups with the Company's ITVM. These retailers are the lotteries' distribution system for all scratch-off and pull-tab lottery tickets. While the lotteries must abide by the established procurement laws of their respective jurisdictions in selecting an ITVM manufacturer, in many lottery jurisdictions retailer advisory boards provide input to the lotteries on various issues affecting the lottery. The Company believes that retailers' opinions are a significant factor in a customer's decision regarding which manufacturer's ITVM to deploy in its instant ticket distribution system.

On occasion, the Company participates in cooperative supply arrangements with other lottery suppliers. These arrangements allow lotteries to reduce their operating costs and provide a more efficient means for contracting products and services. The Company's ITVMs are deployed in Pennsylvania and West Virginia pursuant to cooperative supply arrangements between the Company and

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International Game Technologies, which is the primary contractor for the Pennsylvania and West Virginia Lotteries. ITVMs are deployed in Georgia pursuant to a cooperative supply arrangement with Scientific Games, Inc. and in California and New Jersey pursuant to maintenance or purchase agreements between the Company and GTECH Corporation, which is the on-line supplier to both Lotteries. The Company is responsible for installing, servicing and maintaining the ITVMs in Georgia but is not required to provide preventive maintenance or servicing for the ITVMs supplied for use in Pennsylvania, West Virginia, California and New Jersey.

### PCDMs

The Company has been marketing its PCDMs since late 1995 and to date has employed a marketing strategy that is similar to the strategy that it has used successfully to market its ITVMs. The focus of the Company's marketing strategy is on the superior performance and reliability of its PCDMs as well as on competitive pricing. The Company markets its PCDMs to both domestic and international providers of long distance telephone service. The Company attends telecommunications trade shows, maintains personal contact with telecommunications companies through its sales force and advertises in trade publications to increase its presence in the telecommunications industry.

The Company is expanding its marketing presence with the retail grocers associations, convenience store operators associations, retail stores at both the corporate and store levels, and

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other types of corporate or association member entities to familiarize these groups with the Company's PCDM. These retailers are the distribution system for prepaid telephone calling cards. To further increase the likelihood of receiving PCDM orders from sellers of prepaid telephone calling cards, the Company is offering additional and more flexible financing alternatives; however, almost all the PCDMs in the field today have been sold rather than leased.

### CONTRACTS

#### ITVMs

The Company's lottery contracts typically are entered into following a competitive bidding process. Once a lottery has determined to utilize ITVMs in its distribution network, the lottery usually will request proposals from ITVM providers. Lotteries within the United States typically follow a procedure whereby the lottery issues a Request for Proposal ("RFP") to determine the contract award for installation of ITVMs. The RFP generally seeks information concerning each company's products, cost of the products or services to be provided, quality of management, experience in the industry and other factors that the lottery may deem material to a contract award. The RFP also may specify product criteria and other qualifications or conditions that must be satisfied, such as UL(R) listing and FCC approval of the ITVM and in-state or minority supplier requirements. Generally, a committee of key lottery staff members evaluates the proposals based on an established point system, and the contract is awarded to the company with the most points.

The nature of the RFP process varies from jurisdiction to jurisdiction. The length of time that a lottery might take to award a contract can be difficult to predict, and delays in the contract award process are frequent. Additionally, the point system or the weighting of the various points varies from jurisdiction to jurisdiction, which often makes it difficult for the bidding companies to determine the relative importance of the various factors to be considered by the evaluation committee. In certain cases the contract award



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is challenged by the losing bidder, which can result in protracted legal proceedings for all parties.

The Company offers lotteries a choice of three types of contracts: (i) Standard Lease Agreements, (ii) Sales Agreements, and (iii) Percentage Lease Agreements. ITVM lease revenues as a percentage of the Company's total revenues were 42.2%, 42.9% and 36.0% in 2000, 2001 and 2002, respectively.

The Standard Lease Agreements provide that the lottery will pay a fixed monthly price per machine for a specific period of time. These agreements typically specify a number of years for the initial contract term with additional option periods at the election of the lottery. The lottery may award a separate service contract for the maintenance of the machines, incorporate the cost of service into the established monthly lease price or perform machine service itself. Similar arrangements are available for replacement parts for the ITVMs.

As noted above, the lease payments provided for in the typical Standard Lease Agreement are fixed in most cases during the term of the agreement, and these agreements typically permit the lottery to order additional ITVMs at any time during the lease term. If the lottery orders a significant number of ITVMs near the end of the lease term, the Company would

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have to incur significant manufacturing costs but may receive lease payments for only a relatively short period of time through the remainder of the lease term. However, the Company believes that it is more likely that the lottery would elect to extend the lease term rather than return the ITVMs after only a short period of use. Additionally, the Company is unable to pass along to the lottery any increases in its manufacturing and service costs during the term of the typical Standard Lease Agreement. In the case of a Standard Lease Agreement which provides for a short initial term (such as one year) with an option for the lottery to extend the lease term for additional one-year periods, if the lottery does not extend the initial lease term, the Company might incur a loss on the manufacture of the ITVMs leased to the lottery under the initial lease agreement.

Sales Agreements typically provide that the lottery will buy a certain number of ITVMs over a specific period of time. Under the Sales Agreement, the lottery generally pays for the ITVMs when delivered and has complete ownership of the ITVMs. The lottery usually will contract with the vendor to maintain and service the ITVMs, although some lotteries provide the maintenance and service with their own service staffs. The lottery generally will enter into a parts replacement contract with the vendor for replacement parts.

Percentage Lease Agreements provide that the lottery will pay a percentage of sales for tickets sold through our ITVMS. This amount will vary depending upon the location of the machine, the number of games available and the general trends in instant lottery sales.

All types of ITVM contracts typically contain stringent installation, performance and maintenance requirements. Failure to perform the contract requirements may result in significant liquidated damages or contract termination. To date, the Company has not had to pay any liquidated damages or had any contract terminated by any lottery.

The Company's lottery contracts also typically require the Company to indemnify the lottery, its officers and retailers for any liabilities arising from the operation of the ITVMs or any services provided by the Company. The Company maintains liability insurance, fidelity insurance and performance and

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litigation bonds to protect itself and the lottery from potential liability. No such indemnification or insurance claims have ever been asserted against the Company.

The Company's contracts generally have an initial term of one to five years with options to extend the duration of the contracts for periods between one and five years. The option extensions generally are under the same terms and conditions as the original contract. The Company's contracts with lotteries, like most other types of state contracts, typically permit a lottery to terminate the contract upon 30 days written notice for any reason. Upon termination of a lease contract, the lottery would return the leased equipment to the Company. To date, no lottery has terminated its contract with the Company.

Twenty-seven states and the District of Columbia currently utilize ITVMs in some manner as part of their instant ticket distribution system. As of December 31, 2002, Company ITVMs were deployed in all of these states and the District of Columbia as well as in 14 international jurisdictions. The Company currently has 11,484 ITVMs under lease with 18 states and the District of Columbia. These leases expire on various dates through 2005. In certain

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cases, the Company's contracts are with third parties who are the primary contractors to the lottery. See "Marketing and Sales - ITVMs" above.

Significant portions of the Company's annual revenues are derived from a limited number of contracts, which vary in size and by customer from year to year. During 2002, the Company's contract with the Illinois Lottery for the sale of ITVMs accounted for 21% of the Company's revenues, a sales and lease contract with the New York Lottery accounted for 18% of the Company's revenues and a contract with the California Lottery accounted for 17% of the Company revenues.

### PCDMs

Unlike the competitive bidding process applicable to the lotteries' awards of ITVM contracts, purchasers of PCDMs typically do not issue RFPs or otherwise mandate a competitive bidding process. Information regarding the Company and its PCDM, and information regarding a telephone company's product needs and criteria and other qualifications or conditions that must be satisfied, typically is exchanged on a less formal basis in sales presentations and subsequent meetings between representatives of the Company and representatives of the telephone company.

Most PCDMs to date have been acquired through purchase orders rather than contracts and are sold rather than leased. Like contracts with the lotteries, the purchase orders may contain stringent installation, performance and service requirements. As of December 31, 2002, the Company had sold 935 PCDMs.

### MANUFACTURING PROCESS

The manufacturing process consists of purchasing component parts, assembling the ITVMs and PCDMs and then testing the final products. Generally, the Company's machines use components which are built to Company specifications and are available from multiple sources. The Company has a primary vendor and secondary suppliers for most of its components and typically has been able to

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obtain adequate supplies of required components on a timely basis. However, certain important components, such as components of the Company's ITVM burster, PTVM dispensing mechanism and PCDM dispensing mechanism currently are purchased from a single source. Because other suppliers exist that can duplicate these components should the Company elect or be forced to use a different supplier, the Company does not believe that a change in suppliers would result in the termination of a production contract. However, the Company could experience a delay of 30 to 60 days in production which could adversely affect the Company's ability to make timely deliveries of machines and to obtain new contracts. The single-source supplier of certain components of the Company's burster mechanism, PTVM dispensing mechanism and PCDM dispensing mechanism is Algonquin Industries, Inc. Kazmier J. Kasper, a director of the Company, is the President and owner of Algonquin Industries. See "Item 13. Certain Relationships and Related Transactions."

The Company assembles the components utilizing a core group of manufacturing employees and, on an as-needed basis, contracting with employment agencies for appropriately trained manufacturing labor. The use of temporary, contract manufacturing labor gives the Company the flexibility to meet the production schedules required by large orders.

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The Company's manufacturing facility has the capacity to produce approximately 300 machines per week.

### RESEARCH AND PRODUCT DEVELOPMENT

The Company continually seeks to enhance its existing product lines and to develop new products and has developed many of the technological advancements used in the ITVM industry. The Company was the first to obtain UL(R) listing and FCC approval. The Company also was the first to (i) manufacture and deliver ITVMs under a lease contract agreement, (ii) offer a "random play" push button selector option through which the ITVM rather than the player randomly selects the game to be played and (iii) receive patent protection for the technology used in its ITVM burster dispensing mechanism.

The Company currently employs several engineers and technicians for research and development. To reduce costs, the Company subcontracts the majority of its research and development projects to independent contractors. The Company's copyrighted software is upgraded continually to meet the different demands of the various lotteries. In many instances, after an ITVM feature has been developed for a specific lottery, it is incorporated into the product line as a standard feature of the machine.

The Company's ITVMs may be purchased with optional modem communication software which allows lotteries to gather sales data from each ITVM on an hourly, daily, weekly or monthly basis, depending on the needs of the customer. This data includes the daily or weekly sales totals and breakdown of these totals by game, including the total tickets sold. The Company has developed software that enables a modem equipped ITVM to communicate to the host system automatically if the ITVM malfunctions, thus greatly enhancing the Company's ability to provide prompt service, or if a ticket bin is empty, which allows the lottery to call the retailer or agent and inform them of the situation. Additionally, by utilizing this system with the optional BETA BRITE(R) message display, the lottery can change the message display on any or all of its ITVMs.

The Company has incorporated its patented pull-tab lottery ticket dispensing mechanism into a combination ITVM which also contains the Company's patented burster mechanism. The pull-tab dispensing mechanism also has been incorporated into the Company's PCDMs, and the Company believes that the ability

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of the mechanism to dispense a variety of thicknesses of prepaid telephone calling cards significantly differentiates the Company's PCDMs from those of its competitors.

In 2000, the Company introduced its modular Expandable Dispensing System (EDS). These ITVMs have the unique ability to increase the number of dispensing units in an existing machine. The EDS series is field expandable up to 24 games and incorporates all the same features and benefits as previous models. The expansion is accomplished on-site and in a manner of minutes and gives the lotteries the ability to add one or more dispensing units to the machine, without affecting the overall operation or appearance. These ITVMs are the most modern and technologically advanced ITVMs in the industry.

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Research and development expenditures were \$640,151, \$347,596 and \$529,585 for 2000, 2001 and 2002, respectively.

### CUSTOMER SERVICE AND PRODUCT REPAIR

Typically, the Company or its subcontractors install and service the machines purchased or leased by the Company's customers. The Company maintains a toll-free telephone line for service calls. If the service dispatcher cannot resolve the problem over the telephone, he or she will immediately dispatch one of the Company's service technicians to the machine's location. The modular design and manufacturing standards of the Company's machines enable the Company to conduct any necessary repairs and maintenance quickly and efficiently. The Company estimates that the mean time for all repairs is less than 15 minutes after the service technician arrives at the machine's location.

The Company generally grants a 360-day repair or replacement warranty covering all parts and components of its machines. However, the warranty period may vary depending on the bid specifications. In certain circumstances, the Company may warrant the product for the complete life of the contract. In these instances, the contract generally will be a lease with the Company retaining ownership of the machine.

### PATENTS, TRADEMARKS AND COPYRIGHTS

The Company currently has twenty-three U.S. and foreign patents and thirty pending patent applications relating to its ITVMs and lottery related technology and has filed a disclosure document with the United States Patent and Trademark Office ("PTO").

The Company owns by assignment U.S. Patent No. 4,982,337 entitled "System for Distributing Lottery Tickets." The assignment is recorded at the PTO. This patent is for the Company's basic burster technology, which is the key component of many of the Company's ITVMs. The patent expires December 31, 2007. Improvements to the burster technology owned by the Company are the subject of U.S. Patent No. 5,836,498, which expires April 10, 2016. That version of the improved burster provides for an increased range of operation for reliable and effective separation of the adjacent tickets along the lines of weakness. Additional patent applications are pending on these and other improvements to the burster technology.

The Company has developed a new system designed specifically for retail vending of lottery tickets and other items at the point of sale. The system utilizes the Company's burster technology and includes other modular and distributed components that can be adapted for use at the point of sale. The Company owns U.S. Patent Nos. 5,943,241; 6,038,492; 6,351,688 and 6,356,794; and has corresponding foreign patent properties on this technology.

