

INTERNATIONAL GAME TECHNOLOGY

Form 10-Q

May 05, 2006

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the Quarterly Period Ended March 31, 2006

OR

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

For the transition period from _____ to _____
Commission File Number 001-10684
International Game Technology
(Exact name of registrant as specified in its charter)

Nevada
(State of Incorporation)

88-0173041
(I.R.S. Employer Identification No.)

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

www.IGT.com
(Registrant's website)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days: Yes No
Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2):

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

| Class | Outstanding at May 4, 2006 |
|---|----------------------------|
| Common Stock par value \$.00015625 per share | 339,087,285 |

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DEFINITIONS

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

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Unaudited Condensed Consolidated Financial Statements****CONSOLIDATED INCOME STATEMENTS**

| | Quarters Ended | | Six Months Ended | |
|--|-----------------------|-------------|-------------------------|-------------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| <i>(In millions, except per share amounts)</i> | | | | |
| Revenues | | | | |
| Product sales | \$333.2 | \$252.2 | \$ 657.7 | \$ 606.4 |
| Gaming operations | 311.2 | 298.9 | 602.9 | 585.8 |
| Total revenues | 644.4 | 551.1 | 1,260.6 | 1,192.2 |
| Costs and operating expenses | | | | |
| Cost of product sales | 166.9 | 124.2 | 325.0 | 314.9 |
| Cost of gaming operations | 127.3 | 153.1 | 253.5 | 290.5 |
| Selling, general and administrative | 92.9 | 75.9 | 177.3 | 150.2 |
| Depreciation and amortization | 20.0 | 17.0 | 40.4 | 33.6 |
| Research and development | 44.4 | 36.4 | 85.5 | 68.1 |
| Bad debt provisions | 0.2 | (1.7) | 0.4 | (1.0) |
| Total costs and operating expenses | 451.7 | 404.9 | 882.1 | 856.3 |
| Operating income | 192.7 | 146.2 | 378.5 | 335.9 |
| Other income (expense) | | | | |
| Interest income | 15.9 | 16.1 | 31.6 | 31.5 |
| Interest expense | (11.3) | (14.4) | (24.9) | (29.3) |
| Other | 0.7 | (1.8) | 1.2 | (0.6) |
| Total other income (expense) | 5.3 | (0.1) | 7.9 | 1.6 |
| Income before tax | 198.0 | 146.1 | 386.4 | 337.5 |
| Income tax provisions | 74.0 | 52.2 | 141.8 | 121.1 |
| Net income | \$124.0 | \$ 93.9 | \$ 244.6 | \$ 216.4 |
| Basic earnings per share | \$ 0.37 | \$ 0.27 | \$ 0.73 | \$ 0.63 |
| Diluted earnings per share | \$ 0.35 | \$ 0.26 | \$ 0.69 | \$ 0.59 |
| Cash dividends declared per share | \$0.125 | \$0.120 | \$ 0.250 | \$ 0.240 |
| Weighted average shares outstanding | | | | |

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| | | | | |
|---------|-------|-------|-------|-------|
| Basic | 336.4 | 345.2 | 336.8 | 345.5 |
| Diluted | 361.9 | 372.4 | 362.3 | 373.3 |

See accompanying notes.

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Table of Contents**CONSOLIDATED BALANCE SHEETS**

| | March 31, 2006 | September 30, 2005 |
|---|---------------------------|-------------------------------|
| <i>(In millions, except par value)</i> | | |
| Assets | | |
| Current assets | | |
| Cash and equivalents | \$ 279.2 | \$ 288.9 |
| Investment securities, at market value | 202.1 | 268.3 |
| Restricted cash and investments | 116.5 | 130.9 |
| Accounts receivable, net of allowances for doubtful accounts of \$15.9 and \$20.4 | 400.7 | 327.8 |
| Current maturities of notes and contracts receivable, net | 77.0 | 98.2 |
| Inventories | 140.3 | 142.3 |
| Jackpot annuity investments | 46.4 | 52.2 |
| Deferred income taxes | 54.8 | 50.0 |
| Prepaid expenses and other | 98.5 | 78.6 |
| Total current assets | 1,415.5 | 1,437.2 |
| Notes and contracts receivable, net | 57.6 | 49.3 |
| Property, plant and equipment, net | 410.8 | 385.2 |
| Jackpot annuity investments | 343.4 | 469.4 |
| Deferred income taxes | 57.9 | 43.2 |
| Intangible assets, net | 271.4 | 286.3 |
| Goodwill, net | 1,093.2 | 1,090.9 |
| Other assets | 205.1 | 102.9 |
| | \$ 3,854.9 | \$ 3,864.4 |
| Liabilities and Stockholders Equity | | |
| Liabilities | | |
| Current liabilities | | |
| Current maturities of notes payable | \$ 8.5 | \$ 611.0 |
| Accounts payable | 93.2 | 96.7 |
| Jackpot liabilities | 187.8 | 203.9 |
| Accrued employee benefit plan liabilities | 43.6 | 60.2 |
| Dividends payable | 42.1 | 42.6 |
| Accrued income taxes | 11.2 | 14.5 |
| Other accrued liabilities | 174.1 | 188.7 |
| Total current liabilities | 560.5 | 1,217.6 |
| Notes payable, net of current maturities | 807.6 | 200.0 |
| Non-current jackpot liabilities | 379.9 | 501.9 |
| Other liabilities | 38.1 | 39.2 |
| | 1,786.1 | 1,958.7 |

Commitments and Contingencies**Stockholders Equity**

| | | |
|---|------------|------------|
| Common stock: \$.00015625 par value; 1,280.0 shares authorized; 717.0 and 712.8 shares issued | 0.1 | 0.1 |
| Additional paid-in capital | 1,786.5 | 1,623.6 |
| Treasury stock at cost: 379.9 and 374.6 shares | (2,350.0) | (2,176.9) |
| Deferred compensation | | (11.4) |
| Retained earnings | 2,631.9 | 2,471.1 |
| Accumulated other comprehensive income (loss) | 0.3 | (0.8) |
| | 2,068.8 | 1,905.7 |
| | \$ 3,854.9 | \$ 3,864.4 |

See accompanying notes.

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Table of Contents**CONSOLIDATED CASH FLOWS STATEMENTS**

| | Six Months Ended | |
|--|-------------------------|----------------|
| | March 31, | |
| | 2006 | 2005 |
| <i>(In millions)</i> | | |
| Operations | | |
| Net income | \$ 244.6 | \$ 216.4 |
| Adjustments: | | |
| Depreciation, amortization and asset charges | 112.7 | 100.3 |
| Debt discounts and deferred offering costs | 7.8 | 8.2 |
| Share-based compensation | 17.5 | 2.0 |
| Bad debt provisions | 0.4 | (1.0) |
| Inventory obsolescence provisions | 7.7 | 8.8 |
| Changes in operating assets and liabilities, excluding acquisitions and VIE consolidations/deconsolidations: | | |
| Receivables | (62.8) | 15.5 |
| Inventories | 2.5 | (6.3) |
| Accounts payable and accrued liabilities | (29.3) | (28.9) |
| Jackpot liabilities | (19.3) | (24.6) |
| Income taxes, net of employee stock plans | (31.3) | 34.7 |
| Other current assets | (3.5) | 0.7 |
| Other non-current assets | (42.2) | 17.4 |
| Cash from operations | 204.8 | 343.2 |
| Investing | | |
| Capital expenditures | (134.5) | (105.1) |
| Investment securities, net | 52.9 | (99.2) |
| Jackpot annuity investments, net | 14.1 | 12.6 |
| Loans receivable cash advanced | (0.8) | |
| Loans receivable payments received | 5.4 | 1.5 |
| Proceeds from assets sold | 0.8 | 0.2 |
| Change in restricted cash | 15.5 | 14.3 |
| Investment in unconsolidated affiliate | (56.0) | |
| Business acquisitions | (3.9) | (4.0) |
| Cash from investing | (106.5) | (179.7) |
| Financing | | |
| Debt (repayments) proceeds, net | (5.2) | 0.5 |
| Employee stock plan proceeds | 54.0 | 37.3 |
| Excess tax benefits from employee stock plans | 21.1 | |
| Dividends paid | (84.3) | (124.5) |
| Share repurchases | (173.1) | (97.0) |

| | | |
|--|----------|----------|
| Structured share repurchase plan | 77.8 | |
| Cash from financing | (109.7) | (183.7) |
| Foreign exchange rates effect on cash | 1.7 | (0.8) |
| Net change in cash and equivalents | (9.7) | (21.0) |
| Beginning cash and equivalents | 288.9 | 307.0 |
| Ending cash and equivalents | \$ 279.2 | \$ 286.0 |

See accompanying notes.

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Table of Contents**Supplemental Cash Flows Information**

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

| | Six Months Ended March 31, | |
|--|---------------------------------------|-------------|
| | 2006 | 2005 |
| <i>(In millions)</i> | | |
| Investment securities | | |
| Purchases | \$(271.5) | \$(409.6) |
| Proceeds from sales | 324.4 | 310.4 |
| Net | \$ 52.9 | \$ (99.2) |
| Jackpot funding | | |
| Collections to fund jackpots | \$ 72.5 | \$ 117.2 |
| Payments to winners | (91.8) | (141.8) |
| Net change in jackpot liabilities | (19.3) | (24.6) |
| Jackpot annuity purchases | (8.3) | (11.8) |
| Jackpot annuity proceeds | 22.4 | 24.4 |
| Net change in jackpot annuity investments | 14.1 | 12.6 |
| Net jackpot funding cash flows | \$ (5.2) | \$ (12.0) |
| Capital expenditures | | |
| Property, plant and equipment | \$ (27.0) | \$ (25.6) |
| Gaming operations equipment | (101.7) | (73.5) |
| Intellectual property | (5.8) | (6.0) |
| Total capital expenditures | \$(134.5) | \$(105.1) |
| Payments | | |
| Interest | \$ 9.0 | \$ 5.3 |
| Income taxes | 148.7 | 87.1 |
| Non-cash investing and financing items: | | |
| Capital expenditure accruals | \$ 3.8 | \$ |

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| | | |
|---------------------------|----------|--------|
| Acquisitions | | |
| Fair value of assets | \$ 2.8 | \$ 5.2 |
| Fair value of liabilities | (1.1) | 1.2 |
| VIE deconsolidations | | |
| Fair value of assets | \$ 139.2 | \$ |
| Fair value of liabilities | 139.2 | |

See accompanying notes.

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Table of Contents**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. Summary of Significant Accounting Policies****Basis of Presentation and Consolidation**

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

| | Period End | |
|-----------------------|-------------------|-----------------------|
| | Actual | Presented as |
| Current quarter | April 1, 2006 | March 31, 2006 |
| Prior year quarter | April 2, 2005 | March 31, 2005 |
| Prior fiscal year end | October 1, 2005 | September 30, 2005 |

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

Our consolidated financial statements include the accounts of International Game Technology and all majority-owned or controlled subsidiaries and variable interest entities for which we are the primary beneficiary. All appropriate inter-company accounts and transactions are eliminated. We use the equity method to account for investments in unconsolidated affiliates when we exercise significant influence, but do not control the affiliate and when we are not the primary beneficiary of a variable interest entity.