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The Company owns U.S. Patent No. 5,330,185 for the "Method and Apparatus for Random Play of Lottery Games," which expires March 30, 2013; U.S. Patent No. 5,472,247 for a "Multi-Point High Security Locking Mechanism for Lottery Machines," which expires July 18, 2014; and U.S. Patent No. 5,772,510, which expires October 26, 2015 on a system and associated method for completing lottery tickets prior to being dispensed from a lottery ticket terminal.

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The Company also owns six design patents including U.S. Design Patent No. 376,621 for the Company's double-game countertop ITVM, which expires December 17, 2010 and U.S. Design Patent No. 369,622 directed to a ticket dispensing machine and expires May 7, 2010. Additionally, U.S. Design Patent No. 428,060 is owned by the Company on a front panel for a ticket dispensing machine. The Company also owns U.S. Design Patent Nos. 448,957; 448,956; and 441,227, each entitled "Countertop Lottery Ticket Dispenser." Each of these design patents is directed to various configurations for countertop lottery ticket dispensers. The Company believes that each of these design patents is important but not essential to the Company's business.

The Company has an Information Disclosure Document on file with the PTO for the purpose of identifying technology relating to its "Software Release Control and Data Security for ITVMs." The technology allows secure remote transmission of software updates and operations data between the ITVM and the Company or the respective lottery. The invention also includes a key management system to control the keys used to encrypt data sent to and decrypt the data received at the ITVM.

The Company is the exclusive licensee of the dispensing technology used in PTVMs and PCDMs pursuant to an agreement with Algonquin Industries. Algonquin Industries has been granted ten U.S. patents and has corresponding foreign patents/applications for the licensed technology. Under the terms of the license agreement, the Company is the sole entity entitled to use this technology on its ITVMs. See "Item 13. Certain Relationships and Related Transactions."

The Company also has a number of pending patent applications that are directed to various features of countertop ticket dispensers, self-serve lottery ticket vending machines, lottery ticket separation mechanisms and lottery games. The variety of technologies encompassed by these pending applications includes lottery ticket dispensers in which a single rotary separator serves multiple ticket channels and the separator mechanism itself. Additionally, specific configurations of countertop ticket dispensers, techniques for administering a lottery game and adapting known games to a lottery environment are also included in these pending applications.

The Company has obtained or filed for federal registration in the United States of the following trademarks: INTERLOTT, CHECKWRITER, MVP MODULAR VENDING PLATFORM and INSTANT SUCCESS. The Company does not deem the trademarks to be critical to the future of its business.

The Company requires all of its employees and subcontractors to execute confidentiality and proprietary rights agreements, which prohibit disclosure of the trade secrets of the Company and provides that all inventions or discoveries during the term of their employment or contract for service are assigned to the Company.

### COMPETITION

Competition in the markets for the Company's ITVM and PCDM is based on a number of factors, including technological features, product quality and

reliability, price, compatibility,

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ease of installation and use, marketing and distribution capabilities, product delivery time, and service and support. The Company is aware of three manufacturers of ITVMs and four manufacturers of PCDMs in the United States, and competition among these manufacturers is intense. Of the three ITVM competitors, the Company has the largest share of the ITVM market in the United States. The Company is not aware of any published data regarding market shares in the PCDM industry, but the Company does not believe that it has the largest market share in the PCDM industry.

Additional domestic and international manufacturers, some of which have substantially greater resources and experience than the Company, may elect to enter the ITVM and PCDM markets. The instant ticket market also faces competition from other types of lottery and gaming products, including particularly on-line lottery products. The long distance telephone market similarly may face competition from other types of communications products, including facsimile, e-mail and other on-line products.

The Company believes that its patented dispensing technologies make its ITVM and PCDM dispensing mechanisms technologically superior to the dispensing mechanisms of its competitors and that this is a significant competitive advantage for the Company. The Company also believes that its products have earned a strong reputation for their performance, reliability and cost effectiveness. To remain competitive, the Company believes that it will need to continue to incorporate new technological developments into its existing products and to develop new products, as well as to maintain a competitive price for its products. These efforts, together with the Company's continuing sales and marketing efforts, will be critical to the Company's future success. Although the Company believes that its current successes, coupled with its history of continued product enhancement and cost reduction, will enable it to compete favorably with its competitors, there can be no assurance that the Company will be able to maintain or improve its competitive position in the ITVM and PCDM markets.

#### GOVERNMENT REGULATION

##### ITVMs

Lotteries are not permitted in the various states and jurisdictions of the United States unless expressly authorized by legislation. Similarly, the commencement of ITVM sales and leasing in a jurisdiction requires authorizing legislation and implementing regulations.

Currently, 38 states and the District of Columbia have enacted legislation to allow for the operation of a lottery, and 27 of these jurisdictions currently utilize ITVMs in some manner as part of their instant ticket distribution process. The operation of the lotteries in each of these jurisdictions is strictly regulated. The formal rules and regulations governing lotteries vary from jurisdiction to jurisdiction but typically authorize the lottery, create the governing authority, dictate the price structure, establish allocation of revenues, determine the type of games permitted, detail appropriate marketing structures, specify procedures for selecting vendors and define the qualifications of lottery personnel. Although the Company currently believes that it is unlikely that states which have enacted legislation that expressly authorizes the use of ITVMs will adopt legislation in the foreseeable future that prohibits the use of ITVMs, there can be no assurance that this will not occur.

To ensure the integrity of the lottery, state laws provide for extensive background investigations of each of the lottery's vendors and their affiliates, subcontractors, officers, directors, employees and principal stockholders. These regulations generally require detailed continuing disclosure. If the lottery deems a person unsuitable, the lottery may require the termination of the person's relationship with the Company. The failure of a person associated with the Company to obtain or retain approval in any jurisdiction could have a material adverse effect on the Company. Generally, regulatory authorities have broad discretion when granting such approvals. The Company has never been disqualified from a lottery contract as a result of a failure to obtain any such approvals.

The Federal Gambling Devices Act of 1962 (the "Act") makes it unlawful, with certain exceptions, for a person or entity to transport any gambling devices across interstate lines unless that person or entity has first registered with the United States Department of Justice. Although the Company believes that it is not required to register under the Act, the Company has registered voluntarily and intends to renew its registration annually. The Act also imposes various record keeping and equipment identification requirements. Violation of the Act may result in seizure or forfeiture of equipment, as well as other penalties.

The Company retains governmental affairs representatives in various jurisdictions of the United States to monitor legislation, advise the Company on contract proposals, and assist with other issues that may affect the Company. The Company believes it has complied with all applicable state regulatory provisions relating to disclosure of its activities and those of its advisors.

International jurisdictions that operate lotteries also impose strict regulations. International regulations may vary from those in the United States. Additionally, international regulations frequently impose restrictions on international corporations doing business within the specific jurisdiction. As a result, the Company may contract with local representation or align itself with a local partner when pursuing international contracts.

#### PCDMs

The Company is not aware of any federal, state or local regulations that apply to the manufacture, lease or sale of PCDMs.

#### BACKLOG

The Company's backlog of ITVMs as of December 31, 2002 was approximately \$6,818,795, which was equal to the total base lease payments or sales value for ITVMs that were committed for production but had not been shipped to various lotteries as of December 31, 2002. At December 31, 2001, the comparable backlog was approximately \$4,881,900. It is anticipated that substantially all of the Company's backlog at December 31, 2002 will be shipped on or before December 31, 2003.

The Company has various lease or sales agreements that permit the lotteries, at their sole option, to lease or purchase additional ITVMs. However, the Company does not include these

additional ITVMs in backlog unless the Company has received a firm order for the ITVMs. Due to the relatively large size of individual orders, the small number

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of customers and the long sales cycle of the lottery industry, management considers backlog to be an indicator of current activity and not necessarily predictive of future orders.

### EMPLOYEES

The Company utilizes a work force of full-time employees supported from time to time by temporary or contract manufacturing and engineering personnel. As of December 31, 2002, the Company had 231 full-time employees, of which 81 were manufacturing employees, 9 were engineering employees, 100 were service employees, 28 were clerical and administrative employees, 7 were sales employees and 6 were executives or senior managers. Two of the executives and senior managers were devoted to sales and four were devoted to management and administration. No Company employees are represented by any union, and the Company believes that its relations with its employees are good.

### ITEM 2. PROPERTIES

The Company's manufacturing, sales, distribution and executive offices are located in approximately 52,500 square feet of leased space in Mason, Ohio. The facility is comprised of 15,000 square feet of office space and 37,500 square feet of manufacturing and storage space. The Company believes that this facility is suitable for and adequate to support its operations for the foreseeable future. The lease for this facility expires on March 31, 2005.

### ITEM 3. LEGAL PROCEEDINGS

On November 1, 2002, the Company filed a Complaint against Pollard Banknote Limited (and related parties) for patent infringement by Pollard in connection with its marketing of Instant Ticket Vending Machines that are alleged to infringe Interlott's patented burster technology. Interlott Technologies, Inc. v. Pollard Banknote Limited, et al., United States District Court for the Northern District of Ohio. An Answer and Counterclaim was filed by Pollard on November 25, 2002, in which Pollard denied liability for infringement and asserted that Interlott's burster patent (No. 4,982,337) is invalid or unenforceable. Document production is in its early stages and no depositions have yet been taken. It is not possible to predict a likely outcome at this time.

The Company is involved from time to time in litigation in the ordinary course of its business. The Company does not believe that, other than described above, there is any currently pending or threatened litigation against the Company that, individually or in the aggregate, is likely to have a material adverse effect on its business, financial condition or results of operations.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted by the Company to a vote of its stockholders during the fourth quarter ended December 31, 2002.

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## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the American Stock Exchange



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under the symbol "ILI." The table below shows the high and low closing sale prices per share for the Common Stock as reported by the American Stock Exchange for the periods indicated.

	High	Low
	----	---
2001:		
First Quarter	\$ 6.38	\$ 3.82
Second Quarter	5.24	4.00
Third Quarter	6.40	4.50
Fourth Quarter	4.90	4.02
2002:		
First Quarter	\$ 5.75	\$ 4.45
Second Quarter	6.95	5.40
Third Quarter	7.25	5.20
Fourth Quarter	6.10	5.15

At March 4, 2003 there were approximately 50 stockholders of record and an unknown number of beneficial owners holding stock in nominee or "street" name. The Company has paid no cash dividends on its Common Stock and currently intends to retain all future earnings for use in the development of its business.

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### ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial data derived from the Company's audited financial statements for each year in the five-year period ended December 31, 2002 and should be read in conjunction with the Company's Financial Statements and with Management's Discussion and Analysis of Financial Condition and Results of Operations set forth below.

	Year Ended December 31,			
	2002	2001	2000	1999
	(in thousands, except per share data)			
Revenues				
Machine sales	\$ 27,209	\$ 19,359	\$ 21,959	\$ 3,312
Machine leases	18,698	18,337	17,966	16,902
Other	6,097	5,021	2,664	2,120
Net revenues	52,003	42,716	42,589	22,334
Net income	3,091	1,949	3,610	2,070
Net income per share(1)	0.48	0.30	0.56	0.32
Depreciation and amortization	7,247	7,315	6,622	5,548
Leased ITVMs, less				
accumulated depreciation	13,277	17,883	21,573	21,549

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Total assets	51,722	54,917	40,004	36,204
Total debt	21,335	29,743	16,000	16,292
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Redeemable preferred stock	--	--	--	\$ 1,335
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(1) Reflects the weighted average number of shares outstanding for the respective periods, taking into account a 2-for-1 split of the Company's Common Stock effected in December 2000.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The Company's revenue base consists of revenues from (1) operating leases for instant ticket vending machines ("ITVMs") and phone card dispensing machines ("PCDMs"), (2) sales of ITVMs which are accounted for as sales type leases in the same manner as a direct sale but have the on-going cash flow characteristics of operating leases, (3) sales of ITVMs and PCDMs, and (4) to a lesser extent, sales of parts for ITVMs and PCDMs and service agreements. Leases provide the Company with a consistent revenue stream, opportunities to generate income on financing, and the potential to deploy a greater number of ITVMs within a lottery's budget due to the lower initial cash outlay required by the lottery. Leasing ITVMs also gives a lottery the flexibility to enhance its ITVMs in the future with new technology from the Company. On the other hand, leasing ITVMs requires the Company to invest capital or otherwise finance the manufacture of ITVMs, whereas sales of ITVMs result in the receipt of payment in full upon

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delivery of the ITVMs. When the Company sells ITVMs, the Company generally is able to manufacture and deliver the ITVMs and receive full payment for them before it must pay for the materials used to manufacture the ITVMs. Nevertheless, the Company believes that the advantages of leasing ITVMs, as described above, justify the initial capital investment or financing costs required to manufacture ITVMs for lease.

Some of the benefits of leasing described above apply to PCDMs; however due to the typically smaller size of a PCDM customer order, a great majority of the PCDMs deployed to date have been sold rather than leased.

The Company historically has experienced fluctuations in its financial results due to the unpredictable nature, timing and results of the lotteries' contract bid and award process. The Company's revenues and capital expenditures can vary significantly from period to period because the Company's sales cycle may be relatively long and because the amount and timing of revenues and capital expenditures depend on factors such as the size and timing of awarded contracts and changes in customer budgets and demands. Operating results may be affected by the lead-time sometimes required for business opportunities to result in signed lease or sales agreements, working capital requirements associated with manufacturing ITVMs pursuant to new orders and the extended time that may elapse between the award of a contract and the receipt of revenues from the sale or lease of ITVMs.

On June 1, 2001 the Company completed the acquisition of the lottery

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assets of On-Point Technology Systems, Inc., including patents, technology, accounts receivable of \$1.0 million, \$3.4 million of inventory, service contracts and lease contracts with four state and two international lotteries. On-Point's lottery related revenues during 2000 were \$10.2 million. The purchase price included approximately \$13 million paid at the closing; deferred payments of \$9 million payable, subject to adjustment, over five years; and an earn-out of up to \$6 million based on certain future revenues.

### 2002 AS COMPARED TO 2001

Total revenues increased by 22% or \$9,287,350 from \$42,715,686 in 2001 to \$52,003,036 in 2002, primarily due to a \$7,850,185 increase in machine sales to several state lotteries. Other revenues increased \$1,076,015 from \$5,020,599 in 2001 to \$6,096,614 in 2002 primarily as a result of the full year effect of the addition of maintenance contracts for the New York and Virginia lotteries which were acquired from On-Point on June 1, 2001. Revenues from leases increased by 2%, from \$18,336,526 in 2001 to \$18,697,676 in 2002. The total number of ITVMs and PCDMs under lease decreased in 2002. Lease revenues were 43% and 36% of total revenues for 2001 and 2002, respectively. Revenues from sales of ITVMs and PCDMs were 45% and 52% of total revenues in 2001 and 2002, respectively.

Cost of revenues for machine sales increased 26% from \$14,251,360 in 2001 to \$17,914,274 in 2002. This increase was due to an increase in the number of machines sold in 2002. Excluding depreciation, cost of revenues for leased ITVMs and PCDMs increased 23% from \$10,748,221 in 2001 to \$13,105,267 in 2002. The dollar increase in cost of lease revenues was the result of a full year of higher personnel and subcontractor costs related to a large number of machines acquired from On-Point on June 1, 2001 which amounted to \$1,504,551, to increased

travel cost and temporary labor of \$133,000 related to deployment costs for new leased machines deployed during 2002 and to removal costs for machines being returned. Additionally, manufacturing salaries and indirect labor increased by \$359,411. As a result of these factors, gross margin as a percent of revenues increased 2% from 27% in 2001 to 29% in 2002.

Depreciation of ITVMs and PCDMs decreased 5% from \$6,394,051 in 2001 to \$6,079,605 in 2002. The decrease was due primarily to the full twelve months' effect in 2002 of the removal of equipment from the field in July 2001 due to the expiration of a lease contract.

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. The Company adopted SFAS No. 142 on January 1, 2002, as required. Any effect will be the difference in no longer amortizing goodwill and any impairment that is determined. At this time, the Company believes that no impairment exists. The Company considers cash flow

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losses as an indicator of potential impairment. When undiscounted cash flows are less than the carrying value, an impairment loss will be recognized.

Goodwill amortization from June 2001, when the assets of On-Point were acquired, through December 31, 2001, was approximately \$166,600. Amortization for 2002 would have been \$244,081.

Selling, general and administrative expenses increased 15% from \$5,915,233 in 2001 to \$6,784,042 in 2002. The increase resulted primarily from an increase in legal and professional fees of \$420,884 and higher administrative salary and wage expenses of \$162,208. As a percentage of revenues, selling, general and administrative expenses decreased from 14% in 2001 to 13% in 2002.

Research and development costs increased by 52% from \$347,596 in 2001 to \$529,585 in 2002 as the Company completed the development phase of its GameGuard countertop units and improved dispensing mechanisms. The Company generally contracts out its research and development efforts. This allows the Company to focus its expenditures on the technical expertise necessary to accomplish a specific project.

Operating income increased by 54% from \$4,892,644 in 2001 to \$7,510,263 in 2002. This increase resulted primarily from the higher sales volume and higher margins for machines sold. As a percentage of revenues, operating income increased from 11% in 2001 to 14% in 2002.

Interest expense increased by 4% from \$2,049,605 in 2001 to \$2,138,409 in 2002. The increase reflected the full year cost of additional borrowings to finance the acquisition of the lottery assets of On-Point on June 1, 2001.

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Pre-tax income increased 75% from \$2,884,335 in 2001 to \$5,035,979 in 2002.

The effective income tax rate increased from 32.4% in 2001 to 38.6% in 2002. This difference was due primarily to a change in the tax accounting method for patents which reduced income tax expense by \$199,654 in 2001.

As a result of the above factors, the Company's net income increased by 59% from \$1,949,306 in 2001 to \$3,090,645 in 2002.

2001 AS COMPARED TO 2000

Total revenues increased by \$126,596, from \$42,589,090 in 2000 to \$42,715,686 in 2001, due to a \$2,356,585 increase in other revenues and a \$370,081 increase in lease revenues offset by a \$2,600,070 decrease in machine sales. Other revenues increased by 88% from \$2,664,014 in 2000 to \$5,020,599 in 2001, primarily as a result of the addition of maintenance contracts for the New York and Virginia lotteries which were acquired from On-Point. Revenues from leases increased by 2%, from \$17,966,445 in 2000 to \$18,336,526 in 2001, primarily due to the addition of a lease of machines to the Illinois lottery which was also acquired as part of the purchase of On-Point. This increase was partially offset by the expiration of a lease contract with the Florida lottery which expired on July 1, 2001. The total number of ITVMs and PCDMs under lease decreased in 2001. Lease revenues were 42% and 43% of total revenues for 2000 and 2001, respectively. Machine sales in 2000 included a record purchase of ITVMs for one state lottery that was produced and shipped over the first three quarters of the year. In 2001, a large sale was completed during the first two quarters while smaller orders were produced during the third and fourth quarter

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resulting in lower total sales for 2001. Revenues from sales of ITVMs and PCDMs were 52% and 45% of total revenues in 2000 and 2001, respectively.

Cost of revenues for machine sales and other decreased 10% from \$15,850,677 in 2000 to \$14,251,360 in 2001. This decrease reflected a 9% decrease in the number of machines sold in 2001 and slightly lower machine costs. Excluding depreciation, cost of revenues for leased ITVMs and PCDMs increased 58% from \$6,798,596 in 2000 to \$10,748,221 in 2001. The dollar increase in cost of lease revenues was the result of amortization of leases acquired from On-Point of \$499,450, higher personnel and subcontractor costs related to a large number of machines acquired from On-Point which amounted to \$2,490,928 and the cost of new leased machines deployed during 2001 in the amount of \$93,744.

Depreciation of ITVMs and PCDMs increased less than 1% from \$6,366,899 in 2000 to \$6,394,051 in 2001. The increase was due to newer units being deployed that have more dispensing capacity and cost more.

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be

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Disposed Of. At this time, the Company believes that no impairment exists. The Company considers cash flow losses as an indicator of potential impairment. When undiscounted cash flows are less than the carrying value, an impairment loss will be recognized.

The Company adopted SFAS No. 142 on January 1, 2002, as required. Any effect will be the difference in no longer amortizing goodwill and any impairment that is determined. Goodwill amortization from June 2001, when the assets of On-Point were acquired, through December 31, 2001, was approximately \$166,600.

Selling, general and administrative expenses increased 9% from \$5,421,062 in 2000 to \$5,915,233 in 2001. The increase resulted primarily from higher salary and wage expenses of \$339,267 and an increase in legal and professional fees of \$144,332. As a percentage of revenues, selling, general and administrative expenses increased from 13% in 2000 to 14% in 2001.

Research and development costs decreased by 46% from \$640,150 in 2000 to \$347,596 in 2001 as the Company completed the development phase of its Expandable Dispensing System (EDS) in 2000 for deployment in 2001. The Company generally contracts out its research and development efforts. This allows the Company to focus its expenditures on the technical expertise necessary to accomplish a specific project.

Operating income decreased by 34% from \$7,425,152 in 2000 to \$4,892,644

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in 2001. This decrease resulted primarily from the higher cost of revenues for leased machines discussed above and from the amortization of goodwill and leases relating to the On-Point acquisition. As a percentage of revenues, operating income decreased from 17% in 2000 to 12% in 2001.

Interest expense increased by 30% from \$1,580,969 in 2000 to \$2,049,605 in 2001. The increase reflected the cost of additional borrowings to finance the acquisition of the lottery assets of On-Point on June 1, 2001.

Pre-tax income decreased 50% from \$5,786,798 in 2000 to \$2,884,335 in 2001.

The effective income tax rate decreased from 37.6% in 2000 to 32.4% in 2001. This decrease was due primarily to a change in the tax accounting method for patents which reduced income tax expense by \$199,654 in 2001.

As a result of the above factors, the Company's net income decreased by 46% from \$3,610,199 in 2000 to \$1,949,306 in 2001.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities increased 56% from \$8,842,961 in 2001 to \$13,751,187 in 2002. This increase in net cash was partially due to a decrease in inventory as a result of returned ITVMs being refurbished and sold, as well as an increase in the principal portion of sale-type leases received. Also, deferred taxes increased as the result of additional sales-type leases in 2002. Net cash used in investing activities decreased 75% from \$21,663,552 in 2001 to \$5,491,632 in 2002. The 2001 investing activity included \$13,486,146 for the acquisition of On-Point Technologies. Financing activities in 2002 used net cash of \$8,377,395 as

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compared to \$13,311,278 of net cash provided by financing activities in 2001. This was due principally to the payoff of the \$5 million subordinated note and additional payments made from operating cash flow to reduce the credit line.

The Company's decision to lease a significant portion of its ITVMs generally offers the Company better gross margins than direct sales agreements. However, leasing inherently requires more capital and a longer-term payout than sales. As of December 31, 2002, the Company had a total of 11,484 ITVMs and PCDMs under operating and sales type leases. The Company's current backlog of \$6.8 million includes machines to be sold to the New York lottery of \$3.4 million and machines to be sold to the California lottery in the amount of \$2.2 million. There are no leased machines in the backlog at this time.

Inventories decreased by \$2.2 million from \$10.6 million in 2001 to \$8.4 million in 2002 primarily due to the sale of \$1.7 million of inventory returned in 2001 from expired leases that was refurbished and resold in 2002.

Goodwill in the amount of \$4,572,655 and acquired leases in the amount of \$2,925,355 at December 31, 2002 resulted from the On-Point acquisition.

The Company's revolving credit facility is classified as a current liability due to the revolver clause of the agreement. As a result, current liabilities exceeded current assets as of December 31, 2001 and 2002 by \$7,322,359 and \$6,253,474, respectively. Prior to the closing of the acquisition of the lottery assets of On-Point, to finance the cash payment paid at closing, the Company increased its existing credit facility with its bank from \$25 million to \$30 million, and also completed a mezzanine financing of junior debt

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in the principal amount of \$5 million with the bank. The credit facility is a three year credit line, which expires on May 31, 2004, secured by a lien on all of the assets of the Company. The interest rate on the credit facility is based on the prime rate or LIBOR, adjusted up or down depending on the Company's funded debt to EBITDA ratio. The current rate is LIBOR plus 2.00% (3.4% at March 1, 2003). The terms of the credit facility require the Company to maintain a cash balance at all times equal to .875% of the total amount of the facility. Additionally, the Company must comply with certain loan covenants which include, among other things, a minimum ratio of funded debt to EBITDA and a minimum tangible net worth requirement. The Company was in full compliance with the requirements of the covenants as of December 31, 2002.

The mezzanine financing consisted of a \$5 million term note due June 30, 2003, which was subordinate to the credit facility. This note bore interest at a fixed rate of 9% per annum and required the Company to pay a success fee equal to 1% of the unpaid principal balance of the note outstanding on the last day of the fiscal quarter for each of the four (4) fiscal quarters ending on September 30, 2001, December 31, 2001, March 31, 2002, and June 30, 2002; and equal to 1.5% of the unpaid principal balance of the note outstanding on the last day of the fiscal quarter for each of the four (4) fiscal quarters ending on September 30, 2002, December 31, 2002, March 31, 2003 and June 30, 2003. The note could be prepaid whenever availability on the credit facility exceeded \$2 million and the Company was in compliance with all loan covenants. These requirements were met, and the note was paid off in its entirety on August 13, 2002.

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At March 5, 2003, the Company had \$9,803,834 available under its credit facility. The Company believes that the amount available on its credit facility, together with cash flows from operations, will be sufficient to meet its currently foreseeable short and long-term needs for liquidity.

The Company entered into an interest rate swap agreement with a total notional principal amount of \$5 million at July 3, 2001 which expires on May 31, 2004 and an interest rate swap agreement with a total notional principal amount of \$10 million at November 7, 2002 which also expires on May 31, 2004. The objective of these agreements is to convert a portion of the Company's floating rate revolving credit facility to a fixed rate. The estimated fair value of the interest rate swap agreements was approximately (\$453,484) at December 31, 2002. The estimated fair value is based upon appropriate market information and projected interest rate changes obtained from a reputable institution. The estimated amount of deferred loss on the hedge to be reclassified to earnings in 2003 is \$320,000.

At December 31, 2000, the Company was indebted to one stockholder in the amount of \$79,000. Additionally in 2000, four stockholders elected to convert their shares of redeemable preferred stock to notes payable in the amount of \$1,335,000. The notes held by these five stockholders require, among other things, that 25% of the net income of the Company for the fiscal year be paid toward the aggregate principal amount owed on the notes on the first business day of the fourth month following the fiscal year end. Consequently, on April 1, 2002, \$487,327 was paid on these notes leaving a balance of \$24,124 at December 31, 2002. That amount will be paid in full on April 1, 2003. See Note 6 of Notes to Financial Statements.

The Company's capital expenditures totaled \$8,177,406 and \$5,491,632 for 2001 and 2002, respectively. These amounts included \$7,979,117 and \$5,481,016 for the manufacture of machines leased during the respective periods. Other expenditures represented machinery and equipment costs for expanded plant

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and office capacity.

The Company had no material commitments for additional capital expenditures as of December 31, 2002 other than for the manufacture of ITVMs and PCDMs for future sale or lease.

At December 31, 2002, the Company had estimated tax net operating loss carryforwards of approximately \$374,800 which are available to offset future federal taxable income, if any, through 2009. The use of these carryforwards is subject to certain annual limitations due to an ownership change in 1992. The net operating loss carryforward reduced taxable income by \$161,559 for a net federal tax benefit of \$54,930 in 2002.