Unconsolidated Affiliate

In February 2006, IGT paid \$56.0 million for a 10% equity interest in Casino IP Holdings, LLC (LLC), a variable interest entity formed to hold, develop, and license Walker Digital's intellectual property identified for gambling use. IGT agreed to cooperatively develop and market products, expected to be integral to our operations, using certain LLC innovations. We are not the primary beneficiary of the LLC and apply the equity method of accounting. Our maximum exposure to loss at March 31, 2006, is our net investment in the LLC of \$55.2 million, included in other non-current assets. Our portion of LLC losses totaling \$0.8 million is not material and presented as a component of SG&A expense.

WAP Trust VIE Consolidations

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

On November 4, 2005, because of an earlier change in gaming regulations, IGT assumed direct responsibility for New Jersey WAP jackpot system operations previously under the control of a separate trust administrator, including casino collections and future winner payments. The administration of past winner payments remains the responsibility of the existing separate New Jersey trusts, and IGT has no remaining obligations related to past winner payments.

Accordingly, we deconsolidated approximately \$139.2 million of New Jersey VIE assets and liabilities related to past winners during the first quarter of fiscal 2006. This deconsolidation had no material impact on consolidated gaming operations revenues or expenses.

We continue to consolidate the Iowa Trust VIEs, with assets and liabilities totaling \$4.3 million at March 31, 2006. IGT, as trustee and administrator, will establish and consolidate any future New Jersey WAP trusts required only for periodic payments to winners who decline lump sum payout.

Restricted Cash

To be consistent with the current period presentation, we reclassified the \$14.3 million decrease in restricted cash for the six months ended March 31, 2005, in investing cash flows rather than net change in cash as previously presented. This reclassification had no impact on operating cash flows.

Hurricane Damages

We suffered damages and losses to our US gulf coast operations from the hurricanes in August and September 2005, primarily affecting gaming operations machines destroyed or temporarily shutdown. At March 31, 2006, approximately 500 gaming operations machines remain offline at damaged casinos.

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

Recently Issued Accounting Standards**SFAS 156**

In March 2006, the FASB issued SFAS 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*, amending various accounting guidance for servicing assets and liabilities. This statement is effective for fiscal years beginning after September 15, 2006, which will be IGT's fiscal year 2007. We do not anticipate a significant impact on our results of operations, financial position or cash flows from the adoption of this statement.

SFAS 155

In February 2006, the FASB issued SFAS 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140*, allowing companies to elect fair value measurement for instruments in their entirety in cases otherwise requiring a derivative to be bifurcated. This statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006, which will be IGT's fiscal year 2007. We do not expect the adoption of this statement to have a material impact on our results of operations, financial position or cash flows.

SFAS 154

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

FIN 47

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

SFAS 123R (including FSP's) and SAB 107

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

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

SFAS 123R is effective for the first annual reporting period that begins after June 15, 2005. The adoption of SFAS 123R resulted in a reduction to earnings for the first half of 2006 consistent with past pro forma stock based compensation disclosures. See Note 2 for additional information.

SFAS 151

In November 2004, the FASB issued SFAS 151, *Inventory Costs, amending ARB 43 Chapter 4, Inventory Pricing*. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight and handling costs, and wasted material (spoilage). SFAS 151 introduces the concept of normal capacity requiring

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allocation of fixed production overheads to inventory based upon normal capacity of production facilities. We must expense unallocated overhead costs in the period incurred. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, which is IGT's fiscal year 2006. The adoption of this statement had no material impact on our results of operations, financial position or cash flows.

2. Share-based Compensation

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

Stock Incentive Plan

Under the IGT SIP, our eligible employees and non-employee directors may be granted non-qualified and incentive stock options, non-vested shares (also known as restricted shares), or stock appreciation rights. SIP grants may vest over time of service or based on performance. We generally grant stock options at an exercise price equal to the market price at the date of grant, with a 10-year contractual term. Our share-based compensation arrangements typically vest ratably over five years of continuous service. At March 31, 2006, 17.6 million shares remain available for grant under the IGT SIP. Each restricted share granted counts as four shares against this allowance.

Current year stock options activity as of and for the six months ended March 31, 2006

| Options | Shares (thousands) | Exercise Price (per share) | Weighted Average | |
|----------------------------------|-----------------------|----------------------------------|---|---|
| | | | Remaining Contractual Term (years) | Aggregate Intrinsic Value (millions) |
| Outstanding at beginning of year | 22,774 | \$22.80 | | |
| Granted | 1,296 | 29.92 | | |
| Exercised | (3,702) | 12.86 | | |
| Forfeited | (158) | 27.79 | | |
| Expired | (28) | 19.84 | | |
| Outstanding at end of period | 20,182 | \$25.04 | 7.2 | \$212.9 |
| Exercisable at end of period | 9,316 | \$20.34 | 6.2 | \$141.5 |

Current year restricted shares activity as of and for the six months ended March 31, 2006

| Restricted Shares | Shares (thousands) | Grant Date Fair Value (per share) | Weighted Average | |
|----------------------------------|-----------------------|--|---|---|
| | | | Remaining Contractual Term (years) | Aggregate Intrinsic Value (millions) |
| Outstanding at beginning of year | 514 | \$26.78 | | |
| Granted | 236 | 31.45 | | |
| Vested | (109) | 32.34 | | |
| Forfeited | (3) | 34.71 | | |
| Outstanding at end of period | 638 | \$28.41 | 3.9 | \$22.5 |

Employee Stock Purchase Plan

Under the IGT qualified ESPP, eligible employees are granted an option with a 12-month term to purchase a limited number of shares, exercisable the last day in February each year. Eligible employees may participate in this plan through payroll deductions up to certain limits. The option price is currently equal to 85% of the market price of our stock on the grant date or exercise date, whichever is less. Approximately 248,000 shares

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were issued in February 2006 under this plan. Based on expected payroll contributions as of March 31, 2006, we expect to issue approximately 244,000 shares in February 2007 under this plan. At March 31, 2006, 3.0 million shares were available for future grants.

Additionally, eligible UK employees may enroll annually in the Barcrest Savings Related Share Option Scheme established in January 1999. Employees must elect to vest over three, five, or seven years and the option price is equal to 80% of the market price of our stock on the grant date. Approximately 2,000 shares were issued during the first six months of fiscal 2006 under this plan and approximately 707,000 shares were available for grant at March 31, 2006. Based on enrollment through March 2006, we expect to issue approximately 151,000 shares under this plan over the next seven years.

Expense Measurement and Recognition

On October 1, 2005, IGT adopted the provisions of SFAS 123R and SAB 107 requiring the measurement and recognition of all share-based compensation under the fair value method. We implemented SFAS 123R using the modified prospective transition method and adjusted previously recorded deferred compensation back to additional paid-in capital. We continue to evaluate the provisions of SFAS 123(R)-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*, and have not yet elected the alternative method for establishing the APIC pool or determined the impact on cash flows.

For the six months ended March 31, 2006, we recognized share-based compensation for all current award grants and for the unvested portion of previous award grants based on grant date fair values. Prior to fiscal 2006, we accounted for share-based awards under the APB 25 intrinsic value method, which resulted in compensation expense recorded only for restricted share awards and the modification or acquisition of outstanding unvested options. Prior period financial statements have not been adjusted to reflect fair value share-based compensation expense under SFAS 123R. With the adoption of SFAS 123R, we changed our method of expense attribution for fair value share-based compensation from the accelerated approach to the straight-line approach for future service based awards granted. We anticipate the straight-line method will provide a more meaningful measure of costs incurred. Compensation for share-based awards granted prior to the beginning of fiscal 2006 will continue to be recognized under the accelerated method. Unrecognized costs related to all share-based awards outstanding at March 31, 2006 totaled \$57.3 million and is expected to be recognized over a weighted average period of 1.90 years.

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

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

Option Valuation Assumptions

| | Quarters Ended March 31, | | Six Months Ended March 31, | |
|--------------------------|-----------------------------|-------|-------------------------------|-------|
| | 2006 | 2005 | 2006 | 2005 |
| Expected volatility | 0.28 | 0.35 | 0.29 | 0.34 |
| Expected dividends | 1.43% | 1.69% | 1.57% | 1.53% |
| Expected term (in years) | 4.3 | 3.7 | 4.4 | 3.4 |
| Risk free rate | 4.55% | 3.70% | 4.42% | 3.35% |

Table of Contents**Additional Share-based Compensation Information**

| | Quarters Ended | | Six Months Ended | |
|--|-----------------------|-------------|-------------------------|-------------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| <i>(In millions, except per share amounts)</i> | | | | |
| Reported Share-based Compensation | | | | |
| Pre-tax share-based compensation | \$ 8.0 | \$ 0.9 | \$ 17.5 | \$ 2.0 |
| Tax benefit | (2.3) | (0.3) | (5.1) | (0.7) |
| After-tax share-based compensation | \$ 5.7 | \$ 0.6 | \$ 12.4 | \$ 1.3 |
| Pro Forma Net Income Comparison | | | | |
| Reported net income | \$ 124.0 | \$ 93.9 | \$ 244.6 | \$ 216.4 |
| Additional after-tax proforma share-based compensation | | (6.8) | | (13.8) |
| Comparative net income (prior year pro forma) | \$ 124.0 | \$ 87.1 | \$ 244.6 | \$ 202.6 |
| Basic EPS as reported | \$ 0.37 | \$ 0.27 | \$ 0.73 | \$ 0.63 |
| Basic EPS (prior year pro forma) | \$ 0.37 | \$ 0.25 | \$ 0.73 | \$ 0.59 |
| Diluted EPS as reported | \$ 0.35 | \$ 0.26 | \$ 0.69 | \$ 0.59 |
| Diluted EPS (prior year pro forma) | \$ 0.35 | \$ 0.24 | \$ 0.69 | \$ 0.56 |
| Other Share-based Compensation Information | | | | |
| Weighted average grant date fair value per share: | | | | |
| Options granted | \$ 8.30 | \$ 7.83 | \$ 7.42 | \$ 8.12 |
| Restricted shares granted | \$ 31.45 | \$ 0.00 | \$ 31.45 | \$ 35.70 |
| Total intrinsic value of options exercised | \$ 66.2 | \$ 30.7 | \$ 79.8 | \$ 47.4 |
| Total fair value of restricted shares vested | 2.1 | 1.6 | 3.5 | 2.5 |
| Exercises under all share-based payment arrangements: | | | | |
| Cash received | \$ 44.8 | \$ 27.0 | \$ 54.0 | \$ 37.3 |
| Tax benefit realized for tax return deductions | 23.7 | 11.1 | 26.8 | 17.1 |

3. Inventories

| | March 31, | September 30, |
|----------------------|------------------|----------------------|
| | 2006 | 2005 |
| <i>(In millions)</i> | | |
| Raw materials | \$ 74.9 | \$ 69.8 |
| Work-in-process | 5.8 | 4.6 |
| Finished goods | 59.6 | 67.9 |

| | | | | |
|-------------------|----|-------|----|-------|
| Total inventories | \$ | 140.3 | \$ | 142.3 |
|-------------------|----|-------|----|-------|

Table of Contents**4. Property, Plant and Equipment**

| | March 31, 2006 | September 30, 2005 |
|--|---------------------------|-----------------------------------|
| <i>(In millions)</i> | | |
| Land | \$ 20.3 | \$ 20.7 |
| Buildings | 98.8 | 102.4 |
| Gaming operations equipment | 537.2 | 483.2 |
| Manufacturing machinery and equipment | 233.1 | 220.1 |
| Leasehold improvements | 11.9 | 10.5 |
| Construction in process | 47.7 | 39.3 |
| Total | 949.0 | 876.2 |
| Less accumulated depreciation and amortization | (538.2) | (491.0) |
| Property, plant and equipment, net | \$ 410.8 | \$ 385.2 |

Las Vegas facilities under construction totaled \$36.8 million at March 31, 2006 and \$25.1 million at September 30, 2005. During the first quarter of fiscal 2006, we listed our facilities in Rapid City, South Dakota for sale and reclassified them to other assets held for sale. As of March 31, 2006, the remaining net book value of these held for sale assets is \$4.6 million.