### CRITICAL ACCOUNTING POLICIES

Our accounting policies affecting our financial condition and results of operation are more fully described in Note (1) to our financial statements. Certain of the Company's accounting policies require the application of judgment by management in selecting appropriate assumptions for calculating financial estimates which inherently contain some degree of uncertainty. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the reported carrying value of assets and liabilities and the

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reported amounts of revenues and expenses that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

### Revenue Recognition

The Company derives revenues from delivery of products and services in the form of sales, sales type leases, operating leases, maintenance fees and extended warranties. All products and services are provided under the terms of a written contract with a contractually fixed and determinable price. Payment terms are also defined under the contracts and collectibility is reasonably assured. Revenues from sales of ITVMs and spare parts are recognized when title to the product passes to the customer or when the products are delivered to the customer in accordance with the terms of the contract. Revenues from sales type leases are recorded in the same manner as direct sales and are recognized when products are delivered to the customer. Revenues from operating leases, maintenance services and extended warranties are recognized over time, typically monthly, during the period of time when the services are provided.

### Goodwill and Other Intangibles

The Company records all assets and liabilities acquired in purchase acquisitions, including goodwill and other intangibles, at fair value as required by SFAS 141. Goodwill and indefinite-lived assets are no longer amortized but are subject, at a minimum, to annual tests for impairment. Other intangible assets are amortized over their estimated useful lives using straight-line methods and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount. The initial goodwill and other intangibles recorded and subsequent impairment analysis



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requires management to make subjective judgments concerning estimates of how the acquired asset will perform in the future using a discounted cash flow analysis. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology.

### Property and Equipment - Leased Machines

Property and equipment - leased machines are stated at cost. Depreciation of property and equipment is calculated on the straight-line method over the estimated five-year useful life of the machines after a reduction reflecting the Company's estimate of the machines' residual value of 15%. Although most lottery contracts have varying terms, the typical term with extensions is approximately five years. In the event that the contract term is less than five years, the leased machines are returned to inventory at net book value which becomes the basis for refurbished or certified new equipment which can be resold or leased to another lottery. In the event that the contract extends beyond a five-year term, the machines are fully depreciated to a net book value of zero.

### Allowance for Inventory Obsolescence

The allowance for inventory obsolescence is established to provide for probable losses inherent in maintaining an inventory of various generations of technologically advanced machines and parts. Due to our very successful rehabilitated and recertified new equipment

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programs which offer extremely competitive pricing alternatives and in light of the fact that there is a significant base of installed machines that need service parts, it is uncommon that an inventory item reaches a stage of total obsolescence. In the event that it becomes readily apparent that a machine or certain machine components have little or no chance of being sold to any existing or potential customers, an impairment reduction is recorded in the allowance.

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements in this report are forward-looking statements. They include statements regarding our current beliefs, plans, expectations and assumptions about matters such as our expected financial position and operating results, our business strategy and our financing plans. These statements can sometimes be identified by our use of forward-looking words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "seek," "should" and similar expressions. Our forward-looking statements are subject to numerous risks, uncertainties and assumptions, many of which are beyond our control. These risks, uncertainties and assumptions include the risk factors discussed below. We cannot guarantee that our forward-looking statements will turn out to be correct or that our beliefs, plans, expectations and assumptions will not change. Our forward-looking statements may be incorrect, and actual results could be very different from and worse than our expectations as expressed in those statements.

Any forward-looking statements in this report are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Act of 1995.

THE FOLLOWING RISK FACTORS APPLY TO INTERLOTT AND ITS BUSINESS:

WE MAY EXPERIENCE FLUCTUATIONS IN OUR FINANCIAL RESULTS AND, AS A

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RESULT, OUR STOCK PRICE.

In the past, we have experienced significant fluctuations in our financial results. Our revenues, capital expenditures and operating results can vary significantly due to:

- relatively long sales cycles;
- the unpredictable timing and amount of contracts awarded by state lotteries and telephone companies;
- the extended time between the award of a contract and the receipt of revenues from the sale or lease of ITVMs and PCDMs;
- changes in customer budgets; and
- working capital required to manufacture ITVMs and PCDMs pursuant to new orders.

These factors may make it difficult to forecast revenues and expenditures over extended periods. Consequently, our operating results for any period could be below the expectations of securities analysts and investors. This in turn could lead to sudden and sometimes dramatic declines in the market price of our stock.

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OUR GROWTH WILL DEPEND UPON CONTINUED MARKET ACCEPTANCE OF ITVMs AND PCDMs.

Our ability to generate additional revenues and earnings will depend upon the continuation of existing leases of ITVMs and PCDMs, the distribution of ITVMs and PCDMs in additional states and international jurisdictions, the approval of lotteries in remaining states and international jurisdictions and increased future orders of ITVMs and PCDMs. As of December 31, 2002, 27 states and the District of Columbia used ITVMs as part of their instant ticket distribution system. We had leased or sold ITVMs in all of those states, the District of Columbia and in 14 international jurisdictions. We have marketed PCDMs since 1995 and, as of December 31, 2002, we had sold or leased 935 PCDMs. However, the popularity of instant lottery games, the use of prepaid telephone calling cards and the related demand for our products may not continue. Although the total dollar amount of instant ticket sales continues to increase, the rate of increase has declined.

SIGNIFICANT PORTIONS OF OUR ANNUAL REVENUE FREQUENTLY ARE DERIVED FROM A LIMITED NUMBER OF CONTRACTS, WHICH VARY IN SIZE AND BY CUSTOMER FROM YEAR TO YEAR.

We have traditionally derived a significant portion of our annual revenues from a limited number of state lottery authorities or their representatives for the lease, sale or service of ITVMs. In particular, during 2002, contracts with the Illinois, New York and California lotteries accounted for 21%, 18% and 17% of our total revenues, respectively. This can cause our revenues and earnings to fluctuate between quarters based on the timing of orders and realization of revenues from these orders. Further, none of our large customers has any obligation to lease or purchase additional machines from us. A loss of any of these large contracts could have a material adverse effect on our business, financial condition and results of operations.

WE MAY NOT BE SUCCESSFUL IN PROTECTING OUR PROPRIETARY RIGHTS OR

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AVOIDING CLAIMS THAT WE INFRINGE THE PROPRIETARY RIGHTS OF OTHERS.

We principally rely upon patent, copyright, trademark and trade secret laws, license agreements and employee nondisclosure agreements to protect our proprietary rights and technology. These laws and contractual provisions provide only limited protection. Our success depends largely on our burster technology that is protected by a patent that expires on December 31, 2007. Additionally, we have twenty-two other patents and thirty pending patent applications with the United States Patent and Trademark Office and foreign patent offices. We also have an exclusive license agreement with Algonquin Industries, Inc. for use of their patented pull-tab instant ticket dispensing mechanism in our PTVM and PCDM. We cannot be certain that we and Algonquin have taken adequate steps to prevent misappropriation of the technology that we use or that competitors will not independently develop technologies that are substantially equivalent or superior to our technology. Moreover, we could incur substantial costs and diversion of management resources in the defense of any claims relating to the proprietary rights of others, which could have a material adverse effect on our business, financial condition and results of operations.

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WE MAY NOT BE ABLE TO ADAPT TO CHANGES IN TECHNOLOGY, PRODUCTS AND INDUSTRY STANDARDS.

The instant ticket market, the ITVM market, the prepaid telephone calling card market and the PCDM market are characterized by rapidly changing technology and evolving industry practices. Competitors may introduce other types of lottery, gaming and prepaid telephone calling card products. To be successful, we must:

- use leading technologies effectively;
- continue developing our technical expertise;
- enhance our existing products and services; and
- develop new products and services.

If we fail to do any of these things, our customers may choose to purchase products and services from our competitors. Our inability to anticipate changes in technology and industry practices and to develop and introduce new products and services in a timely manner would likely result in a material adverse effect on our business, financial condition and results of operation.

THE STATE LOTTERIES CAN CANCEL THEIR CONTRACTS WITH US FOR ANY REASON AND CAN ASSESS SIGNIFICANT DAMAGES AGAINST US IF WE DO NOT SATISFACTORILY PERFORM THE CONTRACTS.

Our contracts with lotteries, like most other types of state contracts, typically permit a lottery to terminate the contract upon 30 days written notice for any reason. We may not be able to re-lease or sell any ITVMs that are returned to us by a lottery following the cancellation or expiration of a lease. These lottery contracts also impose demanding installation, performance and maintenance requirements. Our failure to perform the contract requirements could result in significant liquidated damages or contract termination. Our lottery contracts typically require us to indemnify the lottery, its officers and retailers for any liabilities arising from the operation of the ITVMs or any services that we provide. These provisions present an ongoing risk of significant damage assessments or contract terminations, which could have a material adverse effect on our business, financial condition and results of

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operation.

A SINGLE STOCKHOLDER CONTROLS A MAJORITY OF OUR STOCK AND CAN EXERT SIGNIFICANT INFLUENCE OVER OUR CORPORATE MATTERS.

As of March 15, 2003, L. Roger Wells, Jr. beneficially owned 54.8% of the Company's outstanding common stock. As a result, Mr. Wells can control the election of directors and the outcome of certain corporate actions requiring stockholder approval.

OUR ITVM LEASE CONTRACTS MAY RESULT IN LOSSES.

Our standard lease agreements provide for fixed lease payments during the term of the agreement and some permit the lottery to order additional ITVMs at any time during the lease term. If one of these lotteries were to order a large number of ITVMs near the end of the lease term, we would incur significant manufacturing costs but might receive lease payments for only a relatively short period of time through the remainder of the lease term. Additionally, we are unable to pass along to the lottery any increases in manufacturing and service costs during the

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term of a lease agreement. Our standard lease agreements provide for a short initial term, such as one year, with an option for the lottery to extend the lease term for additional one-year periods. If the lottery does not extend the initial lease term, we might incur a loss on the manufacture of the ITVMs if we are unable to re-lease or sell the machines.

THE ITVM AND PCDM MARKETS ARE VERY COMPETITIVE.

We may not be able to compete successfully against current or future competitors, some of whom may have greater resources and experience than us. The instant ticket market also may face competition from other types of lottery and gaming products, particularly on-line lottery products. The long distance telephone market similarly may face competition from other types of communications products, including facsimile, e-mail and other on-line products. If the ability to provide ITVMs and PCDMs internationally becomes a competitive advantage in the instant ticket lottery and prepaid calling card industries, we will have to expand our presence internationally or risk a disadvantage relative to our competitors. Increased competition could cause us to increase our selling and marketing expenses and research and development costs. We may not be able to offset the effects of any such increased costs through an increase in the number of lottery contracts and higher revenue from sales and leases of ITVMs and PCDMs, and we may not have the resources to compete successfully. These developments could have a material adverse effect on our business, financial condition and results of operation.

BECAUSE WE DEPEND UPON SINGLE OR LIMITED SOURCE SUPPLIERS, WE COULD TEMPORARILY LOSE OUR SUPPLY OF SOME CRITICAL PARTS OR EXPERIENCE SIGNIFICANT PRICE INCREASES.

We currently purchase certain important parts, such as components of our ITVM burster, PTVM dispensing mechanism and PCDM dispensing mechanism, from a single source. The purchase of these components from outside suppliers on a sole source basis subjects us to certain risks, including the continued availability of suppliers, price increases and potential quality assurance problems. Because other suppliers exist that can duplicate these components should we elect or be forced to use a different supplier, we do not believe that a change in suppliers would result in the termination of a production contract.

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However, we could experience a delay of 30 to 60 days in the production of ITVMs and PCDMs should we elect or be forced to use other suppliers. Any delay of 30 to 60 days could have a material adverse effect on our business, financial condition and results of operation.

OUR INDUSTRY IS SUBJECT TO SIGNIFICANT GOVERNMENT REGULATION WHICH COULD NEGATIVELY AFFECT US.

State and local governments strictly regulate the operation of lotteries and the sales and leasing of ITVMs. Further, international jurisdictions that operate lotteries impose strict regulations which may vary from those in the United States. Any adverse change in the lottery laws of any jurisdiction in which we sell and lease ITVMs could impose burdensome requirements or requirements that we may be unable to satisfy. Our failure to comply with changing lottery-related laws and regulations could have a material adverse effect on our business, financial condition and results of operation.

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In addition, state laws provide for background investigations on each of the lottery's vendors and their affiliates, subcontractors, officers, directors, employees and principal stockholders. The failure of any of these parties associated with us to obtain or retain approval in any jurisdiction could have a material adverse effect on our business, financial condition and results of operation.

### ITEM 7(A). QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company entered into an interest rate swap agreement with a total notional principal amount of \$5 million at July 3, 2001 which expires on May 31, 2004 and an interest rate swap agreement with a total notional principal amount of \$10 million at November 7, 2002 which also expires on May 31, 2004. The objective of these agreements is to convert a portion of the Company's floating rate revolving credit facility to a fixed rate. The estimated fair value of the interest rate swap agreements was approximately (\$453,484) at December 31, 2002. The estimated fair value is based upon appropriate market information and projected interest rate changes obtained from a reputable institution.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

#### INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders  
Interlott Technologies, Inc.:

We have audited the accompanying balance sheets of Interlott Technologies, Inc. as of December 31, 2002 and 2001, and the related statements of income, stockholders' equity, and cash flows for the three years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted

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in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Interlott Technologies, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for the three years ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II for each of the three years in the period ended December 31, 2002. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

As discussed in Note (1) to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002.

/s/ Grant Thornton LLP

Cincinnati, Ohio

February 17, 2003, except for Note 18 as to which the date is March 17, 2003.

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INTERLOTT TECHNOLOGIES, INC.

Balance Sheet

December 31, 2002 and 2001

	2002	
	-----	
ASSETS		
Current assets:		
Cash	\$ 419,492	
Accounts receivable, less allowance for doubtful accounts of \$53,332 in 2002 and \$203,101 in 2001	6,646,988	
Investment in sales type leases, current portion	2,588,005	
Inventories	8,440,471	1
Prepaid & refundable taxes	562,598	
Note receivable from stockholder	-	
Deferred tax asset	508,600	
Prepaid expenses	639,307	
=====		
Total current assets	19,805,461	2
=====		
Property and equipment:		
Leased machines	35,113,524	3
Machinery and equipment	784,219	
Building and leasehold improvements	688,234	

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Furniture and fixtures	182,717	
	36,768,694	3
Less accumulated depreciation and amortization	(22,963,442)	(1)
Net property and equipment	13,805,252	1
Other assets	238,176	
Goodwill net of accumulated amortization of \$166,581 in 2001	4,572,655	
Value of leases acquired net of accumulated amortization of \$1,355,650 in 2002 and \$499,450 in 2001	2,925,355	
Investment in sales type leases, less current portion	10,154,855	
Product development rights, net of accumulated amortization of \$880,000 in 2002 and \$806,661 in 2001	220,000	
	\$ 51,721,754	5

See accompanying notes to financial statements.

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INTERLOTT TECHNOLOGIES, INC.

Balance Sheet, Continued

December 31, 2002 and 2001

	2002
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Notes payable to financial institutions	\$ 21,310,417
Notes payable - related parties	24,124
Accounts payable	2,663,405
Accounts payable - related parties	380,855
Accrued expenses	1,680,134
Total current liabilities	26,058,935
Subordinated term note	-
Deferred tax liability	2,009,600
Total liabilities	28,068,535
Commitments and contingent liabilities	
Interest rate swap agreements	453,484
Notes payable - related parties	-
Stockholders' equity:	
Common stock, \$.01 par value; 20,000,000 shares authorized, 6,455,826 shares issued and outstanding in 2002 and 6,441,498 shares issued and outstanding in 2001	64,558
Additional paid-in capital	10,568,907

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Treasury stock	(63,298)
Accumulated comprehensive income (loss)	(299,299)
Retained earnings	12,928,867
=====	
Total stockholders' equity	23,199,735
	-----
	\$ 51,721,754
=====	

See accompanying notes to financial statements.

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INTERLOTT TECHNOLOGIES, INC.

Statement of Income

Years Ended December 31, 2002, 2001 and 2000

	2002	2001
	-----	-----
Revenues:		
Machine sales	\$ 27,208,746	19,358,561
Machine leases	18,697,676	18,336,526
Other	6,096,614	5,020,599
	-----	-----
	52,003,036	42,715,686
Cost of revenues:		
Machine sales and other	17,914,274	14,251,360
Machine leases	19,264,872	17,142,272
	-----	-----
	37,179,146	31,393,632
	-----	-----
Gross margin	14,823,890	11,322,054
Operating expenses:		
Selling, general and administrative expenses	6,784,042	5,915,233
Research and development costs	529,585	347,596
Amortization of goodwill	-	166,581
	-----	-----
	7,313,627	6,429,410
	-----	-----
Operating income	7,510,263	4,892,644
Other income (expense)		
Interest expense	(2,138,409)	(2,049,605)
Other	(335,875)	41,296
	-----	-----
	(2,474,284)	(2,008,309)
Income before income taxes	5,035,979	2,884,335
Income tax provision	1,945,334	935,029
	-----	-----
Net income	\$ 3,090,645	1,949,306
	=====	=====



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Basic net income per share	\$ 0.48	0.30
	=====	=====
Diluted net income per share	\$ 0.46	0.30
	=====	=====

See accompanying notes to financial statements.

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INTERLOTT TECHNOLOGIES, INC.

Statement of Stockholders' Equity

Years ended December 31, 2000, 2001 and 2002

	Comprehensive Income	Shares	Com Sto
	-----	-----	-----
Balances at December 31, 1999	\$ -	6,420,000	\$ 32
Shares issued for exercise of options	-	7,000	
Shares issued in connection with Employee Stock Purchase Plan	-	2,910	
Stock split	-	-	32
Net income	-	-	
-----			
Balances at December 31, 2000	-	6,429,910	64
Cumulative effect of transition adjustment	-	-	
Shares issued for exercise of options	-	1,000	
Shares issued in connection with Employee Stock Purchase Plan	-	10,588	
Comprehensive income (loss):			
Net income	1,949,306	-	
Other comprehensive loss related to swap agreements (net of tax of \$162,260)	(314,975)	-	
-----			
Total comprehensive income	1,634,331		
-----			
Balances at December 31, 2001	-	6,441,498	64
Cumulative effect of transition adjustment	-	-	
Shares issued for exercise of options	-	10,750	
Shares issued in connection with Employee Stock Purchase Plan	-	14,078	
Shares redeemed in connection with Stock Buyback Program	-	(10,500)	
Comprehensive income (loss):			
Net income	3,090,645	-	
Other comprehensive gain related to swap agreements (net of tax of \$43,074)	83,616	-	
-----			
Total comprehensive income	\$6,442,923		
Balances at December 31, 2002	-	6,455,826	\$ 64
		=====	-----

Accumulated

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	Comprehensive Income (Loss)	Treasury shares
	-----	-----
Balances at December 31, 1999	\$ -	\$ -
Shares issued for exercise of options	-	-
Shares issued in connection with Employee Stock Purchase Plan	-	-
Stock split	-	-
Net income	-	-
-----		
Balances at December 31, 2000	-	-
Cumulative effect of transition adjustment	(67,940)	-
Shares issued for exercise of options	-	-
Shares issued in connection with Employee Stock Purchase Plan	-	-
Comprehensive income (loss):		
Net income	-	-
Other comprehensive loss related to swap agreements (net of tax of \$162,260)	(314,975)	-
-----		
Total comprehensive income		
Balances at December 31, 2001	(382,915)	-
Cumulative effect of transition adjustment	-	-
Shares issued for exercise of options	-	-
Shares issued in connection with Employee Stock Purchase Plan	-	-
Shares redeemed in connection with Stock Buyback Program	-	(63,298)
Comprehensive income (loss):		
Net income	-	-
Other comprehensive gain related to swap agreements (net of tax of \$43,074)	83,616	-
-----		
Total comprehensive income		
Balances at December 31, 2002	\$ (299,299)	\$ (63,298)
	-----	-----

See accompanying notes to financial statements.

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INTERLOTT TECHNOLOGIES, INC.

Statement of Cash Flows

Years ended December 31, 2002, 2001 and 2000

	2002
	-----
Cash flows from operating activities:	
Net income	\$ 3,090,645
Adjustments to reconcile net income to net cash provided by operating activities:	
Net book value of equipment disposals	-
Depreciation and amortization	7,247,227
Principal portion of sales type leases received	2,557,262
Increase (decrease) in deferred income tax liability	1,397,576

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Gain on sale of equipment under sales type lease	(3,436,490)
Decrease (increase) in accounts receivable	478,262
Decrease in inventories - net of leased equipment returned	2,232,557
(Increase) decrease in prepaid expenses and other asset	(25,064)
(Increase) decrease in deferred tax asset	(326,250)
Increase in accounts payable	413,531
Increase in accounts payable - related parties	63,350
Increase (decrease) in accrued expenses	216,959
(Decrease) in income taxes payable	(158,378)
<hr/>	
Net cash provided by operating activities	13,751,187
<hr/>	
Cash flows from investing activities:	
Cost of leased machines	(5,481,016)
Acquisition of business	-
Purchases of property and equipment	(10,616)
<hr/>	
Net cash used in investing activities	(5,491,632)
<hr/>	
Cash flows from financing activities:	
(Increase) in notes receivable from shareholder	-
(Decrease) increase in notes payable	(2,945,242)
Repayment of subordinated term note	(5,000,000)
Proceeds from exercise of stock options	58,287
Proceeds from Employee Stock Purchase Plan	60,290
Payments for Treasury Stock repurchased	(63,403)
Repayment of long-term debt	(27,227)
Payments of notes payable - related parties	(460,100)
<hr/>	
Net cash (used in) provided by financing activities	(8,377,395)
<hr/>	
(Decrease) increase in cash	(117,840)
Cash at beginning of year	537,332
<hr/>	
Cash at end of year	\$ 419,492
<hr/>	
Supplemental disclosures of cash flow information:	
Net book value of leased equipment returned from the field	\$ 44,738
Interest paid	\$ 2,264,269
Notes payable to stockholders issued in exchange for redeemable preferred stock	\$ -
Income taxes paid	\$ 1,290,347
Interest swap liability	\$ 83,616
<hr/>	
Business combination accounted for as a purchase	
Accounts receivable	\$ -
Inventory	\$ -
Lease acquisition costs	\$ -
Goodwill	\$ -
<hr/>	
	\$ -

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(a) BUSINESS DESCRIPTION

Interlott Technologies, Inc. (the Company), a Delaware corporation, designs, manufactures, leases, sells and services vending machines for use in connection with public lotteries operated by states and foreign public entities, as well as for use by providers of prepaid telephone cards.

(b) REVENUE RECOGNITION

The Company derives revenues from delivery of products and services in the form of sales, sales type leases, operating leases, maintenance fees and extended warranties. All products and services are provided under the terms of a written contract with a contractually fixed and determinable price. Payment terms are also defined under the contracts and collectibility is reasonably assured. Revenues from sales of ITVMs and spare parts are recognized when title to the product passes to the customer or when the products are delivered to the customer in accordance with the terms of the contract. Revenues from sales type leases are recorded in the same manner as direct sales and are recognized when products are delivered to the customer. Revenues from operating leases, maintenance services and extended warranties are recognized over time, typically monthly, during the period of time when the services are provided.

(c) OPERATING AND SALES TYPE LEASES

Depending on the specific terms contained in the lease agreement, the lease is either classified as an operating lease or capitalized as a sales type lease, in accordance with Statement of Financial Accounting Standards (SFAS) No. 13, Accounting for Leases, as amended.

The net investment in operating leases consists of leased machines, which are carried at cost, less the amount depreciated to date. Operating lease revenue consists of the contractual lease payments and is recognized ratably over the lease term. Expenses are principally depreciation of the leased machines (see Note 1e).

The net investment in sales type leases consists of the present value of the future minimum lease payments. Sales type lease revenue consists of the profits earned on the sale of the leased machines and interest earned on the present value of the lease payments. Interest revenue is recognized as a constant percentage return on the net investment.

Any future losses related to lease cancellations would be recorded in the period the losses become known and estimable.

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(d) INVENTORIES

Inventories consist of parts and supplies, and vending machines assembled or in the process of assembly. Inventories are stated at the lower of cost or market, with cost determined using standard costing, which approximates the first-in, first-out method.

(e) PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation of property and equipment is calculated on the straight-line method over the estimated useful lives of the assets, to the Company's estimate of the assets' residual values, as follows:

Leased machines	5 years
Machinery and equipment	10 years
Furniture and fixtures	5 years

Leasehold improvements are amortized on the straight-line method over the lease term. Amortization of assets held under leasehold improvements is included with depreciation expense.

(f) PRODUCT DEVELOPMENT RIGHTS

Product development rights represent the exclusive rights to certain patents and other related manufacturing technologies to manufacture and assemble the Company's instant ticket vending machines (ITVMs). The asset is amortized on the straight-line method over fifteen years, which represents the lower of the remaining life of the patents or the estimated remaining life of the technology currently in use.

(g) INCOME TAXES

The Company accounts for income taxes using the asset and liability method. In accordance with this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

(h) DISCLOSURE ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, Disclosure About Fair Value of Financial Instruments, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amounts as of December 31, 2002 and 2001 of cash, accounts receivable, accounts payable, accounts payable - related parties, accrued expenses and income taxes payable approximate fair value due to the short maturity of these investments. The carrying

amount of notes payable approximate fair value, as such borrowings bear interest at the Company's current rates for such types of instruments.

(i) STOCK INCENTIVE PLANS

On January 1, 1996, the Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, which permits entities to recognize compensation expense over the vesting period of the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosures of SFAS No. 123.

(j) RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expense in the year incurred.

(k) EARNINGS PER SHARE

Basic earnings per share is based upon the weighted average number of common shares outstanding. Diluted earnings per share is based upon the weighted average number of common shares outstanding, including the effects of all dilutive potential common shares outstanding.

(l) USE OF ESTIMATES

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(m) ACCOUNTS PAYABLE

Accounts payable included \$752,043 and \$518,642, respectively, of outstanding checks at December 31, 2002 and 2001.

(n) INTANGIBLE ASSETS

Amortization of goodwill was calculated on the straight line method based on a 20 year life.

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after September 30, 2001. The Company adopted

SFAS No. 141 on July 1, 2001. The change had no material effect on the Company's financial position or results of operations.

SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, Accounting for the Impairment of Long Lived Assets and for Long-Lived Assets to Be Disposed Of. At this time, the Company believes that no impairment exists. Because the Company is a single reporting unit, market capitalization is considered an indicator of potential impairment.

The Company adopted SFAS No. 142 on January 1, 2002, as required. There was no amortization of goodwill in 2000 or 2002. Had amortization of goodwill not been taken during 2001, the Company's net income and earnings per share would have been increased to the pro forma amount presented below:

		2001
Net income	As reported	\$1,949,306
	Pro forma	2,059,249
Basic earnings per share	As reported	.30
	Pro forma	.32
Diluted earnings per share	As reported	.30
	Pro forma	.31

(o) ACCOUNTS RECEIVABLE

Accounts receivable are reflected net of allowances for doubtful accounts of \$53,332 and \$203,101 at December 31, 2002 and December 31, 2001, respectively.

The adequacy of the allowance for doubtful accounts is determined at each balance sheet date by reviewing individual past due invoices on a customer-by-customer basis, identifying the issue related to the delinquent payment and evaluating the probable resolution of that issue. The significant majority of Interlott's accounts receivable are from state lotteries and collection of undisputed items is rarely a problem. There are, however, instances where an invoiced item may be disputed by a lottery and in many cases these issues must be resolved through discussions and negotiations with regard to contract

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interpretations.