5. Acquisitions

On August 25, 2005, we completed the acquisition of WagerWorks, a provider of internet gaming technology, content and services. We anticipate this business combination will facilitate the distribution of our game content across remote channels and mediums, including the internet and interactive television. Pro forma financial information is not provided as this acquisition is not material to our consolidated results.

As the business valuation is not yet complete, the purchase price allocation is preliminary. As of March 31, 2006, we allocated the aggregate purchase price of \$89.1 million to:

- ^a tangible assets of \$5.7 million, including \$1.4 million in cash
- ^a current liabilities of \$8.1 million
- ^a identifiable intangibles of \$31.1 million, including \$10.1 million in patents, \$7.0 million in contracts, and \$14.0 million in developed technology
- ^a \$1.8 million of in-process R&D with no future alternative use, charged to R&D expense
- ^a \$58.6 million in goodwill not deductible for tax purposes

6. Allowances for Doubtful Notes and Contracts Receivable

| | March 31, 2005 | September 30, 2005 |
|----------------------|---------------------------|-----------------------------------|
| <i>(In millions)</i> | | |
| Current | \$ 26.6 | \$ 27.6 |
| Long-term | 16.3 | 15.2 |

\$ 42.9 \$ 42.8

7. Concentrations of Credit Risk

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

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Our revenues and resulting receivables are concentrated in specific legalized gaming regions. The composition of our accounts, contracts, and notes receivable at March 31, 2006 was:

| | |
|---------------------------------|-------------|
| Nevada | 27% |
| California | 11 |
| Other (5% or less individually) | 36 |
| Total North America | 74% |
| Europe | 14% |
| Other (5% or less individually) | 12 |
| Total International | 26% |
| Consolidated | 100% |

8. Intangible Assets and Goodwill**Intangible Additions**

Patent additions in the following table include capitalized legal costs. See Note 5 for additional information regarding acquisitions and valuation adjustments.

| Six months ended March 31, 2006 | Acquisitions and Valuation Adjustments | Other Additions | Weighted Average Life (Years) |
|-----------------------------------|--|--------------------|----------------------------------|
| <i>(In millions, except life)</i> | | | |
| Finite lived intangibles: | | | |
| Patents | \$ 0.1 | \$ 5.9 | 6 |
| Contracts | (3.9) | | 8 |
| Developed technology | 0.8 | 4.5 | 7 |
| Total | \$ (3.0) | \$ 10.4 | |

Intangible Balances

| | March 31, 2006 | | | September 30, 2005 | | |
|--------------------------------|----------------|-----------------------------|---------|--------------------|-----------------------------|---------|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| <i>(In millions)</i> | | | | | | |
| Finite lived intangible assets | | | | | | |
| Patents | \$325.4 | \$ 104.7 | \$220.7 | \$323.3 | \$ 92.7 | \$230.6 |
| Contracts | 19.5 | 7.5 | 12.0 | 23.4 | 5.6 | 17.8 |
| Trademarks | 5.0 | 4.3 | 0.7 | 9.8 | 8.5 | 1.3 |
| Developed technology | 44.2 | 11.1 | 33.1 | 38.9 | 7.7 | 31.2 |
| Customer relationships | 6.7 | 1.8 | 4.9 | 6.7 | 1.3 | 5.4 |

| | | | | | | |
|---------------------|---------|----------|---------|---------|----------|---------|
| Backlog | | | | 6.1 | 6.1 | |
| Net carrying amount | \$400.8 | \$ 129.4 | \$271.4 | \$408.2 | \$ 121.9 | \$286.3 |

Intangible Amortization

Our aggregate amortization expense totaled \$11.1 million in the current quarter versus \$9.2 million in the prior year quarter and \$22.4 million in the six months ended March 31, 2006 versus \$18.4 million for the same prior year period.

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| <i>(In millions)</i> | | | | | |
| Estimated annual amortization | \$45.3 | \$42.6 | \$38.2 | \$35.0 | \$31.1 |

Table of Contents**Goodwill Activity by Segment**

| Six months ended March 31, 2005 | North America | International | Total |
|---|--------------------------|----------------------|--------------|
| <i>(In millions)</i> | | | |
| Beginning balance | \$ 994.3 | \$ 96.6 | \$1,090.9 |
| Business acquisition | | 2.4 | 2.4 |
| WagerWorks purchase price adjustments | | 2.0 | 2.0 |
| Tax benefit of Anchor options exercised | (1.5) | | (1.5) |
| Foreign currency translation adjustment | | (0.6) | (0.6) |
| Ending balance | \$ 992.8 | \$ 100.4 | \$1,093.2 |

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

9. Credit Facilities & Indebtedness

| Outstanding Balance | March 31, 2006 | September 30, 2005 |
|--|---------------------------|-----------------------------------|
| <i>(In millions)</i> | | |
| Senior credit facility | \$200.0 | \$ 200.0 |
| Foreign credit facilities | 8.5 | 8.8 |
| Senior convertible debentures, net of unamortized discount | 607.6 | 602.2 |
| Total notes payable, net | \$816.1 | \$ 811.0 |

We continue to be in compliance with all applicable debt covenants at March 31, 2006.

Senior Credit Facility

On December 20, 2005, we entered into an amended and restated unsecured \$2.5 billion credit facility with a syndicate of banks, replacing the previous credit facility of \$1.5 billion. The new five-year credit facility provides a \$2.5 billion revolving line of credit; of which up to \$100.0 million is available for letters of credit and up to \$50.0 million is available for swingline (same day funds) borrowing. Borrowings outstanding totaled \$200.0 million at March 31, 2006 and \$4.2 million was reserved for letters of credit.

Interest rates and facility fees applicable to the credit facility are based on our public credit ratings and debt to capitalization ratio. Currently, the interest rate is LIBOR plus 37.5 bps with a facility fee of 12.5 bps. The revolver interest rate was 5.315% at March 31, 2006.

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

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

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

^a incur liens

^a enter into business combinations, liquidate, or dissolve

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

^a change the nature of the business

Foreign Credit Facilities

Our foreign credit facilities totaled \$49.7 million, with \$41.2 million available at March 31, 2006. Renewals occur annually in January and July.

Senior Convertible Debentures

On April 4, 2006, IGT entered into a new indenture as the result of exchanging our old Debentures for an equal aggregate principal amount at maturity of new Debentures and an exchange fee of \$2.51 per Debenture. In the aggregate, \$964.8 million, or 99.5%, of the old Debentures principal amount at maturity were tendered and

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accepted for exchange. The terms of the new Debentures are substantially similar to the old Debentures, except that the new Debentures include a net share settlement feature requiring us to satisfy our conversion obligation to holders in cash up to the accreted principal amount and in common shares for any remaining conversion value. Except for the exchange fee, there will be no impact on interest expense as a result of the exchange.

This exchange will reduce share dilution associated with the Debentures by enabling us to apply the treasury stock method for calculating diluted EPS related to contingently issuable shares. After the holders' redemption right expired on January 29, 2006, we reclassified the Debentures to non-current liabilities.

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

10. Earnings Per Share

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

| | Quarters Ended | | Six Months Ended | |
|--|-----------------------|-------------|-------------------------|-------------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| <i>(In millions, except per share amounts)</i> | | | | |
| Income from continuing operations | \$ 124.0 | \$ 93.9 | \$ 244.6 | \$ 216.4 |
| After-tax interest expense on convertible debentures | 1.9 | 2.4 | 4.2 | 4.7 |
| Diluted EPS Numerator | \$ 125.9 | \$ 96.3 | \$ 248.8 | \$ 221.1 |
| Weighted average common shares outstanding: | | | | |
| Basic | 336.4 | 345.2 | 336.8 | 345.5 |
| Dilutive effect of stock awards | 5.0 | 6.7 | 5.0 | 7.3 |
| Dilutive effect of debentures | 20.5 | 20.5 | 20.5 | 20.5 |
| Diluted EPS Denominator | 361.9 | 372.4 | 362.3 | 373.3 |
| Basic earnings per share | \$ 0.37 | \$ 0.27 | \$ 0.73 | \$ 0.63 |
| Diluted earnings per share | \$ 0.35 | \$ 0.26 | \$ 0.69 | \$ 0.59 |
| Weighted average antidilutive stock award shares excluded from diluted EPS | 7.6 | 8.9 | 9.2 | 5.6 |

On April 4, 2006, we issued new Debentures to holders who had properly tendered their old Debentures. This exchange will reduce share dilution associated with the Debentures by enabling us to apply the treasury stock method for calculating diluted EPS related to contingently issuable shares. Had the exchange occurred at the beginning of the second quarter, diluted weighted average shares outstanding would have been reduced by approximately 17.0 million shares, thereby increasing diluted EPS by \$0.01 for the quarter. See Note 9 for additional information about the exchange. There were no other transactions between March 31, 2006 and May 4, 2006 that would have materially

changed the number of basic or diluted shares outstanding.

11. Income Taxes

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

Table of Contents**12. Comprehensive Income**

| | Quarters Ended | | Six Months Ended | |
|---|----------------|---------|------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| | March 31, | | March 31, | |
| | | | | |
| <i>(In millions)</i> | | | | |
| Net income | \$ 124.0 | \$ 93.9 | \$ 244.6 | \$ 216.4 |
| Currency translation adjustments | 1.3 | (1.9) | 1.2 | 2.5 |
| Investment securities unrealized losses | (0.1) | | (0.1) | (0.1) |
| Comprehensive income | \$ 125.2 | \$ 92.0 | \$ 245.7 | \$ 218.8 |

13. Commitments and Contingencies**Litigation**

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

Alliance/Bally

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

On April 28, 2006, IGT filed a complaint in US District Court for the District of Delaware, alleging that defendants Bally Technologies, Inc., Bally Gaming Int l, Inc., and Bally Gaming, Inc. infringed nine US patents held by IGT, US Patent numbers RE 38,812; RE 37,885; 6,832,958; 6,319,125; 6,244,958; 6,431,983; 6,607,441; 6,565,434; and 6,620,046. The complaint alleges that the BALLY POWER BONUSING technology infringes one or more of the claims of the asserted IGT patents. The lawsuit seeks monetary damages and an injunction.

Aristocrat

On June 30, 2005, Aristocrat Technologies Australia PTY Ltd. filed a patent infringement lawsuit against IGT. The Complaint was served on IGT on December 13, 2005. Aristocrat alleges that IGT has willfully infringed U.S. Patent No. 6,093,102. Aristocrat contends that the patent covers its Reel Power® video slot technology and IGT s Multiway® video slot games. The lawsuit seeks unspecified damages and an injunction. IGT believes that the patent is invalid and not infringed and intends to vigorously defend the lawsuit. On January 13, 2006, Aristocrat filed a First Amended Complaint adding Aristocrat Technologies, Inc. as a plaintiff. On January 19, 2006, IGT filed its Answer to the First Amended Complaint. Discovery is ongoing.