(p) RECLASSIFICATION

Common stock and additional paid-in capital have been adjusted to report the stock split made in 2000.

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(2) INVESTMENT IN SALES TYPE LEASES

The Company leases ITVMs to several state lotteries under sales type leases. The components of the net investment in sales type leases at December 31, 2002 and 2001 were as follows:

	2002	2001
Minimum lease payments receivable	\$15,649,566	\$ 9,082,572
Less unearned revenue on lease payments receivable	2,906,706	1,164,356
	-----	-----
	12,742,860	7,918,216
Less current portion	2,588,005	2,299,706
	-----	-----
Investment in sales type leases, less current portion	\$10,154,855	\$ 5,618,510
	=====	=====

Future minimum lease payments to be received by the Company under these sales type leases are as follows:

YEARS ENDING DECEMBER 31,

-----	
2003	\$ 4,210,275
2004	3,663,375
2005	3,019,494
2006	2,769,256
2007	1,974,242
2008	12,924
	-----
	\$15,649,566
	=====

(3) INVENTORIES

Inventories at December 31, 2002 and 2001 consisted of the following:

	2002	2001
Finished goods	\$ 1,721,996	\$ 2,255,882



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Work in process	396,719	531,355
Raw materials and supplies	6,321,756	7,841,053
	-----	-----
	\$ 8,440,471	\$10,628,290
	=====	=====

(4) LEASED MACHINES

At December 31, 2002 and 2001, the Company leased ITVMs to various state lotteries under operating leases. The leases generally provide for the lotteries to make monthly or quarterly payments for rentals of the ITVMs over various lease terms. The components of the net investment in operating leases, which include estimated residual values, at December 31, 2002 and 2001 were as follows:

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	2002	2001
Leased machines	\$35,113,524	\$33,759,213
Less accumulated depreciation	21,836,911	15,876,044
	-----	-----
	\$13,276,613	\$17,883,169
	=====	=====

Future minimum lease payments to be received by the Company under operating leases are as follows:

YEARS ENDING DECEMBER 31,

-----	
2003	\$11,500,139
2004	4,957,683
2005	484,035
2006	394,200
2007	197,100
	-----
	\$17,533,157
	=====

(5) NOTES PAYABLE TO FINANCIAL INSTITUTIONS

In January 2001, the Company entered into a \$25 million three year revolving credit facility with a bank. Initial proceeds from the note were used to retire the Company's prior revolving credit facility. In conjunction with the establishment of the facility, the Company opened a lockbox and controlled disbursement account under which all lockbox receipts are recorded as payments against the facility and presented checks are recorded as draws on the facility. Borrowings under the credit facility are collateralized by all assets of the Company and an assignment of proceeds from lease agreements. The terms of the credit facility require the Company to maintain a cash balance at all times

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equal to .875% of the total amount of the facility. Additionally, the Company must comply with certain loan covenants which include, among other things, a minimum ratio of funded debt to EBITDA and a minimum tangible net worth requirement. At December 31, 2002, the Company was in full compliance with the requirements of the covenants.

In June 2001, in connection with the acquisition of the lottery assets of On-Point Technology Systems, Inc., the Company increased the credit facility from \$25 million to \$30 million, and completed a mezzanine financing of junior debt in the form of a term note due June 30, 2003 in the principal amount of \$5 million with the same bank. The rate of interest on the credit facility is based on the prime rate or LIBOR rate adjusted up or down depending on the Company's funded debt to EBITDA ratio. The current rate is LIBOR plus 2.0% (3.4% at December 31, 2002). The \$5 million term note was paid off on August 13, 2002.

At December 31, 2002, the Company had borrowings of \$21,310,417 outstanding with additional borrowings of \$8,689,583 available under the revolving credit facility. The credit facility expires on May 31, 2004.

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### (6) NOTES PAYABLE - RELATED PARTIES

The Company had the following notes payable to related parties at December 31, 2002 and 2001:

	2002	2001
Notes payable to former preferred stockholders, in the principal amount of \$1,335,000 due in annual installments limited in the aggregate with the stockholder note identified in the immediately following paragraph to twenty-five percent (25%) of the net profits, if any, of the Company from its business operations as reported in the Company's annual financial statements. The notes were issued in exchange for shares of redeemable preferred stock. Payments began April 2, 2001. The notes do not provide for any interest and are unsecured.	\$ 22,776	\$482,876
Note payable to a stockholder, in the original amount of \$79,000, due and limited in the aggregate with the preferred stockholder notes identified in the preceding paragraph to twenty-five percent (25%) of the net profits of the Company, if any, from its business operations as reported in the Company's annual financial statements. Payments began April 2, 2001. The note does not provide for any interest and is unsecured.	1,348	28,575
	-----	-----
	24,124	511,451
Less current portion	24,124	487,327
	-----	-----

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\$ -                    \$ 24,124  
 =====                    =====

(7) ADDITIONAL FINANCIAL INSTRUMENT

The Company entered into an interest rate swap agreement with a total notional principal amount of \$5 million at July 3, 2001 which expires on May 31, 2004 and an interest rate swap agreement with a total notional principal amount of \$10 million at November 7, 2002 which also expires on May 31, 2004. The objective of these agreements is to convert a portion of the Company's floating rate revolving credit facility to a fixed rate. The estimated fair value of the interest rate swap agreements was approximately (\$453,484) at December 31, 2002. The estimated fair value is based upon appropriate market information and projected interest rate changes obtained from a reputable institution. The estimated amount of deferred loss on the hedge to be reclassified to earnings in 2003 is \$320,000.

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(8) Income Taxes

Income tax expense is summarized as follows:

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Current:			
Federal	\$ 651,622	\$ 851,391	\$1,629,300
State and local	234,264	264,899	352,899
Deferred:			
Federal	1,059,448	181,261	194,400
	-----	-----	-----
	\$1,945,334	\$ 935,029	\$2,176,599
	=====	=====	=====

A reconciliation of income tax expense in relation to the amounts computed by application of the U.S. federal income tax rate of 34% to pretax income follows:

	2002	2001	2000
Federal income tax expense at the statutory rate	\$ 1,712,233	\$ 980,674	\$ 1,967,800
Officers life insurance	8,000	8,000	8,000
Amortization of product development rights	-	(199,654)	25,000
State and local taxes, net of federal benefit	145,244	174,833	232,000
Other	79,857	(28,824)	(56,000)
	-----	-----	-----
	\$ 1,945,334	\$ 935,029	\$ 2,176,800
	=====	=====	=====

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001 are presented below:

	2002	2001
Deferred tax assets:		
Bad debt allowance	\$ 18,100	\$ 69,000
Investment in sales type leases	333,000	601,800
Net operating loss carryforwards	127,400	182,300
Inventory valuation reserve	286,100	156,000
Change in accounting for patent amortization	-	184,100
Interest rate swap agreement	154,200	197,300
Accrued expenses	82,900	75,400
	-----	-----
Total gross deferred tax assets	\$ 1,001,700	\$ 1,465,900
	=====	=====
Deferred tax liabilities:		
Property and equipment, principally due to differences in depreciation	\$ 2,405,000	\$ 1,754,800
Involuntary conversion of assets	97,700	97,700
	-----	-----
Total gross deferred tax liabilities	2,502,700	1,852,500
	-----	-----
Net deferred tax liabilities	\$ (1,501,000)	\$ (386,600)
	=====	=====

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized.

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The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future income and tax planning strategies in making this assessment.

At December 31, 2002, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$374,800 which are available to offset future federal taxable income, if any, through 2009. However, due to an ownership change on September 25, 1992, utilization of these carryforwards is subject to certain annual limitations.

(9) STOCK INCENTIVE PLANS

The Company's 1994 Stock Incentive Plan was amended and restated effective December 29, 2000. The Company also has a 1994 Directors Stock Incentive Plan under which options were granted prior to the amendment of the 1994 Stock Incentive Plan. Stock options are granted

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with an exercise price equal to the stock's fair market value at the date of grant. Options vest at the rate of 25% per year beginning one year from the date of grant, subject to the recipient's continued employment or service to the Company, and must be exercised within 10 years after that date.

As permitted by SFAS No. 123, the Company applies the intrinsic value method prescribed by APB Opinion No. 25 and related interpretations in accounting for its stock option plans. Accordingly, no compensation cost has been recognized in the accompanying statements of income.

A summary of the status of the Company's stock options as of December 31, 2002, 2001 and 2000 and the changes therein for the years then ended is presented below:

	2002		2001		2000
	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES
Outstanding at beginning of year	791,300	\$ 4.37	502,800	\$ 3.92	513,100
Granted	267,000	5.40	290,850	5.25	-
Exercised	11,750	3.06	1,000	3.25	7,000
Forfeited	2,150	3.83	1,350	3.53	3,300
Outstanding at end of year	1,044,400	4.68	791,300	4.37	502,800
Options exercisable at year-end	629,525	4.30	476,525	4.24	434,850
Weighted-average fair value of options granted during the Year		\$ 2.86		\$ 4.31	

Had compensation cost for options been determined consistent with the fair value methodology of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts presented below:

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		2002	2001
Net income	As reported	\$ 3,090,645	\$ 1,949,306
	Pro forma	2,741,573	1,691,799
Basic earnings per share	As reported	.48	.30
	Pro forma	.42	.26
Diluted earnings per share	As reported	.46	.30
	Pro forma	.41	.26

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The fair value of options granted during 2002 and 2001 was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions: no dividends paid, as it has been the Company's policy not to declare or pay dividends and the Company does not anticipate paying dividends in the foreseeable future; expected volatility of 36% and 76%, respectively, based on the calculated volatility of the Company's stock; risk-free rates of return of 3.46% and 4.81%, respectively; and expected lives of 10 years. No options were granted in 2000.

Information about stock options outstanding at December 31, 2002 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercis
	Number Outstanding	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Exercisable
\$2.41 - 4.32	406,450	4.40	\$3.60	378,575
\$5.07 - 5.75	637,950	7.68	5.36	250,950
	1,044,400	6.41	\$4.68	629,525
	=====	=====	=====	=====

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(10) EARNINGS PER SHARE

	Net Earnings (Numerator)	Shares (Denominator)
2000		
Basic earnings per share:		
Net earnings available to common stockholders	\$ 3,610,199	6,422,914
Diluted earnings per share:		
Effect of dilutive stock options		71,592
Earnings available to common stockholders and assumed conversions	3,610,199	6,494,506
2001		
Basic earnings per share:		
Net earnings available to common stockholders	1,949,306	6,436,801
Diluted earnings per share:		
Effect of dilutive stock options		119,484
Earnings available to common stockholders and assumed conversions	1,949,306	6,556,285

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2002

Basic earnings per share:

Net earnings available to common stockholders	3,090,645	6,455,930
---	-----------	-----------

Diluted earnings per share:

Effect of dilutive stock options		232,959
Earnings available to common stockholders and assumed conversions	\$ 3,090,645	6,688,889

Options to purchase 0, 394,800 and 243,950 shares of common stock were outstanding in 2002, 2001 and 2000, respectively, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

### (11) NONCASH INVESTING ACTIVITIES

Leased machines with net book values of \$44,738 in 2002 and \$2,404,876 in 2001 were returned to the Company's inventories upon lease expirations. The Company refurbished many of these returned machines and also used parts from others in the manufacturing of certified new machines, a large portion of which were sold or deployed in 2002 under new leases.

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### (12) RELATED PARTY TRANSACTIONS

Accounts payable - related parties of \$380,855 and \$317,505 at December 31, 2002 and 2001, respectively, represent management fees and expenses payable to a company owned 100% by the majority stockholder as well as parts expenses payable to an entity which is owned by a director.

Amounts expensed related to the company owned by the majority stockholder were \$36,000 for each of the years ended December 31, 2002, 2001 and 2000, respectively.

The entity owned by a director supplies the Company with certain parts for its dispensing mechanisms. In addition, on January 13, 1994, the Company entered into a manufacturing and license agreement with this entity pursuant to which the Company purchased an exclusive license to make, use and sell pull-tab lottery ticket dispensing mechanisms produced by this entity. The Company had purchases from this entity which were charged to cost of revenues of approximately \$5,120,953, \$5,240,275 and \$6,205,187 for the years ended December 31, 2002, 2001 and 2000, respectively.

Interest expense arising from notes payable-related parties amounted to \$0, \$0 and \$4,510 for the years ended December 31, 2002, 2001 and 2000, respectively.

### (13) CUSTOMER AND SUPPLIER CONCENTRATIONS

A significant portion of the Company's revenues are derived from a limited number of state lottery authorities or their representatives. In each of the years ended December 31, 2002, 2001 and 2000, a single customer generated 16%, 17% and 19%, respectively, of the machine lease revenues. In addition, single state contracts generated 32%, 59% and 76% of the machine sales revenues for the years ended December 31,

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2002, 2001 and 2000, respectively. Future revenue from machine sales and leases is dependent upon winning awards in a competitive bidding process.

The Company currently purchases certain components used in its vending machines, including components used in its burster mechanism, from single suppliers. The purchase of components from outside suppliers on a sole source basis subjects the Company to certain risks, including the continued availability of suppliers, price increases and potential quality assurance problems. Because other suppliers exist that can duplicate these components should the Company elect or be forced to use a different supplier, the Company does not believe that a change in suppliers would result in the termination of a production contract. However, the Company could experience a delay of 30 to 60 days in production, which could adversely affect the Company's ability to make timely deliveries of vending machines and to obtain new contracts.

### (14) LEASE COMMITMENTS

Future minimum lease payments to be paid by the Company under operating leases are as follows:

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December 31,  
-----

2003	\$382,682
2004	341,749
2005	75,558
	-----
	\$799,989
	=====

### (15) COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 2002, the Company had outstanding approximately \$3,734,000 in purchase commitments for raw materials which are used in the manufacturing of ITVMs. Management intends to utilize these commitments as machines are produced.

### (16) EMPLOYEE BENEFIT PLANS

In 1999, the Company established a savings plan intended to qualify under sections 401(a) and 401(k) of the Internal Revenue Code. The plan covers substantially all employees of the Company. Under this plan, the Company's expenses in 2002 and 2001 were \$68,319 and \$51,109, respectively, which represented one half of the employees' contributions not exceeding 4% of gross pay.

The Company has an Employee Stock Purchase Plan under section 423 of the Internal Revenue Code. The Plan provides substantially all employees of the Company with an opportunity to purchase, through payroll deductions, shares of the Company's common stock. The purchase price per share is the lower of 85% of the closing market price of the common stock on the first day of the calendar quarter or 85% of the



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closing market price of the common stock on the last day of the calendar quarter. 50,000 shares of common stock of the Company are reserved for issuance under this plan.

### (17) ACQUISITION

On June 1, 2001, the Company completed the acquisition of the lottery assets of On-Point Technology Systems, Inc. of San Marcos, California. Through the purchase, the Company acquired all of the lottery assets of On-Point, including patents, technology, accounts receivable, inventory, service contracts, and lease contracts for the New York, Illinois, Virginia and Missouri state lotteries.

The purchase price included approximately \$13 million paid at closing, deferred payments of \$9 million payable, subject to adjustment, over 5 years, and an earn-out of up to \$6 million based upon certain future revenues. The \$9 million in deferred payments is based on certain gross profit benchmarks from new product sales related to the four lottery contracts acquired from On-Point. These gross profit benchmarks are cumulative and, due to failure to realize the projected amounts, only \$29,000 has been paid to date. Because these payments are contingent upon future performance, amounts will only be recorded as earned. The Company believes that it is probable that some payments may be required in the future although the amount is undeterminable at this point in time.

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In addition, at the closing the Company and On-Point entered into a separate agreement to market a patented design for an on-line activated instant lottery ticket.

The acquisition was accounted for as a purchase. The total costs of the acquisition were allocated to tangible and intangible assets acquired based upon their respective fair values. The allocation of the purchase price and goodwill are summarized as follows:

Accounts Receivable	\$ 1,043,852
Inventory	3,422,053
Lease acquisition costs	4,281,005
Goodwill	4,739,236
	-----
	\$13,486,146
	=====

The following table provides certain information, on a pro forma (unaudited) basis, concerning the impact of the acquisition on results of operations had the transaction been completed on January 1, 2000.

12/31/2001	12/31/2000
-----	-----

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Revenues		
As reported	\$42,715,686	\$42,589,090
Pro forma	45,659,686	52,882,080
Income before extraordinary items		
As reported	\$ 1,949,306	\$ 3,610,199
Pro forma	2,347,206	747,443
Net income		
As reported	\$ 1,949,306	\$ 3,610,199
Pro forma	2,347,206	747,443
Basic and diluted earnings per share		
As reported	\$ 0.30	\$ 0.56
Pro forma	\$ 0.36	\$ 0.12

(18) SUBSEQUENT EVENTS

On March 17, 2003, the Company entered into an agreement to be acquired by GTECH Holdings Corporation (NYSE: GTK). The agreement calls for each share of the Company's common stock to be changed into the right to receive \$9.00 in cash, GTECH common stock or a combination of the two, with 51.5% of the aggregate merger consideration to be paid in GTECH common stock and the balance in cash. Including estimated assumed debt of approximately \$21 million, the transaction would have a total value of approximately \$85 million. The transaction, which is subject to the approval of the Company's shareholders,

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regulatory approvals and certain other closing conditions, is expected to be completed by late July 2003. Approval of GTECH shareholders is not required.

QUARTERLY FINANCIAL DATA

(in thousands, except per share data)

2002	FIRST	SECOND	THIRD	FOURTH
Net sales	\$11,142	\$10,151	\$14,420	\$16,291
Gross profit	3,207	2,912	3,805	4,900
Net income	522	185	782	1,601
Basic income per share	0.08	0.03	0.12	0.25
Diluted income per share	0.08	0.03	0.12	0.24

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2001	FIRST	SECOND	THIRD	FOURTH
Net sales	\$ 7,811	\$15,273	\$ 9,705	\$ 9,927
Gross profit	2,350	4,310	2,407	2,255
Net income	196	1,335	85	333
Basic income per share	0.03	0.21	0.01	0.05
Diluted income per share	0.03	0.20	0.01	0.05

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS AND EXECUTIVE OFFICERS

The directors and executive officers of the Company (at March 20, 2003) are as follows:

Name	Age	Title
L. Rogers Wells	65	Chairman of the Board and Director
Gary S. Bell	52	Director
Kazmier J. Kasper	56	Director
H. Jean McEntire	57	Director
David F. Nichols	41	President, Chief Executive Officer and Director
Edmund F. Turek	76	Director
John J. Wingfield	56	Director
Thomas W. Stokes	39	Chief Operating Officer
Dennis W. Blazer	55	Chief Financial Officer

Mr. Wells is Chairman of the Board and served as Chief Executive Officer of the Company until 1999. He has been the principal stockholder of the Company since 1992. Mr. Wells served as a director of the Company from 1992, and as Chairman of the Board and Chief Executive Officer of the Company from 1993, until his resignation from these positions in October 1994. He was re-elected to

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these positions in February 1995. In addition, Mr. Wells owns American Materials, Incorporated, which assembles and distributes automobile and truck components and serves as a regional warehousing and distribution center for various businesses. Mr. Wells also owns International Investments, Inc., which invests in and provides financing to various businesses. From 1987 through 1991, Mr. Wells served as Secretary of Finance and Administration for the Commonwealth of Kentucky and from 1989 through 1991 served as Secretary to the Governor's Executive Cabinet. During his tenure as Secretary of Finance and Administration, Mr. Wells served as Chairman of various finance and development authorities, including the Kentucky Rural Economic Development Authority, the Kentucky Infrastructure Authority and the Kentucky Housing Corporation.

Mr. Bell has been Secretary and Treasurer of the Company since 1993. He is President of International Investments, Inc., an investment company owned by Mr. L. Rogers Wells, Jr., and previously served as Chief Financial Officer of that company from 1995 until 1997 and during 1993 and 1994. He has been an independent business and financial consultant since 1994

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and holds various business interests in a number of small, closely-held partnerships and corporations. Mr. Bell was a commercial loan officer for Peoples Bank & Trust Company, Greensburg, Kentucky from 1997 to 1999. From 1982 until 1993, he served in various positions with The New Farmers National Bank of Glasgow and its holding company, Commonwealth Bancorp, including Executive Vice President and Chief Credit Officer of The New Farmers National Bank of Glasgow from 1986 until 1993. Mr. Bell also served as Chief Credit Officer of Bowling Green Bank & Trust Company, N.A., another subsidiary of Commonwealth Bancorp, from 1991 until 1993. Mr. Bell has been a director of the Company since 1993.

Mr. Kasper has been President and owner of Algonquin Industries, Inc. and Hi-Tech Metals, Inc. in Bellingham, Massachusetts since 1974. These two companies manufacture machine parts for the computer, optic, robotic, gaming, environmental, biomedical and electromechanical industries. Mr. Kasper has been a director of the Company since 1993.

Ms. McEntire has been a director of the Company since 1993. She was a consultant to the Company for special projects related to marketing from 1997 to 1998 and was the Company's Vice President - Marketing from 1993 to 1997 and its Director of Retailer Relations from 1992 until 1993. In these capacities, she was primarily responsible for marketing to the lotteries and vendor support services for the Company. Ms. McEntire served from 1983 to 1987 as Regional Manager and then as Regional Coordinator of the Ohio Lottery Commission. From 1987 to 1989 she was Account Manager for British American Banknote, a Canadian manufacturer of instant lottery tickets. In 1989, she served as a consultant for the Ohio Department of Rehabilitation and Corrections, Bureau of Community Services. Ms. McEntire returned to the Ohio Lottery in 1990 as Deputy Director of Sales. From 1998 until August 2002 she served as Project Coordinator for the Coalition of Neighborhoods, a charitable agency that services and coordinates neighborhood activities. Since August 2002, Mrs. McEntire has been the Regional Director of the Ohio Civil Rights Commission.

Mr. Nichols has been President of the Company since 1997 and Chief Executive Officer since 1999. Mr. Nichols served as Senior Vice President of Sales and Marketing of the Company from 1994 to 1997 and as Vice President -- Operations of the Company from 1993 until 1994. From 1991 to 1992, he was Executive Director of the Board of Tax Appeals of the Commonwealth of Kentucky. From 1990 to 1991, Mr. Nichols was Principal Assistant to the Secretary of Finance and Administration for the Commonwealth of Kentucky, and from 1989 to 1990 he was Principal Assistant to the Kentucky Office for Social Security.

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During 1988, Mr. Nichols was Deputy Director of the Kentucky Democratic Party. Mr. Nichols has been a director of the Company since 1997.

Mr. Turek was Vice Chairman of the Board of Directors of the Company from 1997 until 1999 and has been a director of the Company since 1990. Mr. Turek served as Chairman of the Board, President and Chief Executive Officer of the Company from 1990 to 1992 and continued to serve as President of the Company until 1997, when he was appointed Vice Chairman. Mr. Turek began to develop the Company's instant ticket vending machine in 1987 and has guided product development through several models for instant ticket, telephone and smart card dispensing. Mr. Turek was Vice President of Peripheral Products in the computer division of SCI Systems, Inc. from 1984 to 1989 where he developed business opportunities in the commercial market for the design and manufacture of computer products. Prior to that time Mr. Turek held

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management, product development and operations positions with various companies in the computer and aerospace industries.

Mr. Wingfield has been Vice President of A.G. Edwards & Sons, Inc., a stock brokerage firm, since 1995. Mr. Wingfield is Manager of A.G. Edwards' Louisville office and its satellite office in New Albany, Indiana. He was First Vice President of Stifel, Nicolaus & Company Incorporated, a stock brokerage firm, from 1985 until 1995 and has been a registered stock broker since 1973. Mr. Wingfield has been a director of the Company since 1994.

Mr. Stokes has been Chief Operating Officer since 2000. Prior to that, Mr. Stokes had served as the Company's Vice President of Operations since 1997, as Director of Operations from 1996 to 1997 and as Purchasing Manager from 1993 to 1995. From 1988 to 1992, he served as unit controller for a food management company.

Mr. Blazer has been Chief Financial Officer of the Company since 1998. From 1973 to 1998, he served in various capacities for The Plastic Moldings Corporation, most recently as Vice President of Finance and Administration. Mr. Blazer previously served as an auditor and tax consultant with Ernst & Ernst, certified public accountants. Mr. Blazer is a certified public accountant.

The executive officers of the Company are appointed by and serve at the discretion of the Board of Directors.

### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 and the related regulations of the Securities and Exchange Commission require that the Company's executive officers and directors, as well as any persons who beneficially own more than 10% of the Company's Common Stock, file reports of their ownership of the Company's Common Stock with the SEC and the American Stock Exchange. These persons are required to furnish the Company with copies of all Section 16(a) reports they file. Based on its review of reports and written representations received by it, the Company believes that all Section 16(a) filing requirements were complied with on a timely basis for 2002. An error in Mr. Wells' Form 5 for fiscal year 2001, relating to shares transferred as part of a settlement, was subsequently corrected.

### ITEM 11. EXECUTIVE COMPENSATION

#### SUMMARY OF COMPENSATION

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The following table sets forth, for the years indicated, compensation paid by the Company for services in all capacities to Mr. Wells, the Company's Chairman of the Board; to Mr. Nichols, the Company's Chief Executive Officer; and to the Company's two other executive officers. These persons are sometimes referred to as the "named executive officers."

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### SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION		LONG-TERM
		SALARY (\$)	BONUS (\$)	COMPENSATION
				AWARDS
				SECURITIES
				UNDERLYING
				OPTIONS (#)
L. Rogers Wells, Jr. Chairman of the Board	2002	\$350,000	\$ -0-	134,000
	2001	\$350,000	\$ -0-	25,000
	2000	\$350,000	\$ -0-	-0-
David F. Nichols President; Chief Executive Officer	2002	\$226,317	\$139,400	25,000
	2001	\$220,000	\$ 49,531	212,500
	2000	\$120,000	\$100,000	-0-
Dennis W. Blazer Chief Financial Officer	2002	\$102,019	\$ 27,500	17,000
	2001	\$ 99,000	\$ 16,500	8,500
	2000	\$ 96,577	\$ 22,000	-0-
Thomas W. Stokes Chief Operating Officer	2002	\$118,518	\$ 31,500	20,000
	2001	\$ 88,077	\$ 18,000	10,000
	2000	\$ 85,500	\$ 25,000	-0-

#### STOCK OPTIONS

The following table presents information on option grants made during 2002 to the named executive officers.

#### OPTION GRANTS IN LAST FISCAL YEAR

Name	Individual Grants (1)				Potential Assume Stock Pr 5% (\$
	Number of Securities Underlying Options Granted (#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	
L. Rogers Wells, Jr.	134,000	60.36	5.40	3/5/12	1,178,6

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David F. Nichols	25,000	11.26	5.40	3/5/12	219,9
Dennis W. Blazer	17,000	7.66	5.40	3/5/12	149,5
Thomas W. Stokes	20,000	9.00	5.40	3/5/12	175,9

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- (1) All options become exercisable at the rate of 25% of the shares per year beginning on the first anniversary of the date of grant. Each option becomes exercisable in full (i) if the beneficial ownership of Common Stock of L. Rogers Wells falls below 50.1% and a third party (other than Mr. Wells, the Company or an employee benefit plan of the Company) becomes the beneficial owner of 30% or more of the Company's Common Stock without the approval of the Board of Directors; (ii) in the event of certain situations involving the merger, consolidation or liquidation of the Company or the sale or other disposition of all or substantially all of its assets; or (iii) if during any fiscal year, the individuals making up the Board of Directors at the beginning of such year cease to constitute a majority of the Board of Directors.