Brochu v. Loto Quebec

Loto Quebec commenced an action in warranty against VLC, Inc., a wholly-owned subsidiary of IGT, and another manufacturer of video lottery machines in October 2003, in the Superior Court of the Province of Quebec, District of Quebec, seeking indemnification for any damages that may be awarded against Loto Quebec in a class action suit, also filed in the Superior Court of the Province of Quebec. The class action against Loto Quebec, to which neither IGT nor any of its affiliates are parties, was filed by Jean Brochu on behalf of himself and a class of other persons who allegedly developed pathological behaviors through the play of video lottery machines made available by Loto Quebec in taverns and other public locations. In this action, plaintiff seeks to recover on behalf of the class damages

of approximately CAD\$578.7 million, representing CAD\$4,863 per class member, and CAD\$119.0 million in punitive damages. Loto Quebec filed its Plea in Defense in the main action in February 2006. VLC filed its Plea in Defense in the warranty action in April 2006. The Court has scheduled trial of the entire action against Loto Quebec to commence in early 2007.

Environmental Matters

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

Table of Contents*Miller*

In June 2003, a class action lawsuit was filed in Clark County, Nevada, District Court against Acres and its directors, entitled Paul Miller v. Acres Gaming Incorporated, et al. The complaint alleged that Acres directors breached their fiduciary duties to their stockholders in connection with the approval of the merger transaction between Acres and IGT and sought to enjoin and/or void the merger agreement among other forms of relief. On September 19, 2003, the Court denied plaintiff's motion for a TRO to prevent Acres stockholders from voting on the merger. On September 24, 2003, plaintiff petitioned the Nevada Supreme Court to vacate the denial of the TRO and to enjoin Acres from holding its stockholder vote on the merger. The Nevada Supreme Court denied the petition on September 25, 2003. The plaintiff's action also seeks damages. On December 23, 2003, defendants filed a motion to dismiss plaintiff's second amended complaint for failure to state a claim on which relief may be granted. On April 29, 2004, the Court issued a ruling denying defendants' motion to dismiss the second amended complaint. On May 12, 2004, the Court issued an order denying defendants' motion to dismiss. Pursuant to stipulation of the parties on August 13, 2004, plaintiff filed a third amended complaint. The Court denied defendants' motion to dismiss the third amended complaint. On April 7, 2006 defendant filed a Notice of Removal to United States District Court, D. Nev. (Las Vegas), where proceedings will continue.

Nevada Sales/Use Tax Matter

In February 2003, an IGT employee, subsequently placed on administrative leave, filed a complaint under Nevada's False Claims Act (State of Nevada ex rel. James McAndrews v. International Game Technology, Anchor Coin and Spin for Cash Wide Area Progressive) alleging that IGT failed to pay requisite Nevada sales/use taxes on certain *Wheel of Fortune*[®] games placed in Nevada since 1997 and in connection with royalties received under intellectual property licensing agreements related to the placement of Action Gaming games in Nevada since 1997. In February 2006, the Nevada Supreme Court ordered the case dismissed and in March 2006 the trial court entered an order of dismissal. Mr. McAndrews is no longer an IGT employee.

In October 2004 and again in July 2005, NDT advised us that we had a good-faith legal basis for our position that no sales tax was payable on royalties received, but that NDT believed that sales tax may be payable on some amount of the royalties. We disagreed with NDT's position that sales tax may be payable on any part of the royalties. In February 2006, the audit of our sales/use tax returns by NDT for the years April 2000 through March 2003 was completed. The audit assessment was immaterial to our operating results, financial position and cash flows.

OSHA Matter

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

On November 10, 2004, the employees withdrew their complaint filed with OSHA and filed a notice of intent to file a complaint in federal court. On December 1, 2004, a complaint was filed under seal in the US District Court for Nevada. IGT filed a motion to dismiss the complaint in December 2004. The court denied the motion on May 2, 2005. IGT appealed this denial to the US Court of Appeals for the Ninth Circuit. The Ninth Circuit Court of Appeals denied our appeal in March 2006. Discovery is ongoing. IGT believes that the allegations are without merit and intends to vigorously defend this matter.

In the purchase price allocation, IGT used the relief of royalty valuation methodology to estimate the fair value of the patents at \$164.4 million, which is being amortized over the useful economic life. The carrying value of the patents at March 31, 2006 totaled \$102.7 million, with a remaining life of approximately 10 years.

Poulos

Along with a number of other public gaming corporations, IGT was a defendant in three class action lawsuits, later consolidated into a single action. Plaintiffs alleged that the defendants engaged in fraudulent and misleading conduct by inducing people to play video poker machines and electronic slot machines, based on false beliefs concerning how

the machines operate and the extent to which there is an opportunity to win on a given play. The amended complaint alleges that the defendants' acts constituted violations of the Racketeer Influenced and Corrupt Organizations Act, giving rise to claims for common law fraud and unjust enrichment, and seeks compensatory, special, incidental and punitive damages of several billion dollars.

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In December 1997, the Court denied the motions that would have dismissed the Consolidated Amended Complaint or that would have stayed the action pending Nevada gaming regulatory action. In June 2002, the Court denied the plaintiffs' motion for class certification. An appeal of that denial was filed timely with the US Court of Appeals for the Ninth Circuit. On August 10, 2004, the Ninth Circuit Court of Appeals upheld the US District court's denial of class certification. The class plaintiffs did not appeal the decision and proceeded with only their individual claims. Prior to the scheduled trial date on September 7, 2005, the US District Court of Nevada granted the defendants' pending motions for summary judgment. The plaintiffs timely filed a Notice of Appeal to the US Ninth Circuit Court.

Arrangements with Off-Balance Sheet Risks

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

Performance Bonds

Performance bonds outstanding related to gaming operations totaled \$29.1 million at March 31, 2006. We are liable to reimburse the bond issuer in the event of exercise due to nonperformance.

Letters of Credit

Outstanding letters of credit issued under our line of credit to ensure payment to certain vendors and governmental agencies totaled \$4.2 million at March 31, 2006.

IGT Licensor Arrangements

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

Product Warranties

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

| Six months ended March 31, | 2006 | 2005 |
|---|-------------|-------------|
| <i>(In millions)</i> | | |
| Balance at beginning of year | \$ 6.0 | \$ 6.9 |
| Reduction for payments made | (2.7) | (3.5) |
| Accrual for new warranties issued | 6.6 | 3.6 |
| Adjustments for pre-existing warranties | (0.4) | (1.9) |
| Balance at end of period | \$ 9.5 | \$ 5.1 |

Self-Insurance

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

State and Federal Taxes

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

Table of Contents**14. Derivatives****Foreign Currency Hedging**

At March 31, 2006, we hedged \$139.5 million of net foreign currency exposure with \$125.9 million in forward currency contracts versus \$138.8 million of exposure hedged with \$127.2 million in forward currency contracts at September 30, 2005.

Debentures Yield Adjustment

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

15. Business Segments

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

^a The North America Division aggregates our operations in the US and Canada

^a The International Division aggregates our operations in Asia, Australia, New Zealand, Europe, Japan, Latin America, Russia, South Africa, and the UK.

Our business segments are designed to allocate resources within a framework of management responsibility.

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

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

We do not recognize inter-company revenues or expenses upon the transfer of gaming products between divisions. IGT's segment profit reflects income before tax.

| | Quarters Ended | | Six Months Ended | |
|-------------------------------|-----------------------|-------------|-------------------------|-------------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| <i>(In millions)</i> | | | | |
| North America Division | | | | |
| Revenues | \$ 494.9 | \$ 476.0 | \$ 978.4 | \$ 939.4 |
| Product sales | 201.3 | 183.9 | 408.0 | 366.0 |
| Gaming operations | 293.6 | 292.1 | 570.4 | 573.4 |
| Segment profit | 198.5 | 161.2 | 385.4 | 330.5 |
| International Division | | | | |
| Revenues | \$ 149.5 | \$ 75.1 | \$ 282.2 | \$ 252.8 |
| Product sales | 131.9 | 68.3 | 249.7 | 240.4 |
| Gaming operations | 17.6 | 6.8 | 32.5 | 12.4 |
| Segment profit | 34.1 | 10.3 | 66.4 | 59.0 |
| Corporate Division | | | | |
| Segment profit | \$ (34.6) | \$ (25.4) | \$ (65.4) | \$ (52.0) |

Consolidated

| | | | | |
|-------------------|----------|----------|------------|------------|
| Revenues | \$ 644.4 | \$ 551.1 | \$ 1,260.6 | \$ 1,192.2 |
| Product sales | 333.2 | 252.2 | 657.7 | 606.4 |
| Gaming operations | 311.2 | 298.9 | 602.9 | 585.8 |
| Segment profit | 198.0 | 146.1 | 386.4 | 337.5 |

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

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

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

- ^a **OUR BUSINESS** – a general description of our business and operating segments
- ^a **OUR FOCUS** – a summary of our strategies and opportunities
- ^a **RECENTLY ISSUED ACCOUNTING STANDARDS** – a discussion of recently issued accounting standards with significance to our business
- ^a **CRITICAL ACCOUNTING ESTIMATES** – a discussion of accounting policies that require critical judgments and estimates
- ^a **CONSOLIDATED OPERATING RESULTS** – a year-over-year comparative analysis of net income for the second quarter and first half of fiscal 2006
- ^a **BUSINESS SEGMENT RESULTS** – a year-over-year comparative analysis of business segment results for the second quarter and first half of fiscal 2006
- ^a **LIQUIDITY AND CAPITAL RESOURCES** – a year-over-year comparative analysis of cash flows and capital resources for the first half of fiscal 2006
- ^a **FINANCIAL CONDITION** - analysis of significant changes in our financial position

OUR BUSINESS

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

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

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

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

OUR FOCUS

Product Demand

Demand for our products is driven principally by:

- ^a technological innovations that create new, more sophisticated games and/or customer cost savings
- ^a new or expanding gaming properties
- ^a establishment or expansion of legalized gaming jurisdictions
- ^a entertainment value to the player
- ^a manufacturer's reputation and reliability

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We see opportunities to grow our business through increased profit contributions from our international operations, new North America markets and growth in the installed base of our gaming operation machines. We expect that future replacement sales of our machines will be driven by customer desire to update their floor with new games and technology. We anticipate an acceleration of this trend as we transition to server-based technology. We also see margin expansion opportunities generated by our diversified product mix and increased revenues from non-machine products. Non-machine sales include systems, parts, conversions, and royalties or licensing fees.

Notwithstanding these factors, we remain dependent upon gaming market expansion for growth. Expansion of new markets has been slower to materialize than we previously expected due to delays in legislative actions and/or regulatory approvals. Meaningful growth in new or expanding markets does not appear likely until 2007 and beyond. In spite of these delays, our business strategies remain focused on:

- ^a the development and expansion of our product offerings
- ^a capitalizing on new and expanding market opportunities
- ^a gaining access to important intellectual property
- ^a strategic acquisitions and alliances to enable development of leading gaming technology
- ^a ensuring access to new distribution channels

Product Development

Our business model is the creation of game content and the delivery to consumers through our platforms and systems. We are a prominent designer of games, platforms and systems for the gaming industry. We accomplish this by anticipating consumer needs, responding to feedback and marketing trends, and pioneering innovative gaming machines and reliable systems solutions. Our product development efforts are supported by a considerable emphasis and investment in research and development of future technology, which we expect will enable us to maintain a leadership position in the industry.