The table below sets forth information regarding the number and value of the unexercised stock options held by the named executive officers at December 31, 2002. No options were exercised by the named executive officers during 2002.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR  
AND FY-END OPTION VALUES

Name	Shares Acquired on Exercise (#)	Value Realized (\$) (Market Price on Exercise Less Exercise Price)	Number of Securities Underlying Unexercised Options at FY-End (#) Exercisable/ Unexercisable
L. Rogers Wells, Jr.	-	-	177,000/149,000
David F. Nichols	-	-	212,750/118,750
Dennis W. Blazer	-	-	17,000/22,500
Thomas W. Stokes	-	-	21,500/26,750

- (1) This value is computed by subtracting the option exercise price from the market price of the Common Stock on December 31, 2002 and multiplying that figure by the total number of unexercised options.

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### EMPLOYMENT AGREEMENT

Effective January 1, 2001, the Company entered into an employment agreement with Mr. Nichols for an initial five-year term. Beginning on the fourth anniversary of the agreement and on each subsequent anniversary, the term of the agreement will be extended for an additional year if neither party gives written notice to the contrary. The agreement provides for a minimum annual base salary of \$220,000, for cost-of-living increases and for annual

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consideration for performance increases. Under the agreement, Mr. Nichols is entitled to a bonus of 2 1/2% of the Company's net after tax income plus 5% of any year-over-year after tax net income growth. If the Company terminates the agreement for any reason other than "cause" (as defined in the agreement), disability or death, it will pay Mr. Nichols the greater of (1) two times the sum of his then-current base salary plus the amount of his immediately preceding bonus or (2) his then-current base salary plus immediately preceding bonus for each year remaining in the then-current term of the agreement. The Company also will provide Mr. Nichols with continued health and life insurance benefits through the end of the then-current term of the agreement and will pay him the value of any forfeited or lost pension, profit sharing and similar benefits which would have accrued and vested had he remained employed until that time. Similar benefits are payable if Mr. Nichols resigns within 90 days after a change of control of the Company (as defined in the agreement) or if his employment is actually or constructively terminated within two years after a change of control; in such an event, Mr. Nichols also is entitled to a gross-up for any taxes imposed as a result of the "excess parachute payments" provisions of the Internal Revenue Code.

### DIRECTOR COMPENSATION

Directors who are not employees of the Company receive a fee of \$1,000 for each meeting of the Board of Directors or Board committee attended in person or by telephone. Directors who are employees of the Company receive no directors' fees. The Company paid a total of \$11,000 in directors' fees in 2002.

Each non-employee member of the Board of Directors -- Gary S. Bell, Kazmier J. Kasper, H. Jean McEntire, Edmund F. Turek and John J. Wingfield - receives an annual grant of options to purchase shares of Common Stock. The option grants for 2002 were made on March 6, 2002. Each non-employee director received an option for 9,000 shares of Common Stock. The exercise price of each option is equal to the fair market value of the Common Stock on the date of grant. The options vest at the rate of 25% per year beginning one year after the date of grant and expire ten years from the date of grant.

Edmund F. Turek, the Company's founder, retired as an employee in 1999. Mr. Turek now has a consulting arrangement with the Company pursuant to which he was paid \$120,000 during 2002.

### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

A principal function of the Company's Compensation Committee is to establish the compensation of the executive officers of the Company. The Chairman of the Committee, Gary S. Bell, served during 2002 as Secretary and Treasurer of the Company (in a non-employee capacity) and also served as President of International Investments, Inc. International Investments is owned by L. Rogers Wells, Jr., the Company's Chairman of the Board. Additionally, the Company had an arrangement with International Investments under which it paid International Investments \$3,000 per month (for a total of \$36,000 in 2002) for



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consulting services provided to the Company by Mr. Bell. This arrangement was terminated as of December 31, 2002.

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### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information, as of March 15, 2003, regarding the beneficial ownership of the Company's Common Stock by (a) each person who is known by the Company to own more than 5% of the Common Stock, (b) each director and person named in the Summary Compensation Table individually and (c) all directors and executive officers as a group.

NAME OF BENEFICIAL OWNER	SHARES BENEFICIALLY OWNED (1)	PERCENT OF CLASS OWNED
Lloyd I. Miller III	664,800 (2)	10.3%
L. Rogers Wells, Jr.	3,652,300 (3)	54.8%
Edmund F. Turek	334,500 (4)	5.1%
Gary S. Bell	32,500	*
Dennis W. Blazer	25,969	*
Kazmier J. Kasper	36,500	*
H. Jean McEntire	21,750	*
David F. Nichols	233,136	3.5%
Thomas W. Stokes	28,112	*
John J. Wingfield	39,500	*
All directors and executive officers as a group (9 persons)	4,404,267	62.0%

\* Less than one percent.

- (1) Except as noted below, the named persons have sole voting and investment power with regard to all shares shown as beneficially owned by them. Includes the following numbers of shares which may be acquired upon exercise of stock options which were exercisable on, or became exercisable within 60 days after, March 15, 2003: Mr. Wells, 210,500 shares; Mr. Turek, 54,500 shares; Mr. Bell, 32,500 shares; Mr. Blazer, 21,250 shares; Mr. Kasper, 32,500 shares; Ms. McEntire, 21,750 shares; Mr. Nichols, 229,000 shares; Mr. Stokes, 26,250 shares; Mr. Wingfield, 32,500 shares; and all directors and executive officers as a group, 648,750 shares.
- (2) Mr. Miller reports having sole voting and dispositive power over 417,800 shares and shared voting and dispositive power over 247,000 shares. Mr. Miller's address is 4550 Gordon Drive, Naples, Florida 34102.
- (3) Mr. Wells' address is 7697 Innovation Way, Mason, Ohio 45040.
- (4) Includes 65,000 shares owned by Mr. Turek's wife. Mr. Turek's address is 7697 Innovation Way, Mason, Ohio 45040.

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### EQUITY COMPENSATION PLAN INFORMATION

The Company has three compensation plans under which shares of its common stock may be issued: the 1994 Stock Incentive Plan; the 1994 Directors Stock Incentive Plan, under which options were granted to the Company's nonemployee directors prior to 2000; and the Employee Stock Purchase Plan. Each of these plans has been approved by stockholders. The Company has no equity compensation plans or arrangements that have not been approved by stockholders.

The following table provides information concerning the Company's equity compensation plans as of December 31, 2002. Additional shares authorized for issuance under the 1994 Stock Incentive Plan as amended and restated effective January 15, 2003, and stock options granted on that date, are not included.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,070,511	\$ 4.68	201,594
Equity compensation plans not approved by security holders	--	--	--
<b>Total</b>	<b>1,070,511</b>	<b>\$ 4.68</b>	<b>201,594</b>

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Algonquin Industries, Inc. and Hi-Tech Metals, Inc., of each of which Kazmier J. Kasper, a director of the Company, is President and owner, sell the Company some of the components of the burster mechanisms and other dispensing mechanisms used in the Company's machines. During 2002, the Company paid an aggregate of \$5,120,953 to Algonquin Industries and Hi-Tech Metals for these mechanisms. The Company currently plans to continue purchasing all of these mechanisms from Algonquin Industries and Hi-Tech Metals. The Company believes that the purchases are on terms no less favorable than would be obtainable from unaffiliated third parties.

### ITEM 14. CONTROLS AND PROCEDURES

As of December 31, 2002, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management,

including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of December 31, 2002. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to December 31, 2002.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Documents Filed as Part of This Report.

1. Financial Statements

Independent Auditors' Report of Grant Thornton LLP

Balance Sheets at December 31, 2001 and 2002

Statements of Income for each of the years in the three-year period ended December 31, 2002

Statements of Stockholders' Equity for each of the years in the three-year period ended December 31, 2002

Statements of Cash Flows for each of the years in the three-year period ended December 31, 2002

Notes to Financial Statements

2. Financial Statement Schedules

The following financial statement schedule is set forth on page S-1 of this report:

Schedule II - Valuation and Qualifying Accounts

All other schedules have been omitted because they are not required or are inapplicable or because the information required is included in the financial statements or notes thereto.

3. Exhibits

See Index of Exhibits (page E-1) for a list of the exhibits filed with and incorporated by reference in this report.

(b) Reports on Form 8-K. None.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amended report to be signed on its behalf by the undersigned, thereunto duly authorized, on August 4, 2003.

INTERLOTT TECHNOLOGIES, INC.

By: /s/ L. Rogers Wells, Jr.

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L. Rogers Wells, Jr.  
Chairman of the Board

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## CERTIFICATIONS

I, David F. Nichols, certify that:

1. I have reviewed this annual report on Form 10-K of Interlott Technologies, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
- c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 4, 2003

/s/ David F. Nichols

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Chief Executive Officer

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I, Dennis W. Blazer, certify that:

1. I have reviewed this annual report on Form 10-K of Interlott Technologies, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
- b) evaluated the effectiveness of the registrant's disclosure

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controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

- c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 4, 2003

/s/ Dennis W. Blazer

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Chief Financial Officer

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FINANCIAL STATEMENT SCHEDULE

INTERLOTT TECHNOLOGIES, INC.

Schedule II - Valuation and Qualifying Accounts

COLUMN A	COLUMN B	COLUMN C		COLUMN D	COLUMN E
-----					
ADDITIONS					
DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS	BALANCE AT END OF PERIOD
-----					
Allowance for doubtful accounts					
2000	\$ 158,793	\$ 90,000	\$ 0	\$ 2,921	\$ 245,872

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2001	245,872	180,000	0	222,771	203,101
2002	203,101	244,742	0	394,511	53,332

Inventory  
valuation  
reserve

2000	\$1,000,286	\$ 401,292	\$ 0	\$ 920,494	\$ 481,084
2001	481,084	465,110	0	221,279	724,915
2002	724,915	540,882	0	158,132	1,107,665

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INTERLOTT TECHNOLOGIES, INC.

INDEX OF EXHIBITS

The following exhibits are filed with or incorporated by reference in this report. Where the exhibit is incorporated by reference from a previously filed document, that document is identified in parenthesis. Unless otherwise indicated, each document incorporated by reference was filed by the Company.

EXHIBIT NO. DESCRIPTION

- 2.1 Agreement and Plan of Merger dated as of March 17, 2003 by and among GTECH Holdings Corporation, Bengal Acquisition Co. and Interlott Technologies, Inc. (Current Report on Form 8-K dated March 17, 2003).
- 2.2 Stockholder Voting and Option Agreement dated as of March 17, 2003 among GTECH Holdings Corporation, Bengal Acquisition Co. and L. Rogers Wells, Jr. (Current Report on Form 8-K dated March 17, 2003).
- 3.1 Certificate of Incorporation of the Company, as amended, including Certificate of Designation of Series A Preferred Stock (Registration Statement on Form S-1, No. 33-75142).
- 3.2 Bylaws of the Company (Registration Statement on Form S-1, No. 33-75142).
- 4.1 Credit Agreement dated January 25, 2001 between the Company and Fifth Third Bank (Annual Report on Form 10-K for the year ended December 31, 2000).
- 4.2 Security Agreement dated January 25, 2001 between the Company and Fifth Third Bank (contained in Exhibit 4.3).
- 4.3 Mortgage of Intellectual Property dated January 25, 2001 between the Company and Fifth Third Bank (Annual Report on Form 10-K for

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the year ended December 31, 2000).

- 4.4 Third Amendment dated May 31, 2001 to Credit Agreement between the Company and Fifth Third Bank (Quarterly Report on Form 10-Q for the quarter ended June 30, 2001).
  - 4.5 Amended and Restated Revolving Note dated June 1, 2001 from the Company to Fifth Third Bank (Quarterly Report on Form 10-Q for the quarter ended June 30, 2001).
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- 4.6 Security Agreement dated as of May 31, 2001 between the Company and Fifth Third Bank (Quarterly Report on Form 10-Q for the quarter ended June 30, 2001).
  - 4.7 Fourth Amendment dated October 3, 2001 to Credit Agreement between the Company and Fifth Third Bank (Annual Report on Form 10-K for the year ended December 31, 2001).
  - 4.8 Fifth Amendment dated March 21, 2002 to Credit Agreement between the Company and Fifth Third Bank (Annual Report on Form 10-K for the year ended December 31, 2001).
  - 4.9 Sixth Amendment dated October 23, 2002 to Credit Agreement between the Company and Fifth Third Bank (Quarterly Report on Form 10-Q for the quarter ended September 30, 2002).
  - 10.1 Assignment of United States Letters Patent from BLM Resources, Inc. to the Company with respect to United States Patent No. 4,982,337, "System for Distributing Lottery Tickets" (Registration Statement on Form S-1, No. 33-75142).
  - 10.2 Pull-Tab Manufacturing and License Agreement between Algonquin Industries, Inc., Kazmier Kasper and the Company dated as of January 13, 1994 (Registration Statement on Form S-1, No. 33-75142).
  - 10.3 Asset Purchase Agreement dated February 23, 2001 between the Company and On-Point Technology Systems, Inc. (the Current Report on Form 8-K of On-Point Technology Systems, Inc. dated February 23, 2001 and filed March 9, 2001).
  - 10.4 Management Compensatory Plans
    - (a) 1994 Stock Incentive Plan, as amended and restated (Proxy Statement for 2001 Annual Meeting of Stockholders).
    - (b) 1994 Directors Stock Incentive Plan (Registration Statement on Form S-1, No. 33-75142).
    - (c) Employment Agreement dated as of January 1, 2001 between the Company and David F. Nichols (Annual Report on Form 10-K for the year ended December 31, 2000).
  - 23.1 Consent of Grant Thornton LLP -- filed herewith.



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- 24.1 Powers of Attorney -- previously filed.
- 99.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 -  
furnished herewith.

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