We continue to expand our for-sale game library, emphasizing development of games to address changing consumer preferences and other market trends. We strive to develop games that incorporate exciting winning combinations, innovative and entertaining bonus events and appealing graphics and sound. During the year, we have added themes for video reel slots and video poker and incorporated the popular multi-line multi-coin configuration to our spinning reels. In addition, during the current quarter, we began selling machines on our new *AVP*[®] TrimLine platform, generating a strong backlog, and increased sales of hardware conversion kits that upgrade the spinning reel from 3 to 5 reels.

We anticipate additional fiscal 2006 growth in our gaming operations installed base through new video game introductions. During the quarter, we introduced our first communal gaming device, the *Wheel of Fortune*[®] *Super Spin*, in the North America and international markets. We continue to add themes to our multi-level, mystery progressive brands, that include *Party Time!*[®], *Fort Knox*[®], and our newest brand *Jackpot Hunter*. We continually add innovation and enhanced player appeal to our proprietary games, and remain focused on improving gaming operations revenues through yield management strategies that enhance both the product and jurisdictional mix of our installed base. We continue to expand our international gaming operations with placements in the emerging Mexico market. We remain focused on server-based initiatives, commencing our second commercial field trials and progressing through regulatory approvals during the second quarter. We are proceeding with the necessary steps in a long process of submittals, development and live testing in jurisdictions throughout the world. During the current quarter, we also entered into agreements for facilitating the development and introduction of certain Walker Digital casino innovations into our server-based gaming product line, providing access to an intellectual property portfolio focused on the creative use of casino networks, particularly for player preferences. We continue development efforts to refine our product and business model definition. As markets shift toward a more system-centric gaming environment, we expect a greater portion of our business will eventually come from non-machine revenues.

We continue our product integration efforts with PGIC and SMI to create a comprehensive automated table management system to be known as the *Intelligent Table System*[®], combining complementary capabilities,

technologies, and resources of the three companies. We have begun testing the product's player and real-time bet tracking capabilities using RFID technology provided by PGIC with one Nevada customer. The second phase of integration and testing will incorporate the card tracking capabilities using technology provided by SMI. We anticipate introducing the product in our fiscal 2006 fourth quarter. A well-implemented casino management and patron loyalty system offers strategic and competitive value to a casino's slot operations. We view the extension of this technology into the table games area as the next logical phase in the expansion of these products.

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Market Opportunities

We market our gaming products to legalized gaming jurisdictions around the world. While our most significant markets are in North America, we continue to pursue opportunities in international markets. The opportunities and challenges, and the extent of our successes, vary across these jurisdictions.

We previously estimated that new North America and international markets would materialize during fiscal 2006, but current market dynamics suggest that significant expansion could be delayed until fiscal 2007 and beyond. Although the timing remains uncertain, we do expect that opportunities will eventually come from new jurisdictions and expansion of existing markets.

We continue to monitor expanding and emerging markets in North America as states consider some form of legalized gaming. The new markets in Florida, Pennsylvania, and Arkansas continue with the regulatory process and we anticipate expansion in these markets in fiscal 2007. In California, there is the potential for new and renegotiated tribal state compacts that could spur further expansion in fiscal 2007. We are also monitoring gaming legislation in potential new markets in the states of Kansas, Ohio, Maryland, Massachusetts and Texas, all showing interest in some form of legalized gaming.

Gaming expansion is ongoing in numerous CDS and Class II markets nationwide, including Alabama, California, and Florida. In Oklahoma, the market recently expanded to include Class III compacted gaming in addition to CDS and Class II gaming. Racino markets in Maine, New York and Rhode Island continue to grow. New York continues to expand its program with anticipated future openings in Yonkers and Aqueduct scheduled for late fiscal 2006 and early fiscal 2007. We gained incremental market share of lease operation machines in New York, Rhode Island, and Delaware in the current quarter.

The outlook for international market expansion continues to improve as we focus on opportunities in Asia and Latin America. We are concentrating our management and development resources toward product localization, so we export a US manufactured product customized for local cultures. With the prospects of new international jurisdictions, we anticipate our international markets will continue to grow in significance over the next several years and increase their share of overall contribution.

Competition

The market for gaming machines and systems is intensely competitive principally through new product development. We maintain a global competitive advantage because of our ability to:

- ^a offer a dynamic and diverse library of innovative and strong performing games
- ^a develop and protect our extensive collection of intellectual properties
- ^a provide the highest levels of customer service and support

We also competitively benefit from our:

- ^a financial strength to aggressively research and develop new products, as well as invest in strategic acquisitions and alliances
- ^a extensive and well established infrastructure of sales and manufacturing
- ^a worldwide recognition and geographic diversity

We currently hold a significant share of the total gaming devices on North America casino floors. Within that population, our share of spinning reel and video poker machines remains stable, but we are experiencing increased competitive pressure within the video spinning reel gaming machines business. We expect to maintain a leading share of the total population of gaming devices installed over the long-term, despite quarterly fluctuations that will occur from time to time.

The marketplace for recurring revenue units is also competitive. We proactively manage our proprietary installed base in order to offer the strongest performing games placed on casino floors. We expect our ability to develop exciting new themes and expand our installed base should enable us to maintain a leading market share.

Sales of our *IGT Advantage* systems continue to capture market share because of its value added technology offerings. With a number of significant new *IGT Advantage* systems contracts, we now have systems relationships with most major gaming operators. At March 31, 2006, 550 IGT slot systems were installed worldwide versus 450 systems at March 31, 2005.

Capital Deployment

We continued to generate operating cash flows in the current six months of fiscal 2006, affording us the flexibility to reinvest in our business through capital expenditures and business alliances, as well as to provide

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returns to our shareholders through dividends and share repurchases. See the LIQUIDITY AND CAPITAL RESOURCES section that follows for current share repurchase and dividend activity.

We enter into strategic business alliances as part of our ongoing efforts to create shareholder value designed to complement our internal resources. In keeping with efforts to diversify and expand, during the second quarter we purchased a minority equity interest in Walker Digital's gaming subsidiary, Casino IP Holdings, LLC, and executed agreements for cooperative product development and marketing.

Hurricane Impact

We suffered damages and losses to our US gulf coast operations in the wake of hurricanes in August and September 2005. At March 31, 2006, approximately 500 gaming operations machines remain out of service. No determination has been made as to the total amount or timing of insurance payments. We carry comprehensive business interruption and property damage insurance. We are working closely with our insurance carriers, claims adjustors, and consultants to ascertain the full amount of insurance proceeds due to IGT as a result of the damages and losses suffered in the hurricanes. Business interruption insurance recoveries for lost earnings and any property insurance reimbursements over book value will be recorded when realized and all contingencies are resolved, which may result in future period fluctuations affecting comparability.

RECENTLY ISSUED ACCOUNTING STANDARDS

In the first quarter of fiscal 2006, we adopted SFAS 123R, *Share-Based Payment*, and recognized share-based compensation in our financial statements. See the CONSOLIDATED OPERATING RESULTS section that follows for a discussion of the impact to the current quarter and six months operating results and Note 2 of our Unaudited Condensed Consolidated Financial Statements for additional information regarding the adoption of SFAS 123R.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements were prepared in conformity with accounting principles generally accepted in the US, which require us to make assumptions and estimates about future events and apply judgment that affect reported amounts and disclosures. Because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates and those differences could be material. Our estimates are based on historical experience, current trends in our company, and the industry as a whole, and other factors management considers relevant at the time our consolidated financial statements were prepared.

We consider the following accounting estimates to be the most critical to aid in fully understanding and evaluating our reported financial results and they require us to make difficult, subjective or complex judgments about matters that are inherently uncertain or variable. Senior management has discussed the development, selection and disclosure of the following accounting estimates, considered most sensitive to changes from external factors, with the Audit Committee of our Board of Directors.

- ^a Share-based compensation

- ^a Jackpot liabilities and expenses

- ^a Intangible assets, goodwill and prepaid royalties

- ^a Income taxes

- ^a Bad debt expense

- ^a Inventory and gaming operations equipment

Except for the addition of share-based compensation below, we have made no significant changes to our critical accounting estimates since those presented in our Annual Report on Form 10-K for the year ended September 30, 2005.

Share-based Compensation

We began accounting for share-based compensation in accordance with SFAS 123R in the first quarter of fiscal 2006. Under the fair value recognition provisions, we estimate share-based compensation at the award grant date and recognize expense over the service period. Option valuation models require the input of highly subjective assumptions, and changes in the assumptions used can materially affect the fair value estimate. Additionally, judgment is required in estimating stock price volatility, forfeiture rates, expected dividends, and expected terms that options remain outstanding. See Note 2 of our Unaudited Condensed Consolidated Financial Statements for additional information regarding the adoption of SFAS 123R.

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| | Quarters Ended | | Favorable | | Six Months Ended | | Favorable | |
|---|-------------------|-----------|-------------------------|------|-------------------|------------|-------------------------|------|
| | March 31, 2006 | 2005 | (Unfavorable) Amount | % | March 31, 2006 | 2005 | (Unfavorable) Amount | % |
| <i>(In millions, except units, ASP, ARPU, ARDU & EPS)</i> | | | | | | | | |
| Total | | | | | | | | |
| Revenues | \$ 644.4 | \$ 551.1 | \$ 93.3 | 17% | \$ 1,260.6 | \$ 1,192.2 | \$ 68.4 | 6% |
| Gross profit | 350.2 | 273.8 | 76.4 | 28% | 682.1 | 586.8 | 95.3 | 16% |
| Gross margin | 54% | 50% | 4pp | 8% | 54% | 49% | 5pp | 10% |
| Operating income | \$192.7 | \$ 146.2 | \$ 46.5 | 32% | \$ 378.5 | \$ 335.9 | \$ 42.6 | 13% |
| Operating margin | 30% | 27% | 3pp | 11% | 30% | 28% | 2pp | 7% |
| Net income | \$ 124.0 | \$ 93.9 | \$ 30.1 | 32% | \$ 244.6 | \$ 216.4 | \$ 28.2 | 13% |
| Diluted EPS | \$ 0.35 | \$ 0.26 | \$ 0.09 | 35% | \$ 0.69 | \$ 0.59 | \$ 0.10 | 17% |
| Product Sales | | | | | | | | |
| Machines | \$ 244.7 | \$ 176.1 | \$ 68.6 | 39% | \$ 476.2 | \$ 466.5 | \$ 9.7 | 2% |
| Non-machine | 88.5 | 76.1 | 12.4 | 16% | 181.5 | 139.9 | 41.6 | 30% |
| Total product sales | 333.2 | 252.2 | 81.0 | 32% | 657.7 | 606.4 | 51.3 | 8% |
| Gross profit | \$ 166.3 | \$ 128.0 | \$ 38.3 | 30% | \$ 332.7 | \$ 291.5 | \$ 41.2 | 14% |
| Gross margin | 50% | 51% | (1)pp | -2% | 51% | 48% | 3pp | 6% |
| Units sold | 36,900 | 22,600 | 14,300 | 63% | 66,000 | 77,900 | (11,900) | -15% |
| ASP | \$ 6,600 | \$ 7,800 | \$ (1,200) | -15% | \$ 7,200 | \$ 6,000 | \$ 1,200 | 20% |
| ARPU | \$ 9,000 | \$ 11,100 | \$ (2,100) | -19% | \$ 10,000 | \$ 7,800 | \$ 2,200 | 28% |
| Gaming operations | | | | | | | | |
| Revenues | \$ 311.2 | \$ 298.9 | \$ 12.3 | 4% | \$ 602.9 | \$ 585.8 | \$ 17.1 | 3% |
| Gross profit | 183.9 | 145.8 | 38.1 | 26% | 349.4 | 295.3 | 54.1 | 18% |
| Gross margin | 59% | 49% | 10pp | 20% | 58% | 50% | 8pp | 16% |
| Installed base units | 44,400 | 37,900 | 6,500 | 17% | 44,400 | 37,900 | 6,500 | 17% |
| ARDU | \$ 78.00 | \$ 88.00 | \$ (10.00) | -11% | \$ 78.00 | \$ 86.00 | \$ (8.00) | -9% |

Operating income improved over the prior year, notwithstanding a decrease in North America units sold, primarily due to:

^a increasing game placements and operating efficiencies in gaming operations

^a strong broad-based international operating results

^a growing contributions from non-machine and newer North America platform product sales
EPS was positively impacted by share repurchases. The exchange of our old Debentures for new Debentures with a net settlement feature on April 4, 2006 is expected to further reduce future share dilution benefiting diluted EPS by approximately \$0.01 per quarter. See Note 9 and 10 of our Unaudited Condensed Consolidated Financial Statements for additional information regarding this exchange.

Product Sales

Revenues and gross profits grew in the current periods driven by:

^a broad-based improvements across international markets, especially sales in Japan of our latest pachisuro game release

^a newer platform sales

^a increasing non-machine sales of gaming systems and game theme conversions

Gross margins and ARPU in the current quarter declined due to the greater mix of lower-margin Japanese pachisuro games, offset by stronger North America margins on new platform sales and other international product sales. We estimate our consolidated product sales gross margins will fluctuate between 47% and 50% depending on the geographical mix and types of products sold.

Gaming Operations

Revenue growth in the current quarter and first half of fiscal 2006 is attributable to installed base growth in both casino and lease operations markets and stronger game play performance.

Prior year gross profits were negatively affected by asset obsolescence charges of \$19.9 million as a result of demand transitioning toward newer products and cabinet styles.

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Gross margin expansion year over year was also driven by:

- ^a a greater mix of CDS and Class II market games carrying lower revenue yields, but higher margins
- ^a success with our low-denomination and multi-level progressive games
- ^a lower jackpot expenses related to effective yield and cost management strategies, as well as favorable shifts in interest rates

We estimate our consolidated gaming operations gross margin will trend between 57% and 59% for the remainder of fiscal 2006, depending on the mix of game placements, movements in interest rates and play levels.

Operating Expenses

| | Quarters Ended | | Favorable | | Six Months Ended | | Favorable | |
|-------------------------------------|----------------|---------|-----------|-------|------------------|---------|-----------|-------|
| | 2006 | 2005 | Amount | % | 2006 | 2005 | Amount | % |
| <i>(In millions)</i> | | | | | | | | |
| Selling, general and administrative | \$ 92.9 | \$ 75.9 | \$(17.0) | -22% | \$177.3 | \$150.2 | \$(27.1) | -18% |
| Depreciation and amortization | 20.0 | 17.0 | (3.0) | -18% | 40.4 | 33.6 | (6.8) | -20% |
| Research and development | 44.4 | 36.4 | (8.0) | -22% | 85.5 | 68.1 | (17.4) | -26% |
| Bad debt provisions | 0.2 | (1.7) | (1.9) | -112% | 0.4 | (1.0) | (1.4) | -140% |
| Total | \$157.5 | \$127.6 | \$(29.9) | -23% | \$303.6 | \$250.9 | \$(52.7) | -21% |
| Percent of revenues | 24% | 23% | (1) pp | -4% | 24% | 21% | (3) pp | -14% |

Operating expenses increased during the current periods primarily due to:

- ^a higher legal and compliance costs in SG&A
- ^a additional investment in R&D to support next generation technologies
- ^a current SFAS 123R share-based compensation of \$7.6 million for the quarter and \$16.6 million for the six months in SG&A and R&D
- ^a additional WagerWorks operating expenses of \$6.1 million for the quarter and \$11.6 million for the half year period, including amortization of acquired intangibles
- ^a prior year bad debt provisions benefiting from an improved collection risk profile

Other Income (Expense) and Taxes

| | Quarters Ended | | Favorable | | Six Months Ended | | Favorable | |
|--|----------------|------|-----------|---|------------------|------|-----------|---|
| | 2006 | 2005 | Amount | % | 2006 | 2005 | Amount | % |

(In millions)

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| | | | | | | | | |
|---------------------------------|---------|----------|----------|-----|---------|---------|----------|-----|
| Interest income | \$ 15.9 | \$ 16.1 | \$ (0.2) | -1% | \$ 31.6 | \$ 31.5 | \$ 0.1 | * |
| Interest expense: | (11.3) | (14.4) | 3.1 | 22% | (24.9) | (29.3) | 4.4 | 15% |
| Other | 0.7 | (1.8) | 2.5 | * | 1.2 | (0.6) | 1.8 | * |
| Total other income (expense) | \$ 5.3 | \$ (0.1) | \$ 5.4 | * | \$ 7.9 | \$ 1.6 | \$ 6.3 | * |
| Income tax provisions | \$ 74.0 | \$ 52.2 | \$(21.8) | | \$141.8 | \$121.1 | \$(20.7) | |
| Tax rate | 37.4% | 35.7% | | | 36.7% | 35.9% | | |

Interest income decreased primarily due to the deconsolidation of the NJ trust substantially offset by higher interest yields on investments and receivables. The deconsolidation of the NJ trust also resulted in lower interest expense. See Note 1 of our Unaudited Condensed Consolidated Financial Statements for further information about the NJ trusts deconsolidation. Other improved as a result of legal settlement charges in the prior year quarter.

Our effective tax rate increased during the current quarter due to the expiration of R&D credits and non-deductible amortized share-based compensation. We anticipate our effective tax rate will range between 36.5% and 37.0% for the remainder of fiscal 2006, partially dependent on potential extension of the R&D credit.

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Operating income for each division below reflects applicable operating expenses. See Note 15 of our Unaudited Condensed Consolidated Financial Statements for additional information related to our business segments.

North America Division

| | Quarters Ended | | Favorable | | Six Months Ended | | Favorable | |
|---|-------------------|----------|-------------------------|-----|-------------------|----------|-------------------------|-----|
| | March 31, 2006 | 2005 | (Unfavorable) Amount | % | March 31, 2006 | 2005 | (Unfavorable) Amount | % |
| <i>(In millions, except units, ASP, ARPU)</i> | | | | | | | | |
| Total segment | | | | | | | | |
| Revenues | \$ 494.9 | \$ 476.0 | \$ 18.9 | 4% | \$ 978.4 | \$ 939.4 | \$ 39.0 | 4% |
| Gross profit | 282.1 | 237.8 | 44.3 | 19% | 549.5 | 482.0 | 67.5 | 14% |
| Gross margin | 57% | 50% | 7pp | 14% | 56% | 51% | 5pp | 10% |
| Operating income | \$ 192.8 | \$ 158.5 | \$ 34.3 | 22% | \$ 374.7 | \$ 322.9 | \$ 51.8 | 16% |
| Operating margin | 39% | 33% | 6pp | 18% | 38% | 34% | 4pp | 12% |
| Product Sales | | | | | | | | |
| Machines | \$ 130.5 | \$ 120.7 | \$ 9.8 | 8% | \$ 263.8 | \$ 252.6 | \$ 11.2 | 4% |
| Non-machine | 70.8 | 63.2 | 7.6 | 12% | 144.2 | 113.4 | 30.8 | 27% |
| Total product sales | 201.3 | 183.9 | 17.4 | 9% | 408.0 | 366.0 | 42.0 | 11% |
| Gross profit | \$ 110.4 | \$ 97.5 | \$ 12.9 | 13% | \$ 222.2 | \$ 196.8 | \$ 25.4 | 13% |
| Gross margin | 55% | 53% | 2pp | 4% | 54% | 54% | pp | |
| Units sold | 12,900 | 13,300 | (400) | -3% | 27,200 | 28,000 | (800) | -3% |
| ASP | \$10,100 | \$ 9,100 | \$1,000 | 11% | \$ 9,700 | \$ 9,000 | \$ 700 | 8% |
| ARPU | \$15,600 | \$13,800 | \$1,800 | 13% | \$15,000 | \$13,100 | \$1,900 | 15% |
| Gaming operations | | | | | | | | |
| Revenues | \$ 293.6 | \$ 292.1 | \$ 1.5 | 1% | \$ 570.4 | \$ 573.4 | \$ (3.0) | -1% |
| Gross profit | 171.7 | 140.3 | 31.4 | 22% | 327.3 | 285.2 | 42.1 | 15% |
| Gross margin | 58% | 48% | 10pp | 21% | 57% | 50% | 7pp | 14% |
| Installed base units | 39,200 | 36,900 | 2,300 | 6% | 39,200 | 36,900 | 2,300 | 6% |

The North America division achieved increased revenues, gross profit and margins, and operating income in the current quarter and first six months of fiscal 2006, as a result of an improved machine product mix, higher non-machine (systems, parts, and conversions) sales, growth in our installed base of recurring revenue machines, and improved efficiencies of our gaming operations business.

Product sales revenues, ASP and ARPUs increased in the current quarter and first half of fiscal 2006 despite lower volumes as a result of a stronger product mix that included sales of our new AVP® TrimLine product and increased non-machine related revenues.

Gaming operations revenues grew in the current quarter and declined slightly in the first six months of fiscal 2006 as we experienced significant increases in our installed base of games that carry lower revenue yields but provide higher contributions to gross margins. Improvements in gross margins in the current quarter and first six months of fiscal 2006 were primarily due to:

- ^a a more favorable product mix in the installed base
- ^a success of our low-denomination and multi-level progressive games
- ^a effective yield and cost management
- ^a volume of slot play
- ^a favorable shifts in interest rates

Additionally, gross margins in the prior year periods were adversely affected by asset obsolescence charges of \$19.9 million as demand transitioned toward our innovative new gaming operations products and cabinet styles.

The growth in our installed base of proprietary games included:

- ^a additional casino operation placements in CDS and Class II markets in California, Florida, Alabama, and expansion of our Instant Bingo and poker products in Oklahoma
- ^a incremental leased operation market placements in New York, Rhode Island, and Delaware

While growth in our installed base is dependent on gaming industry expansion, we continually focus on strategies to improve yields. This includes managing the types of games and jurisdictions, replacement of

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underperforming games with higher yielding games, pace of new game introductions, and the size of initial progressive jackpots.

International Division

| | Quarters Ended | | Favorable | | Six Months Ended | | Favorable | |
|---|-------------------|----------|-------------------------|------|-------------------|----------|-------------------------|------|
| | March 31, 2006 | 2005 | (Unfavorable) Amount | % | March 31, 2006 | 2005 | (Unfavorable) Amount | % |
| <i>(In millions, except units, ASP, ARPU)</i> | | | | | | | | |
| Total segment | | | | | | | | |
| Revenues | \$ 149.5 | \$ 75.1 | \$ 74.4 | 99% | \$ 282.2 | \$ 252.8 | \$ 29.4 | 12% |
| Gross profit | 68.1 | 36.0 | 32.1 | 89% | 132.6 | 104.8 | 27.8 | 27% |
| Gross margin | 46% | 48% | (2) pp | -4% | 47% | 41% | 6 pp | 15% |
| Operating income | \$ 34.4 | \$ 10.5 | \$ 23.9 | 228% | \$ 68.6 | \$ 57.9 | \$ 10.7 | 18% |
| Operating margin | 23% | 14% | 9 pp | 64% | 24% | 23% | 1 pp | 4% |
| Product Sales | | | | | | | | |
| Machines | \$ 114.2 | \$ 55.4 | \$ 58.8 | 106% | \$ 212.4 | \$ 213.9 | \$ (1.5) | -1% |
| Non-machine | 17.7 | 12.9 | 4.8 | 37% | 37.3 | 26.5 | 10.8 | 41% |
| Total product sales | 131.9 | 68.3 | 63.6 | 93% | 249.7 | 240.4 | 9.3 | 4% |
| Gross profit | \$ 55.9 | \$ 30.5 | \$ 25.4 | 83% | \$ 110.5 | \$ 94.7 | \$ 15.8 | 17% |
| Gross margin | 42% | 45% | (3) pp | -7% | 44% | 39% | 5 pp | 13% |
| Units sold | 24,000 | 9,300 | 14,700 | 158% | 38,800 | 49,900 | (11,100) | -22% |
| ASP | \$ 4,800 | \$ 5,900 | \$ (1,100) | -19% | \$ 5,500 | \$ 4,300 | \$ 1,200 | 28% |
| ARPU | \$ 5,500 | \$ 7,300 | \$ (1,800) | -25% | \$ 6,400 | \$ 4,800 | \$ 1,600 | 33% |

Gaming operations

| | | | | | | | | |
|----------------------|---------|--------|---------|------|---------|---------|---------|------|
| Revenues | \$ 17.6 | \$ 6.8 | \$ 10.8 | 159% | \$ 32.5 | \$ 12.4 | \$ 20.1 | 162% |
| Installed base units | 5,200 | 1,000 | 4,200 | 420% | 5,200 | 1,000 | 4,200 | 420% |

International product sales revenue grew in the current quarter primarily due to increased volumes that included the release of the *Nobunaga 2* Japanese pachisuro game, our first game developed under Japan's new more restrictive Regulation 5 requirements. We sold 11,700 *Nobunaga 2* games in the current quarter, while the prior year quarter did not include any material unit sales in Japan. During the current quarter, we also realized broad-based international improvements most notably in the UK, Europe, Latin America, and Australia.

Current quarter product sales gross margins and ARPU declined due to the greater mix of lower-margin pachisuro sales in Japan.

Product sales revenues grew despite fewer Japanese units sold in the first half of fiscal 2006, as a result of strong results posted across other international markets. Additionally, gross margins and ARPU improved in the current six months primarily due to:

- ^a fewer lower-margin Japanese pachisuro games sold in the current period compared to 29,600 *The Terminator* games in the prior year
- ^a a more favorable mix of systems and other non-machine revenues
- ^a a strong mix of premium products in Australia

We anticipate international margins will continue to fluctuate depending upon the geographic mix of product sales, especially related to Japan's pachisuro machines. Successes in Japan can contribute significantly to our gross profit and operating income, but these lower priced pachisuro games reduce gross margin.

Additionally, other factors that may influence fluctuations in our international results for the remainder of fiscal 2006 include:

- ^a transitions in Japan's regulatory environment
 - ^a benefits of UK early freedom regulations not expected to repeat in the second half
 - ^a additional environmental requirements resulting from compliance with RoHS Directive in the European Union
- Gaming operations revenues increased in the current quarter and first six months of fiscal 2006 as a result of growth in the installed base. Increases in the installed base were driven by additional lease operation units in the emerging Mexico market as well as the introduction of WAP units in South Africa.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES****Capital Resources**

Our principal source of liquidity is cash generated from operations, which allows us to reinvest in our business. Other sources of capital include, but are not limited to, the issuance of public or private placement debt, bank borrowings under our credit facility and the issuance of equity securities. We expect our available capital resources will sufficiently fund current capital expenditures and operating requirements, scheduled debt repayments, dividends, interest and income tax obligations.

Our working capital increased to \$855.0 million at March 31, 2006 from \$219.6 million at September 30, 2005, primarily due to the reclassification of our Debentures to non-current with the expiration of holders' rights to cash redemption on January 29, 2006. Working capital statistics for the trailing twelve months ended March 31, 2006 compared to the prior year period as follows:

^a average days sales outstanding increased to 80 days versus 73 days

^a inventory turns increased to 4.4 compared to 3.7

Cash Flows Summary

| | Six Months Ended March 31, | | Favorable (Unfavorable) | |
|---------------------------|---------------------------------------|-------------|------------------------------------|----------|
| | 2006 | 2005 | Amount | % |
| <i>(In millions)</i> | | | | |
| Operations | \$ 204.8 | \$ 343.2 | \$ (138.4) | -40% |
| Investing | (106.5) | (179.7) | 73.2 | 41% |
| Financing | (109.7) | (183.7) | 74.0 | 40% |
| Effects of exchange rates | 1.7 | (0.8) | 2.5 | 313% |
| Net change | \$ (9.7) | \$ (21.0) | \$ 11.3 | 54% |

Operations

Operating cash flows for the first half of fiscal 2006 decreased over the prior year period primarily due to:

^a trade receivables consistent with the growth in product sales

^a income tax payment timing

^a prepayments for the extension of exclusive rights to licensed properties

Fluctuations in net cash flows related to WAP jackpot liabilities reflect timing variations in jackpot life cycles, slot play volumes, and winner payments. The deconsolidation of New Jersey's past winner liabilities is also reducing amounts of winner payments, as well as investing cash flows from jackpot annuity proceeds. See Note 1 of our Consolidated Financial Statements in our most recent Form 10-K for additional information about accounting for jackpot liabilities.

Investing

Additional investing cash flows provided in the current six months compared to last year is predominantly due to net investment securities proceeds, offset by our equity investment in Casino IP Holdings, LLC and additional capital expenditures. Increased spending for gaming operations equipment is consistent with the growth in our installed base (refer to OPERATING RESULTS discussion above).

| | Six Months Ended March 31, | | Increase (Decrease) | |
|-----------------------------|---------------------------------------|-------------|--------------------------------|----------|
| Capital Expenditures | 2006 | 2005 | Amount | % |

(In millions)

| | | | | |
|-------------------------------|----------|----------|---------|-----|
| Property, plant and equipment | \$ 27.0 | \$ 25.6 | \$ 1.4 | 5% |
| Gaming operations equipment | 101.7 | 73.5 | 28.2 | 38% |
| Intellectual property | 5.8 | 6.0 | (0.2) | -3% |
| Total capital expenditures | \$ 134.5 | \$ 105.1 | \$ 29.4 | 28% |
| North America | 71% | 95% | | |
| International | 29% | 5% | | |

Financing

Fluctuations in financing cash flows are attributable to additional current period proceeds from employee stock plans, including excess tax benefits realized, and timing differences in dividend payments.

Table of Contents**Stock Repurchase Plan**

Under the 1990 IGT common stock repurchase plan, as amended and adjusted for stock splits, our remaining share repurchase authorization totaled 17.8 million at March 31, 2006. We repurchase shares in open market or privately negotiated transactions, depending on market conditions and other factors, to return value to shareholders and reduce outstanding share dilution. We repurchased 5.3 million shares for an aggregate price of \$173.1 million in the first half of fiscal 2006. There is no expiration date specified for this plan.

In September 2005, we prepaid \$74.0 million in a structured share repurchase transaction designed to settle in cash or IGT shares on November 15, 2005. Since our stock price was above \$27.40 per share on November 15, 2005, we received \$77.8 million in cash. The result of this transaction is reflected in stockholders' equity. We may use structured share repurchases again in the future.

Credit Facilities and Indebtedness

On April 4, 2006, we completed the exchange of 99.5% or \$964.8 million aggregate principal amount at maturity of our old Debentures for new Debentures with a net share settlement feature, which requires us to settle the conversion obligation to holders in cash up to the accreted principal amount and in common shares for any remaining conversion value. All other terms of the new debentures are substantially the same. See Note 9 of our Unaudited Condensed Consolidated Financial Statements for additional information regarding redemption and conversion rights.

On December 20, 2005, we entered into an amended and restated unsecured \$2.5 billion credit facility with a syndicate of banks, replacing the previous credit facility of \$1.5 billion. We continue to be in full compliance with all covenants contained in all debt agreements at March 31, 2006.

FINANCIAL CONDITION

| | March 31, | September | Increase | |
|----------------------------|------------------|------------------|-------------------|----------|
| | 2006 | 30, | (Decrease) | |
| | | 2005 | Amount | % |
| <i>(In millions)</i> | | | | |
| Total assets | \$ 3,854.9 | \$ 3,864.4 | \$ (9.5) | 0% |
| Total liabilities | 1,786.1 | 1,958.7 | (172.6) | -9% |
| Total stockholders' equity | 2,068.8 | 1,905.7 | 163.1 | 9% |

Total assets and liabilities decreased by \$139.2 million during the current period with the deconsolidation of our NJ trust VIEs as explained in Note 1 of our Unaudited Condensed Consolidated Financial Statements. This decrease to total assets was offset by increases in:

^a receivables related to sales timing

^a other assets related to prepaid licensing rights and intellectual property investments

^a gaming operations equipment

Total liabilities also decreased due to employee incentives and taxes paid during the current period.

Total stockholders' equity increased during the first half of fiscal 2006 primarily as the result of:

^a earnings

^a proceeds from employee stock plans

^a partially offset by dividends declared and share repurchases

Arrangements With Off-Balance Sheet Risks

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

arrangements to fund our operations. See Note 13 of our Unaudited Condensed Consolidated Financial Statements for additional disclosures of arrangements with off-balance sheet risk.

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FORWARD LOOKING STATEMENTS AND RISK FACTORS

Risk Factors and Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q contains statements which do not relate to historical or current facts, but are forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information based on forecasts of future results and estimates of amounts not yet determinable. These statements may also relate to future events or trends, our future prospects and proposed new products, services, developments or business strategies, among other things. These statements can generally (although not always) be identified by their use of terms and phrases such as anticipate, believe, could, would, estimate, expect, intend, may, plan, predict, project, pursue, will, continue, and other similar terms and phrases, as well as the use of the future tense.

Examples of forward looking statements in this report include, but are not limited to, the following categories of expectations about:

- ^a our ability to introduce new products and stimulate replacement demand
- ^a our market share and competitive advantage
- ^a the total market installed base
- ^a capitalizing on gaming expansion and new market opportunities
- ^a critical accounting estimates
- ^a tax exposure and tax rates
- ^a future gross margins or EPS
- ^a replacement market trends
- ^a available capital resources
- ^a possible losses from off-balance sheet arrangements
- ^a incremental future growth through acquisitions
- ^a opportunities to increase profit contribution
- ^a future gaming product developments
- ^a ensuring access to new distribution channels
- ^a gaining access to important intellectual property
- ^a regulatory developments

Although we believe that the expectations reflected in any of our forward looking statements are reasonable, actual results could differ materially from those expressed or implied. The forward looking statements included in this Quarterly Report on Form 10-Q are made only as of the date of this Quarterly Report. Our future financial condition and results of operations, as well as any forward looking statements, are subject to change and to inherent known and

unknown risks and uncertainties. We do not intend, and undertake no obligation, to update our forward looking statements to reflect future events or circumstances.

We urge you to carefully review the following discussion of the specific risks and uncertainties that affect our business. These include, but are not limited to, the following:

Our success in the gaming industry depends in large part on our ability to develop innovative products and systems and would be adversely affected by:

- ^a a decline in the popularity of our gaming products with players
- ^a a lack of success in developing new products
- ^a an inability to roll out new games on schedule
- ^a an increase in the popularity of competitors' games
- ^a a negative change in the trend of consumer acceptance of our newest systems innovations

Our business is vulnerable to changing economic conditions, including:

- ^a unfavorable changes in economic conditions including those that affect the relative health of the gaming industry
- ^a unfavorable changes in tax laws or application of such laws that could reduce our profitability
- ^a political or economic instability in international markets
- ^a changes in interest rates causing a reduction of investment income or in the value of market rate sensitive instruments
- ^a fluctuations in foreign exchange rates, tariffs and other trade barriers
- ^a an inability to effectively hedge our foreign currency exposures

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Demand for our products would be adversely affected by:

- ^a reduced growth or continued delays of new market openings and/or existing market expansions
- ^a delays of scheduled openings of newly constructed or planned casinos
- ^a reduced levels of play or weakened customer demand for our gaming machines as a result of declines in travel activity, jackpot fatigue (declining interest in smaller jackpots) or customer capital expenditures
- ^a a decrease in the desire of established gaming properties to upgrade machines, resulting in a decline in the demand for replacement machines
- ^a uncertain timing for technology upgrades
- ^a product anomalies and/or fraudulent manipulation of our gaming products
- ^a loss of casino floor space to table games
- ^a casino operators designing and developing slot machine content
- ^a casino operators developing strategic alliances with competitors
- ^a a decline in public acceptance of gaming

We operate in a highly regulated industry and our ability to operate in certain jurisdictions could be adversely affected by:

- ^a unfavorable public referendums or anti-gaming legislation
- ^a unfavorable legislation affecting or directed at manufacturers or gaming operators, such as referendums to increase taxes on gaming revenues
- ^a adverse changes in or findings of non-compliance with applicable governmental gaming regulations
- ^a delays in legislative actions and/or approvals from regulatory agencies
- ^a a limitation, conditioning, suspension or revocation of any of our gaming licenses
- ^a unfavorable determinations or challenges of suitability by gaming regulatory authorities with respect to our officers, directors or key employees
- ^a customers inability to repay IGT development financing loans due to unfavorable legislation, regulation, or regulatory interpretation that impairs their ability to conduct planned gaming operations

Our intellectual property rights are subject to risks, including:

- ^a potential inability to obtain, maintain and protect our patents, trademarks, copyrights or theme licensing rights used competitively in development of our games and technology
- ^a competitors infringement upon our existing trademarks, patents and copyrights
- ^a approval of competitors patent applications that may restrict our ability to compete effectively

Our outstanding debt obligations subject us to certain additional risks, including:

- ^a increasing our vulnerability to general adverse economic and industry conditions

- ^a limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions and other general corporate requirements
- ^a limiting our flexibility in planning for, or reacting to, changes in our business and the industry
- ^a disadvantaging us compared to competitors with less indebtedness

Our business operations are subject to other risks, including:

- ^a loss or retirement of our key executives or other key employees
- ^a adverse changes in the creditworthiness of parties with whom we have significant receivables or forward currency exchange contracts
- ^a the discovery of facts or determinations by judges, juries or other finders of facts not presently known to us or not in accordance with our evaluation of possible liability or the outcome of litigation related to legal actions pending against IGT
- ^a the timely and cost effective integration of acquired companies into our operations
- ^a increased costs due to reliance on third party suppliers and contract manufacturers
- ^a agreements with casinos in Native America jurisdictions which may subject us to sovereign immunity risk
- ^a natural disasters, acts of war or terrorist incidents
- ^a continued work through several implementation phases of our company-wide ERP solution for computer system procedures and controls; any failures, difficulties or significant delays in implementing or maintaining computer information systems could result in material adverse consequences to our business, including disruption of operations, loss of information and unanticipated increases in costs

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Except for the changes to Convertible Debentures Price Risk below, there have been no material changes in our assessment of sensitivity to market risk since those presented in our Annual Report on Form 10-K, Item 7A, for the fiscal year ended September 30, 2005.

Convertible Debentures Price Risk

The fair value of our Debentures is sensitive to changes in both our stock price and interest rates. Assuming interest rates are held constant, we estimate a 10% decrease in our stock price would have decreased the fair value of our Debentures by approximately \$67.3 million at March 31, 2006 compared to \$12.9 million at September 30, 2005.

Assuming a constant stock price, we estimate a 100 bps increase in interest rates would not have decreased the fair value of our Debentures at March 31, 2006 compared to a decrease of \$1.5 million at September 30, 2005.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information is recorded, processed, summarized and reported in accordance with SEC requirements, accumulated and communicated to appropriate management, including the Chief Executive Officer and Chief Financial Officer, allowing for timely decisions regarding disclosures. We recognize that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving desired control objectives. Judgment is required when designing and evaluating the cost-benefit relationship of potential controls and procedures.

As of the end of the period covered by this report, with the supervision and participation of management, including the CEO and CFO, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures are effective at the reasonable assurance level. Our evaluation excludes WagerWorks, Inc., acquired on August 25, 2005, comprising less than 1.0% of consolidated revenues for the six months ended March 31, 2006 and 2.5% of consolidated assets as of March 31, 2006.

Changes in Internal Control over Financial Reporting

As a part of our normal operations, we update our internal controls as necessary to accommodate any modifications to our business processes or accounting procedures. No changes occurred during the most recent fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

For a description of our legal proceedings, see Note 13 of Notes to Unaudited Condensed Consolidated Financial Statements, which is incorporated by reference in response to this item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**Convertible Debenture Exchange**

On March 29, 2006, IGT's offer to exchange up to \$969.7 million in aggregate principal amount at maturity of its outstanding convertible Debentures expired. In the aggregate, \$964.8 million principal amount at maturity of the old Debentures, representing approximately 99.5% of the outstanding principal amount at maturity of the old Debentures, were tendered and accepted for exchange. The terms of the new Debentures are substantially similar to the old Debentures, except that the new Debentures include a net share settlement feature, which requires us to satisfy our conversion obligation to holders in cash up to the accreted principal amount and in common shares for the remaining conversion value.

On April 4, 2006, the new Debentures were issued to holders who had properly tendered their old Debentures along with an exchange fee of \$2.51 for each \$1,000 in aggregate principal amount at maturity of old Debentures exchanged.

For additional information, including registration exemption and terms of conversion, refer to our Form 8-K filed on April 5, 2006 and exhibit 4.1 included in Item 6 of this report.

Issuer Purchases of Equity Securities

Under the 1990 IGT common stock repurchase plan, as amended and adjusted for stock splits, our remaining share repurchase authorization totaled 17.8 million at March 31, 2006. The stock repurchase authorization is used to return value to our shareholders and reduce the number of shares outstanding. The shares may be repurchased in the open market or in privately negotiated transactions, depending on market conditions and other factors.

Shares purchased in the table below exclude treasury shares acquired in non-cash transactions related to forfeited stock awards or shares exchanged for options exercised. There were no additional share repurchases from March 31, 2006 through May 4, 2006.

| Periods | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as part of a Publicly Announced Plan | Maximum Number of Shares Still Available for Purchase Under the Plan |
|--|---|---|--|---|
| <i>(In millions, except per share amounts)</i> | | | | |
| January 1 - January 28, 2006 | 0.5 | \$35.56 | 0.5 | 20.1 |
| January 29 - February 25, 2006 | 1.7 | \$36.07 | 1.7 | 18.4 |
| February 26 - April 1, 2006 | 0.6 | \$35.61 | 0.6 | 17.8 |
| Balance at end of period | 2.8 | \$35.89 | 2.8 | |

Item 3. Defaults Upon Senior Securities

None.

Table of Contents**Item 4. Submission of Matters to a Vote of Security Holders**

- (a) On March 7, 2006, IGT held its annual meeting of stockholders.
- (b) The following directors were elected to serve until the next annual meeting: Neil Barsky, Robert A. Bittman, Richard R. Burt, Leslie S. Heisz, Robert A. Mathewson, Thomas J. Matthews, Robert Miller and Frederick B. Rentschler. These directors constitute all of the directors of IGT.
- (c) Voting for the directors was as follows:

| | Number of Shares Voted for | Number of Shares Withheld |
|-------------------------|-------------------------------|------------------------------|
| Neil Barsky | 278,396,270 | 29,185,997 |
| Robert A. Bittman | 301,754,679 | 5,827,588 |
| Richard R. Burt | 302,830,488 | 4,751,779 |
| Leslie S. Heisz | 302,904,234 | 4,678,033 |
| Robert A. Mathewson | 292,616,547 | 14,965,720 |
| Thomas J. Matthews | 301,877,340 | 5,704,927 |
| Robert Miller | 284,963,108 | 22,619,159 |
| Frederick B. Rentschler | 300,798,926 | 6,783,341 |

At the meeting, stockholders also approved an amendment to the International Game Technology 2002 Stock Incentive Plan to increase by 9,000,000 the number of shares of common stock authorized to be issued under the plan. The number of shares voted for the plan amendment totaled 178,713,533 with 71,578,383 shares against, 2,350,872 shares abstaining and 54,939,479 broker non-votes.

Stockholders also approved the following amendments to our ESPP with 247,745,417 share voting for the plan amendments, 2,633,946 against, 2,264,526 shares abstaining and 54,938,378 broker non-votes.

- ^a **Discretion to Set Exercise Price.** The amended and restated ESPP allows management the flexibility to establish the exercise price of an ESPP option granted by applying a discount of up to 15% to:
- (1) the fair market value of our common stock on the first day of an Offering Period,
 - (2) the fair market value of our common stock on the last day of an Offering Period, or
 - (3) the lesser of the fair market value of our common stock on the first or last day of an Offering Period.

- ^a **Extension of Plan Term.** As amended and restated, the ESPP extends the term of the plan until February 28, 2015.

In addition, stockholders ratified the appointment of Deloitte & Touche LLP as IGT's independent auditors for the fiscal year ending September 30, 2006. The number of shares voted for the appointment totaled 302,888,509 with 2,653,658 shares against, and 2,040,098 shares abstaining.

Item 5. Other Information

None.

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Item 6. Exhibits

- 4.1 Indenture, dated as of April 4, 2006, between the Company and The Bank of New York, N.A., as Trustee (incorporated by reference to Exhibit 4.1 to Registrant's Report on Form 8-K filed April 5, 2006)
- 10.1* International Game Technology 2002 Stock Incentive Plan, as amended March 7, 2006 (incorporated by reference to Exhibit 10.1 to Registrant's Report on Form 8-K filed March 13, 2006)
- 10.2* International Game Technology Employee Stock Purchase Plan, amended and restated effective as of December 8, 2005 (incorporated by reference to Exhibit 10.2 to Registrant's Report on Form 8-K filed March 13, 2006)
- 10.3* Summary of Named Executive Officer Compensation Arrangements at March 31, 2006
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and section 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and section 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 5, 2006

INTERNATIONAL GAME TECHNOLOGY

By: /s/ Maureen Mullarkey
Maureen T. Mullarkey
Executive Vice President,
Chief Financial Officer and
Treasurer

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Exhibit Index

- 10.3* Summary of Named Executive Officer Compensation Arrangements at March 31, 2006
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a 14(a) of the Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a 14(a) of the Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a 14(b) of the Exchange Act and section 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a 14(b) of the Exchange Act and section 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement