

ALLIANCE GAMING CORP

Form 10-K

September 25, 2003

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended June 30, 2003

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-4281

**ALLIANCE GAMING CORPORATION**

(Exact name of registrant as specified in its charter)

NEVADA  
(State or other jurisdiction of  
incorporation or organization)

88-0104066  
(I.R.S. Employer  
Identification No.)

6601 S. Bermuda Rd. Las Vegas, Nevada 89119  
(Address of principal executive offices)

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

Securities registered pursuant to Section 12(b) of the Act:  
None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, \$0.10 par value

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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

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

## Edgar Filing: ALLIANCE GAMING CORP - Form 10-K

The aggregate market value of the common equity held by non-affiliates of the registrant was approximately \$1,124,750,000 as of September 9, 2003.

The number of shares of Common Stock, \$0.10 par value, outstanding as of September 9, 2003, according to the records of registrant's registrar and transfer agent, was 49,689,418.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive Proxy Statement for its Annual Meeting of Stockholders will be filed with the Securities and Exchange Commission within 120 days of the end of our fiscal year and are incorporated by reference into Part III of this Form 10-K.

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**Year Ended June 30, 2003**

**PART I**

**ITEM 1. BUSINESS**

**General**

Alliance Gaming Corporation is a diversified, worldwide gaming company that (i) designs, manufactures and distributes gaming machines and computerized monitoring systems for gaming machines; and (ii) owns and operates two casinos. As is more fully discussed below, in July 2003 we announced our intention to dispose of certain non-core businesses, which include the route operations in Nevada and Louisiana, and our wall machine and amusement games business in Germany.

Operating under the name *Bally Gaming and Systems*, we are a worldwide leader in designing, manufacturing and distributing gaming machines, having marketed over 80,000 gaming machines during the past five years. We also design, integrate and sell highly specialized computerized monitoring systems that provide casinos with networked accounting and security services for their gaming machines with over 240,000 game monitoring units ( GMUs ) installed worldwide. We also own and operate a dockside casino in Vicksburg, Mississippi, and a local s casino in Sparks, Nevada, which together have approximately 23 table games and approximately 1,500 gaming devices (collectively, Casino Operations ). Further information about our business units is contained in the notes to the Consolidated Financial Statements.

We were incorporated in Nevada on September 30, 1968, under the name Advanced Patent Technology. We changed our name to Gaming and Technology, Inc., in 1983, to United Gaming, Inc., in 1988 and to Alliance Gaming Corporation on December 19, 1994. We conduct our gaming operations through directly and indirectly owned subsidiaries. The terms the Company, we, and our as used herein refer to Alliance Gaming Corporation and subsidiaries unless the context otherwise requires. Our principal executive offices are located at 6601 South Bermuda Road, Las Vegas, Nevada 89119; telephone (702) 270-7600.

**Discontinued Operations**

In July 2003, we announced that we had entered into definitive agreements to divest certain non-core assets including our route operations consisting of United Coin Machine Co. ( UCMC ) and Video Services, Inc. ( VSI ) as well as our German wall machine and amusement games business unit ( Bally Wulff ). On July 18, 2003 we completed the sale of Bally Wulff to a private equity investor and received \$16.5 million in cash. We have entered into a definitive sale agreement with Century Gaming, Inc. for the sale of UCMC. The sales price for UCMC is based on a multiple applied to the trailing 12 month EBITDA (defined in the sale agreement as earnings before interest, taxes, depreciation and amortization, subject to certain adjustments), and is currently estimated at \$127 million including \$18 million of 10% pay-in-kind preferred stock. We have also entered into a definitive agreement for the sale of our interest in VSI, and along with the holders of the minority shares of VSI, together will be sold to Gentilly Gaming, LLC. The sales of UCMC and VSI are expected to be completed in calendar 2004.

For purposes of financial reporting, each of these three businesses are now treated as discontinued operations, and their results are presented net of applicable income taxes below Income From Continuing Operations in the accompanying consolidated statements of operations. The assets and liabilities of these businesses are now classified as held for sale in the accompanying consolidated balance sheets. The prior year results have been reclassified to conform to the current year presentation.

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*Overview.* The Bally Gaming and Systems business unit consists of three separate divisions: Gaming Products, Gaming Operations and Gaming Systems. The following table sets forth the percentages of revenues provided by each of the Bally Gaming and Systems divisions for the periods indicated:

Revenue by division	Percentage of Revenues Years ended June 30,		
	2001	2002	2003
Gaming Products	53%	47%	56%
Gaming Operations	18	24	17
Gaming Systems	29	29	27
	100%	100%	100%

*Markets.* We believe that the domestic installed base of traditional gaming devices now exceeds 725,000 units. The state of Nevada has the largest installed base, totaling approximately 189,000 units as of June 30, 2003.

The gaming industry continues to expand in international markets. Our primary international markets are Europe, Canada, Latin America and, to a lesser extent, the Far East and the Caribbean. We conduct our business in Canada through our staff based in the United States. We also distribute gaming machines, manufactured by Bally Gaming, through direct and indirect subsidiaries: Bally Gaming International, GmbH ( GmbH ), from our sales office in Hannover, Germany and Graz, Austria, principally to customers in Europe and Russia; Bally Gaming de Puerto Rico, Inc., principally to customers in Puerto Rico; and Bally Gaming and Systems, SA, in Montevideo, Uruguay, principally to customers in South America.

*Markets for casino enterprise systems.* Casino enterprise systems are composed of various modules affecting departments throughout the casino. We market our casino enterprise solutions through Bally Gaming and Systems under the names Slot Data Systems (SDS), Advanced Casino Systems Corporation (ACSC), Casino Marketplace (CMP), Casino Management System (CMS), Micro Clever Consulting (MCC) and Honeyframe Systems (HFS).

The primary markets for casino enterprise systems are the United States and, to a lesser extent, Canada, Latin America, Europe and the Caribbean. Markets for systems within the United States include traditional land-based casinos predominantly in Nevada and Atlantic City, New Jersey, Native American casinos and riverboats and dockside casinos. Domestically, our market for casino enterprise systems is new casinos and existing or new customers who either (a) acquire casinos with a competitor's system, which is replaced with our system, or (b) expand their casino floors or upgrade their hardware or software to a new product release. Unlike the United States market, where most jurisdictions require the implementation of systems, there have been few international markets to do so. Management believes, however, that the international market for such systems is increasing, and that Systems' sales to such markets are likely to increase accordingly.

*Gaming Products.* We design, manufacture and sell a variety of electronic slot and video gaming machines. Gaming machines are differentiated from one another by graphic design and theme, cabinet style and size, pay table, reel-type design, betting denomination and minimum/maximum betting amount. Slot machines are normally produced to specific order, with design and configuration customized to a customer's particular requirements. Customers may also change from one gaming model to another gaming model by ordering a conversion kit consisting of artwork, reel strips, and a computer chip. Our video gaming machines are designed to simulate various card games, video reel-spinning games, and keno through a video display, and can offer the player the chance to play a multitude of different games. New games and themes are introduced periodically to satisfy customer demand and to compete with product designs introduced by competitors. The gaming products created are a result of a comprehensive product development effort. The development process includes extensive testing of the new products in-house and on casino floors for reliability and player appeal.



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We introduced our ProSeries reel-type slot machines in late 1993 and our multi-game touch screen machine, the Game Maker®, in late 1994. In March 1998, we introduced the first major upgrade to the ProSeries and upgraded the Game Maker® product line to the V7200 platform that is capable of multi-line video and multi-coin functionality. Revenues from sales of ProSeries machines were approximately \$32.3 million, \$36.4 million and \$95.4 million for the years ended June 30, 2001, 2002 and 2003, respectively.

The V7200 can offer up to ten different video games within one gaming device, or can be configured as a dedicated single title game. The games can be selected by the casino from a game library that has over 200 games. The games simulate various card games, keno and popular reel-spinning games. The V7200 machines are available in upright, bar top, slim-line and slant top cabinets. Revenues from sales of V7200 machines (and its predecessor, the Game Maker®) were approximately \$30.2 million, \$30.4 million and \$17.0 million for the years ended June 30, 2001, 2002 and 2003, respectively.

We commenced development of a new game platform in January 2000, with the intent of creating enhanced audio and video capabilities for our video product line. We engaged Microsoft to assist in the development of an NT based graphics and audio package addition to the legacy V7000 game board. The result was the Evolution platform, or EVO, that offers superior audio and graphic capabilities on the wealth of Windows® based software and content programmers available in the marketplace. This new game platform allows for the creation of game content at much faster rates than before, thus reducing the time to market for new products developed. The first EVO products were marketed in the mid summer of 2002, with sales totaling \$17.5 million and \$41.4 for years ended June 30, 2002, and 2003, respectively.

We typically offer a 90-day parts and labor warranty for new gaming machines sold and are actively involved in customer service after the original installation. We provide several after-sale, value-added services to our customers including customer education programs, a 24-hour customer service telephone hot-line, an Internet web site for technical support, field service support programs, and spare parts programs. Our historical warranty expense as a percentage of revenues has been less than 1%.

In addition, we sell and service used gaming machines and sell parts for existing machines. We often accept used machines as trade-ins toward the purchase of new gaming equipment. While a small secondary market exists in the United States, used machines are typically resold into the international market. Some used equipment is reconditioned for direct sale, but much is sold in container lots on an as is basis through independent brokers. Sale of used equipment was approximately \$3.1 million, \$4.8 million and \$7.2 million for the years ended June 30, 2001, 2002 and 2003, respectively.

Gaming machines have a mechanical life that can exceed ten years. However, in the established markets, our experience is that casino operators usually replace gaming machines after a much shorter period. The factors that result in replacement of gaming machines sooner than their mechanical life include technological advances, development of new entertaining games, new sound and visual features and changing preferences of casino patrons. Casinos typically recoup the purchase cost of their electronic gaming machines in a few months, which allow casinos to replace machines with new models that are popular with casino patrons.

*Gaming Operations.* The proprietary gaming operations division of Bally Gaming and Systems has become a full service provider of gaming products by adding to its product line games which are either linked on a wide-area progressive system, or are non-linked niche games, which are gaming machines that generally offer complex features. These gaming machines are placed in casinos and earn recurring revenues and cash flows for us rather than being sold on a one-time basis. These gaming machines are generally more profitable as a result of the recurring nature of the revenue derived from such games, but they require us to invest capital in the cost of manufacturing the gaming machines, obtaining intellectual property, and in purchasing signs and seating. Gaming Operations generated revenues of approximately \$28.4 million, \$53.2 million and \$55.6 million for the years ended June 30, 2001, 2002 and 2003, respectively.

We received regulatory approval from the Nevada Gaming Control Board of our wide-area progressive jackpot system named Thrillions in November 1998. The Thrillions system has been designed to allow patrons playing nickel,



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quarter and dollar machines to compete for the same progressive jackpot with the odds of winning the jackpot adjusted based on the amount wagered. Separate wide-area progressives are being operated by us in Nevada, Mississippi and Native American lands, and by a separate third-party trust arrangement in Atlantic City, New Jersey.

As of June 30, 2003, the following was the installed base of wide-area progressive games:

	Date	Units
	Introduced	Outstanding
Betty Boop	March 1999	590
Blondie	March 2001	260
Millionaire 777 s	June 2001	435
Popeye	August 2001	170
Cash For Life	March 2003	460
		1,915

We also offer a variety of non-linked daily fee games. These games have been marketed under such titles as Playboy (Playboy and Rabbit Head Design are marks of Playboy and used under license by Bally Gaming, Inc.), Monte Carlo , 24 Karat ®, Soap Opera , and others all of which are approved in most major gaming markets. We believe that games with such intellectual property features will continue to gain floor space in casinos. The Thrillions system has been designed to allow casinos to use their own branding for the product. Currently, Park Place Entertainment utilizes the Thrillions system as a platform for their own network of linked games for their properties in Nevada and Mississippi markets, for which they pay a daily fee per game. We also earn recurring revenues from gaming devices deployed at three horseracing facilities under an agreement with the Delaware State Lottery Commission. As of June 30, 2003, we had an installed base of daily fee games totaling 2,210 units.

*System Products.* We design and sell casino enterprise systems ( CES ) which provide casino operators integrated modules across multiple platforms. Our primary products include slot monitoring, casino management and cashless systems designed to streamline casino business processes through the use of technology. Our slot monitoring products are comprised of (i) hardware consisting of micro controller based printed circuit boards installed within the slot machines as well as card readers, displays and keypads which provide casinos the ability to track player gaming activity through our casino management systems and monitor employee access to slot machines, (ii) firmware developed by us, which provides access to the slot machines and player s activity data gathered by the micro controller hardware; and (iii) slot monitoring business applications developed by us which manages the slot machine activity including security events, revenue, expenses and other financial reporting metrics. Our casino management systems provide casino operators patron loyalty solutions which are similar to frequent guest programs offered in other leisure industries; table games accounting including the calculation of all revenue and expense related items; and cage and credit accountability for all extensions of credit and cage cash balancing functions. Our cashless systems provide a suite of products for casino operators to provide bonusing and cashless gaming activity to casino patrons. Bally products operate on Windows, AS/400 (iSeries), and UNIX platforms allowing our customers to choose a technology solution that meets their existing or future infrastructure requirements.

During 2002, we completed two strategic acquisitions in the systems area: Casino Marketplace and Advanced Casino Systems Corporation ( ACSC ). These acquisitions bolstered our product offerings to include player marketing and bonusing software. The ACSC product remains the only fully integrated AS/400 (iSeries) solution available in the casino industry. This has strategic importance as the AS/400 (iSeries) solution remains the predominant technology platform used in the gaming industry

During 2003, we completed three strategic acquisitions in the systems area: Casino Management System ( CMS ), Micro Clever Consulting ( MCC ) and Honeyframe Systems ( HFS ). These acquisitions bolstered our system product offerings and expanded the number of platforms such products operate on.

*Product Development.* We believe that providing games and systems with high entertainment value that are preferred by the casino patron is a key to meeting the demands of casinos. We believe that the use of existing computer



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technology is accelerating which can give newer gaming machines and systems that incorporate this technology a competitive advantage over older gaming machines and systems. Total spending on product research and development by Bally Gaming and Systems was approximately \$11.0 million, \$15.0 million and \$20.0 million during the years ended June 30, 2001, 2002 and 2003, respectively. The increase in research and development spending in the year ended June 30, 2003, is a result of the EVO system development and advance product development efforts.

We develop our products for both the domestic and international market. Our product development process is divided into two areas: hardware and software. Major areas of hardware development include cabinet style, electronic capability, printer capability, and coin and currency handling. Hardware development efforts are focused on player appeal, product reliability and ease of maintenance. Development cycles for hardware can range from a few days for simple enhancements to more than a year for new electronics or new mechanical packages.

The software development process for new games, which includes graphics development, involves a continuous effort requiring relatively significant human resource allocations. Creativity in software development is an important element in product differentiation, as the major manufacturers tend to deploy similar hardware and related technology. Ideas for new models are generated internally, from customers and from other third parties, many of whom have entered into strategic relationships with us. On an annual basis, we expect to introduce more than ninety new models to the market. However, no assurance can be made with respect to the rate of new model introductions or obtaining of regulatory approvals for them.

All new or modified hardware and software are designed to satisfy all applicable testing standards. Typically, new products require regulatory approval for most North American jurisdictions, but many jurisdictions outside North America generally do not require approval. For Nevada, new gaming machine platforms must be filed with the state gaming laboratory which tests the products for from two to three months or more before a mandatory 30 to 60 day field test is conducted in a casino. The Nevada State Gaming Control Board and the Nevada Gaming Commission must each approve new product platforms at their monthly, public meetings. For modifications of existing products or casino associated equipment, the process in Nevada is similar to new platforms, except a field test is usually not required and the Nevada State Gaming Control Board staff can approve the product administratively. Each jurisdiction that requires regulatory approval of new products has its own filing requirement and process. Once products are approved by the gaming regulators, customers may require a 30 to 90 day field trial of the product in their casinos with the right to return the product at any time during the field trial period. We do not recognize revenue until the customer ends the field trial and accepts the gaming machines.

Product development for casino enterprise systems is also divided into hardware and software. The major areas of hardware development include micro controller circuit board design and programming as well as user interface devices such as card readers, keypads, and displays. Systems has developed a modular and extendible hardware and software architecture, which focuses development on achieving greater functionality, product reliability, and ease of maintenance for the casino operator and ease of use for the slot player. In addition, the architecture allows customers to upgrade existing components or add new components with minimal impact. Development cycles for hardware can vary between a few months for minor revisions to more than a year for major design changes or for changes made by various slot manufacturers with which Systems product must communicate and be physically integrated. Software development results in (i) periodic product releases that include new features that extend and enhance casino enterprise systems; (ii) periodic maintenance releases that enable casino operators to correct problems or improve the usability of the system; and (iii) documentation needed to install and use the system.

We have developed a series of cashless products marketed under the Bally eSERIES name. The eSERIES represents an integrated set of cashless features to enhance the gaming experience of casino patrons. These products allow the transfer of funds using bar coded coupons and/or encrypted pin numbers to download either restricted or unrestricted credits to the gaming device. These products allow casino operators to reduce cash and coin handling expenses and minimize overall operating expenditures. Our cashless products are in use in Nevada, Michigan, New Jersey, Mississippi, Louisiana, Iowa, Colorado, Missouri, Indiana and various Native American jurisdictions encompassing many states.

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The software development process for our systems includes the design and development of features to meet various regulatory standards. The regulatory standards vary by jurisdiction forcing us to develop multiple software settings based on the individual state and tribal gaming standards. Each jurisdiction requires the approval of any software modifications or new products prior to deploying at casino locations. Approval processes can vary significantly by jurisdiction, based on the software changes developed, technology enhancements, and regulator resources.

*Sales and Marketing.* Bally Gaming and Systems uses a direct sales force and, to a lesser extent, an independent distributor network to distribute our products. Bally Gaming and Systems North America sales staff consists of approximately 44 people in offices in Nevada, New Jersey, Mississippi, Illinois, California and Florida.

Bally Gaming and Systems direct sales force generated approximately 81%, 76% and 98% of new unit machine sales for the years ended June 30, 2001, 2002 and 2003, respectively. On a limited basis, Bally Gaming and Systems uses distributors for sales to certain international jurisdictions. The agreements with distributors do not specify minimum purchases but generally provide that we may terminate such agreements if certain performance standards are not met. These independent distributors generated approximately 19%, 24% and 2% of new gaming machine unit sales for the years ended June 30, 2001, 2002, and 2003, respectively.

As of June 30, 2003, we had approximately 240,000 game monitoring units installed in 194 locations, of which approximately 99% are in the United States. Substantially all System s revenues are generated by our direct sales force.

Bally Gaming sells gaming equipment on normal credit terms (generally 2%, net 30) and also offers financing to qualified customers for periods generally between 6 and 48 months with interest at rates ranging from 8% to 14%. During fiscal year 2003 we provided equipment financing to two Native American tribes totaling \$24.1 million. These notes have terms of 36 and 48 months and rates of interest of 6% and 10%, respectively. Both of these notes are currently performing in accordance with their terms and the principal outstanding on these loans totaled \$21.7 million as of June 30, 2003. International sales are generally consummated on a cash basis backed by a letter of credit or financed over three years or less. In addition, in certain situations we have participated in the financing of other gaming-related equipment manufactured by third parties in the emerging markets. For casino enterprise system sales, we generally offer limited financing terms, normally less than one year, for sales to new installations. Most sales, however, are invoiced on a net 30-day basis. Management believes that financing of customer sales is an important factor in certain emerging markets.

For casino enterprise system sales, we offer our customers the option of signing separate hardware and software maintenance agreements at the time of sale. These agreements are for periods of one year and automatically renew unless otherwise canceled in writing by the customer or us. After an initial warranty period, typically 90 days, the customer is invoiced a monthly hardware and software maintenance fee which provides essentially for repair or replacement of malfunctioning hardware and software, software version upgrades, and on-call support for software.

*Customers.* The demand for slot machines and video gaming machines varies depending on new construction and renovation of casinos and other facilities with needs for new equipment as well as the replacement of existing machines, which have an average replacement cycle of three to seven years. For the year ended June 30, 2003, the ten largest customers (including corporate customers with multiple casino properties) accounted for approximately 33% of the Bally Gaming and Systems new unit sales, with the largest single customer accounting for 5% of new unit sales.

The demand for casino enterprise systems is driven by regulatory requirements in a given jurisdiction and by a casino operators competitive need to properly track machine and player activity and to establish and compile individual machine and player profitability and other demographic information. All of this enables casinos to develop or enhance marketing strategies. Revenues for casino enterprise systems are derived from selling to new installations and to new or existing customers who either (a) acquire casinos with a competitor s system, which is replaced with our system or (b) expand their casino floors or upgrade their hardware to a new product release. For the year ended June 30, 2003, the ten largest casino enterprise system customers (which include certain multi-site casino operators that have corporate agreements) accounted for approximately 58% of game monitoring unit sales revenues. Due to the high initial costs of installing a casino enterprise system, customers for such systems generally do not change suppliers once they have installed such a system.

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Future growth of Bally Gaming and Systems will be based on continued penetration of the international markets, further expansion in the established and emerging markets, as well as continued development efforts to provide customers with new and innovative hardware and software product offerings.

*Assembly Operations.* Bally Gaming and Systems Las Vegas facility was completed in 1990 specifically for the design, assembly and distribution of gaming equipment. The 150,000-square foot facility was designed to meet fluctuating product design demands and volume requirements, and management believes the facility enables Bally Gaming and Systems to increase production without significant capital expenditures. All assembly of game monitoring unit products is performed in the Las Vegas facility.

In March 2001, we entered into an agreement with Multimedia Games, Inc. to supply gaming devices for use in Class III and other markets. The agreement was amended in April 2001 to include Class II markets. Multimedia also purchases the rights to certain Bally themes, which entitles them to certain Bally proprietary game themes. Multimedia redesigns these game themes to be compatible with its operating system configurations. Sales of base gaming devices to Multimedia totaled approximately \$10.7 million and \$7.9 million for years ended June 30, 2002 and 2003, respectively, and sales of game themes totaled \$1.0 million and \$5.5 million for the years ended June 30, 2002 and 2003, respectively.

Management believes our assembly operations allow for rapid generation of different models to fill orders quickly and efficiently. Another major advantage of the existing plant operation is that machines can be altered in many ways including the size, type and color of glass, sound and payoff patterns to produce a customized product for each customer. Bally Gaming and Systems keeps an inventory of parts that allow machines to be altered quickly to conform to a particular customer's design/feature request. Bally Gaming and Systems produces products for individual customer orders, thereby reducing the risk of a backlog of finished goods inventories. Bally Gaming and Systems designs all of the major assemblies that are incorporated into the final machine configuration.

*Competition.* The market for gaming machines and progressive systems in North America is dominated by a single competitor, International Game Technology, Inc. ( IGT ). Worldwide there are a number of other well-established, well-financed and well-known companies producing gaming machines that compete with each of our lines in each of our markets. The other major competitors are AC Coin and Slot, Aristocrat, Innovative Gaming Corporation of America, Mikohn Gaming Corporation ( Mikohn ), Shuffle Master, Inc., Sigma Games, Inc., Universal Distributing of Nevada, Inc., WMS Industries, Inc. ( WMS ) and companies that market gaming machines under the brand names of Atronic, Cirsra, Konami, Novomatic and Sega Enterprises Ltd. Many of these companies look to expand their market share by decreasing our current market share. Other companies may enter the gaming machine business and several of these companies offer or plan to offer second feature bonus games. Besides Bally Gaming, IGT, Aristocrat and Mikohn offer wide-area progressive systems, and others may enter this area. Competition among gaming product manufacturers, particularly with respect to sales of gaming machines into new and emerging markets, is vigorous. The competition is based on which machines generate the most net win to the casinos, competitive customer pricing and financing terms, quality of the product and having an extensive distribution, sales and support network.

The main competition in casino enterprise systems currently consists of IGT, Acres Gaming, Aristocrat, MIS and to a lesser extent, Konami and Mikohn. Competition is keen in this market due to the number of providers and the limited number of casinos and jurisdictions in which they operate. Pricing, product feature and function, accuracy, and reliability are all key factors in determining a provider's success in selling its system. Management believes the future success of our operations will be determined by our ability to bring new and innovative products to the market while maintaining our base of loyal existing customers.

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**Casino Operations**

*Rainbow Casino.* The Rainbow Hotel Casino located in Vicksburg, Mississippi, began operations in July 1994. The facility includes a 33,000-square foot casino, with 930 gaming devices and 15 table games as well as a 250-seat restaurant/buffet and 20,000-square foot conference center. The facility also includes the 89-room Rainbow Hotel, which is owned and operated by a third party. Rainbow Casino is marketed as a locals casino and draws customers principally from within a 75-mile radius of Vicksburg. The Vicksburg casino market generated approximately \$243 million in gaming revenue in the twelve months ended June 30, 2003, representing a growth rate of 1%.

We are the general partners of Rainbow Casino Vicksburg Partnership, L.P. ( RCVP ) the limited partnership that operates the Rainbow Casino. The limited partner, Rainbow Corporation, an independent third party is entitled to receive 10% of the net available cash flows after debt service and other items, as defined (which amount increases to 20% of such amount for the proportional revenues above \$35.0 million) each year through December 31, 2010. The Company holds the remaining economic interest in the partnership.

*Rail City Casino.* In April 1990, the Company purchased, for an aggregate purchase price of \$9.5 million, substantially all of the assets of the Rail City Casino (formerly the Plantation Station Casino) located near the border between the cities of Reno and Sparks in northern Nevada. Rail City is a 20,000 square-foot casino, which as of June 30, 2003 operated approximately 560 gaming devices, 8 table games, and live keno. In addition, Rail City Casino includes a 380-seat restaurant, and offers a race and sports book that is leased to an independent race and sports book operator. Rail City Casino is convenient to both Reno and Sparks and caters primarily to the local market.

*Sales and Marketing.* Our casinos target the mid-level gaming customers in the market. We promote our casinos primarily through direct mail, special promotional events, and by providing quality food at reasonable prices.

*Competition.* Gaming of all types is available throughout Nevada and Mississippi in numerous locations, including many locations that compete directly or indirectly with our casino operations. The operation of casinos is a highly competitive business. The principal competitive factors in the industry include the quality and location of the facility, the nature and quality of the amenities and customer services offered and the implementation and success of marketing programs. Many of Rail City Casino's competitors include large casino-hotels that offer more amenities, as well as smaller casinos and taverns that appeal to local area residents. The Rainbow Casino faces substantial direct competition for gaming customers from the three other gaming facilities in Vicksburg as well as other gaming operations through out Mississippi.

**Route Operations (Discontinued Operations)**

*Nevada Operations*

In July 2003 we announced that we had entered into an agreement to sell our Nevada route operations, UCMC, to Century Gaming, Inc., a privately held route operator based in Montana. The sale is subject to certain terms and conditions, including obtaining regulatory approval, which is a process we expect, will be completed in calendar 2004.

*Overview.* Our Nevada route operations involve the selection, ownership, installation, operation and maintenance of video poker devices, reel-type slot machines and other electronic gaming machines in local establishments such as taverns, restaurants, supermarkets, drug stores, convenience stores and casinos operated by third parties ( local establishments ). Our route operations target Nevada residents who generally frequent local establishments close to their homes.

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The following table sets forth certain historical data concerning our Nevada route operations:

	Years ended June 30,		
	2001	2002	2003
Average number of gaming machines operated	8,083	8,281	8,050
Average number of locations	703	702	681
Average win per day per gaming machine	\$67.75	\$68.30	\$67.60

At June 30, 2003, we operated approximately 7,500 machines on our Nevada route. Contributing to this decrease in the average games deployed was the loss of approximately 300 games, which were destroyed in a fire at one large location owned by a third-party. The Company expects to recover its net investment in these games through proceeds from its insurance carrier.

We enter into long-term agreements with local establishments through either space leases or revenue-sharing arrangements. Under revenue sharing arrangements, most common with taverns, restaurants and convenience stores, we do not pay rent, but rather pay the location owner a percentage of the net win from the gaming machines. Under revenue sharing arrangements, the owner of the local establishment must have a gaming license, in addition to the general slot route operator's license that we hold. Under space lease arrangements, most common with supermarkets and drug stores, we pay a fixed rental amount to the owner of the local establishment and we receive all of the net win derived from the gaming machines. Under space lease arrangements, only we (and not the establishment owner) are required to hold a gaming license. Most of the local establishments serviced by us are restricted by law to operating no more than 15 gaming machines.

Revenue-sharing arrangements accounted for approximately 80%, 82%, and 83% of revenues and 77%, 78%, and 76% of installed machines, respectively, in our Nevada route operations for the years ended June 30, 2001, 2002 and 2003. At June 30, 2003, the weighted average remaining term of our revenue sharing arrangements was approximately 3.5 years. Space lease arrangements accounted for approximately 20%, 18%, and 17% of revenues and 23%, 22%, and 24% of installed machines, respectively, in our Nevada route operations for the years ended June 30, 2001, 2002 and 2003. At June 30, 2003, the weighted average remaining term of our space leases was 3.2 years.

We have historically been able to renew or replace revenues from expiring agreements with revenues generated by renewal or replacement contracts. We have emphasized return on investment rather than increasing market share in renewing or entering into new contracts and have undertaken a systematic review process to adjust our contract mix to emphasize higher margin contracts and, where permissible, canceling or not renewing unprofitable contracts.

*Sales and Marketing.* As the largest route operator in Nevada, we believe that we are able to differentiate ourselves from our competitors because we are a full-service operation that provides our customers support for marketing promotional allowances, and because we use our design capabilities to provide electronic gaming machines with features customized to customers' needs. We developed and continue to implement a system called Gamblers Bonus. Gamblers Bonus is a patented proprietary cardless slot players club and player tracking system, which allows multiple local establishments to be linked together into a distributed gaming environment. Through this technology, we are able to provide our players and customers with many of the same gaming choices otherwise available only in a larger scale casino environment, choices such as multi-location progressive jackpots, bigger jackpot payouts and traditional players' club programs. Additionally, we are offering a series of games available only to Gamblers Bonus members, and continue to enhance Gamblers Bonus with new games and technology.

Since the launch of Gamblers Bonus, the gaming machines linked to Gamblers Bonus have experienced an increase in net win per day per machine. As of June 30, 2003, we had the Gamblers Bonus installed in over 4,100 gaming machines at approximately 415 locations or 55% of the installed base of gaming machines. We believe Gamblers Bonus will continue to improve both the revenues and operating efficiencies of our Nevada route operations and has the potential to create additional opportunities in the route operations segment of the gaming industry.

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*Customers.* We have a diversified customer base with no one customer accounting for more than 3% of our revenues generated from Nevada route operations during the year ended June 30, 2003, although approximately 7% of such revenues were generated through an affiliated group of such customers. The affiliated group consists of eight partnerships each having one individual partner who is common to all such partnerships. For the year ended June 30, 2003, the ten largest customers accounted for approximately 16% of the Nevada route operations revenues.

*Assembly Operations.* In years prior to 1998, our route operations manufactured their own gaming machines for use in our Nevada route operations. These machines represent approximately 31% of the gaming machines currently used in the Nevada route operations at June 30, 2003. In July 1998, we received regulatory approval to begin using the Bally Game Maker® platform for Gamblers Bonus gaming machines deployed on the Nevada route. At June 30, 2003, approximately 41% of the installed base of gaming machines on the Nevada route was manufactured by Bally Gaming.

*Competition.* We are subject to substantial direct competition for our revenue-sharing and space lease locations from several large route operators and numerous small operators, located principally in Las Vegas, Reno and the surrounding areas and from other forms of gaming. UCMC, Herbst Gaming, Inc., and Golden Gaming are the largest route operators in Nevada. The principal methods of competition for route operators include the economic terms of the revenue sharing or space lease arrangement, the services provided, the Gamblers Bonus product and the reputation of the route operator. Price competition is intense and can reduce our gross margin on such operations if the percentage of the gaming machine revenues retained by the local establishment increases.

*Louisiana Operations*

In July 2003 we announced that we sold our interest in the Louisiana route, VSI, to Gentilly Gaming, LLC., to be effective June 30, 2004. In conjunction with this sale agreement we obtained an extension of the current operation agreement to June 30, 2004.

*Overview.* On the basis of our Nevada route operations expertise, in March 1992 we obtained a contract to operate video poker gaming machines in the greater New Orleans, Louisiana area through a subsidiary, VSI. VSI operates pursuant to an agreement with Fair Grounds Corporation and its affiliates, Jefferson Downs Corporation and Finish Line Management Corporation (collectively, Fair Grounds ), pursuant to which VSI is the exclusive operator of video poker machines at the only racetrack in the greater New Orleans area and nine associated off-track betting parlors (OTB s). We operate the game rooms where the video poker machines are located for each of the nine facilities owned by Fair Grounds, for which we pay a percentage of the revenue generated by the machines. As of June 30, 2003, we had approximately 700 video poker machines in Louisiana.

Under the Louisiana gaming laws and regulations, the majority stockholder of any entity operating video poker machines in Louisiana must be a domiciled resident of the State of Louisiana. As a result, we own 49% of the common stock of VSI and three prominent members of the Louisiana business and legal community own the remaining 51%. We, however, own all the voting stock of VSI and all of VSI s officers and directors are Company employees. We have a 71% interest in dividends of VSI in the event dividends are declared. We also formed two other Louisiana subsidiaries, Southern Video Services, Inc. ( SVS ) and Video Distributing Services, Inc. ( VDSI ). Both SVS and VDSI are structured in a manner similar to VSI except that we are entitled to receive 60% of any SVS dividends. Under the terms of our contract with Fair Grounds, we must conduct any additional video poker operations in Louisiana other than gaming at racetracks or OTB parlors through SVS. To date, SVS and VDSI have not engaged in business in Louisiana.

We are prohibited by the Louisiana Video Draw Poker Device Control Law and the rules and regulations promulgated there under ( the Louisiana Act ) from engaging in both the manufacture and operation of video poker gaming in Louisiana and, therefore, we do not manufacture our own video poker machines for use in Louisiana.



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*Sales and Marketing.* VSI has developed an extensive marketing program under the name "The Rockin Horse Game Room" which is designed to attract primarily local residents to VSI's facilities. Media placement has focused on newspaper and radio advertising with promotions including players' club, direct mailings and offerings of a wide range of prizes. We intend to expand our operations selectively in the greater New Orleans area by increasing the number of video poker machines in certain of our existing locations as demand warrants. We continue to investigate the addition of new locations under our current contract with the Fair Grounds in areas where competitive factors are favorable. Under the Louisiana Act, racetracks and OTBs are permitted to install an unlimited number of video poker machines while truck stops and taverns may install only limited numbers of such machines.

*Competition.* The racetrack and OTB locations where we operate video poker machines compete with several riverboat casinos, one land based casino, and with many truck stops and tavern locations with liquor licenses throughout the New Orleans area. Each truck stop is permitted to operate up to fifty video poker machines and each tavern is permitted to operate up to three video poker machines. Louisiana has riverboat gaming statewide and three riverboats are currently operating in the greater New Orleans area. The riverboats and land-based casino are permitted to have live table games and an unlimited number of gaming machines, including slot machines.

**Wall Machines and Amusement Games (Discontinued operations)**

On July 18, 2003, we completed the sale of our wall machine and amusement game business unit to a third party equity investor for \$16.5 million. Management believes the German wall machine market has declined to under 190,000 units. Management believes that the size of the wall machine market has declined from prior years due to changes mainly in the tavern markets and an increase in non-payout entertainment games, as well as the impact from the overall slowdown in the German economy.

The German legislative authorities regulate and monitor the wall machine industry on an ongoing basis to ensure conformance with certain manufacturing standards and the fairness of each machine to users. Existing legislation covers prescribed licensing procedures, the use, installation and operation of wall machines and the taxation of wall machines.

The regulations regarding the useful life of a wall machine (currently 48 months) are under review, and there is substantial pressure from the operators to increase the life. The timing of such a change, if any, is not known, but if enacted would likely have an adverse impact on the wall machine manufacturing industry.

**Patents, Copyrights and Trade Secrets**

Bally Gaming, Inc., is the copyright owner (or has licenses to use) game software, artwork and video presentation and has registered some of these copyrights with the U.S. Copyright Office. Some games, cash handling mechanisms, and other gaming device mechanisms (either currently used or reserved for future development including several related to Gamblers Bonus) are covered either by pending patent applications or issued patents, both foreign and domestic. The expiration dates of these patents vary and are based on their filing or issue dates. In addition, many of the games have trademarks registered with the U.S. Patent and Trademark Office, state trademark registries, or both. Together with our subsidiaries, we have over two hundred registered or pending trademark applications in the United States and around the world.

Bally Gaming, Inc., is obligated under several patent agreements to pay royalties ranging from approximately \$10 to \$500 per applicable game depending on the components in the gaming machines. In addition, we have obtained the rights to certain game ideas and intellectual property that require Bally Gaming and Systems to pay royalties based on either fixed amounts or variable amounts based upon game performance. Royalty expense for Bally Gaming and Systems for the years ended June 30, 2001, 2002, and 2003 was \$3.5 million, \$2.8 million, and \$4.2 million, respectively.

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**Employees and Labor Relations**

As of June 30, 2003, we and our subsidiaries employed approximately 1,540 persons (excluding employees of Bally Wulff which was sold in July 2003), which include approximately 915 persons in Nevada, 500 persons in Mississippi, 95 persons in various other states and 30 in various foreign countries. These employees are not covered by collective bargaining agreements. We believe we have satisfactory relationships with our employees.

Additionally, for our discontinued route operations, we employed approximately 645 persons in Nevada, and 60 persons in Louisiana. Employees in Nevada and Louisiana are not covered by collective bargaining agreements.

**Gaming Regulations and Licensing**

*General.* The manufacture and distribution of gaming machines and the operation of gaming facilities are subject to extensive federal, state, local, and foreign regulation. Although the laws and regulations of the various jurisdictions in which we operate and may expand our gaming operations vary in their technical requirements and are subject to amendment from time to time, virtually all of these jurisdictions require licenses, permits, documentation of qualification, including evidence of financial stability, and other forms of approval for companies engaged in the manufacture and distribution of gaming machines and the operation of gaming facilities, as well as the individual licensing of officers, directors, major stockholders and key personnel of such companies.

Any person who acquires a controlling interest in the Company would have to meet the requirements of all governmental bodies that regulate our gaming businesses. A change in the make-up of our board of directors and management would require the various gaming authorities to examine the qualifications of the new board and management.

*Nevada.* The ownership and operation of casino gaming facilities in Nevada are subject to (i) the Nevada Gaming Control Act and the regulations promulgated thereunder (the Nevada Act ); and (ii) various local ordinances and regulations. Our gaming, manufacturing, distributing, and slot route operations (collectively referred to as gaming machine operations ) are subject to the licensing and regulatory control of the Nevada State Gaming Control Board (the Nevada Board ), the Nevada Gaming Commission (the Nevada Commission ), the Clark County Liquor and Gaming Licensing Board (the Clark County Board ), and various other county and city regulatory agencies, all of which are collectively referred to as the Nevada Gaming Authorities.

The laws, regulations, and supervisory procedures of the Nevada Gaming Authorities are based on declarations of public policy concerned with, among other things: (i) the prevention of unsavory and unsuitable persons from having any involvement with gaming; (ii) the strict regulation of all persons, locations, practices, associations and activities related to the operation of licensed gaming establishments and the manufacture and distribution of gaming machines, cashless wagering systems and associated equipment; (iii) the establishment and maintenance of responsible accounting practices and procedures; (iv) the maintenance of effective control over the financial practices of licensees, including establishment of minimum procedures for internal fiscal affairs and the safeguarding of assets and revenues, providing reliable record-keeping and requiring the filing of periodic reports with the Nevada Gaming Authorities; (v) the prevention of cheating and fraudulent practices; and (vi) providing a source of state and local revenues through taxation and licensing fees. Change in such laws, regulations and procedures could have an adverse effect on our gaming-related operations.

We are registered with the Nevada Commission as a publicly traded corporation (a Registered Corporation ). Our direct and indirect subsidiaries that manufacture or distribute gaming devices or conduct gaming operations at various locations (collectively, the Nevada Subsidiaries ) are required to be licensed by the Nevada Gaming Authorities. The licenses held by the Nevada Subsidiaries require periodic payments of fees and taxes and are not transferable. The Company, through registered intermediary companies (individually an Intermediary Company and collectively the Intermediary Companies ), has been found suitable to own the stock of the Nevada Subsidiaries, each of which is a corporate licensee (individually a Corporate Licensee and collectively the Corporate Licensees ) under the terms of the Nevada Act. As a Registered Corporation, we are required periodically to submit detailed financial and operating reports to the Nevada Gaming Authorities and furnish any

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other information the Nevada Gaming Authorities may require. No person may become a stockholder of or receive any percentage of the profits from the Corporate Licensees without first obtaining licenses and approvals from the Nevada Gaming Authorities. The Company, the Intermediary Companies, and the Corporate Licensees have obtained from the Nevada Gaming Authorities the various registrations, findings of suitability, approvals, permits, and licenses required to engage in gaming activities, gaming machine operations, and in the manufacture and distribution of gaming devices for use or play in Nevada or for distribution outside of Nevada.

All gaming machines and cashless wagering systems manufactured, sold, or otherwise distributed for use or play in Nevada or for distribution outside of Nevada must be manufactured by licensed manufacturers and distributed or sold by licensed distributors. All gaming machines manufactured for use or play in Nevada must be approved by the Nevada Commission before they are distributed or exposed for play. The approval process for gaming machines and cashless wagering systems includes rigorous testing by the Nevada Board, a field trial, and a determination as to whether the gaming machines or cashless wagering systems meet strict technical standards set forth in the regulations of the Nevada Commission. Associated equipment (as defined in the Nevada Act) must be administratively approved by the chairman of the Nevada Board before it is distributed in Nevada.

The Nevada Gaming Authorities may investigate any individual who has a material relationship or material involvement with us, the Intermediary Companies or the Corporate Licensees to determine whether that individual is suitable or should be licensed as a business associate of a gaming licensee. Officers, directors, and key employees of the Company and the Intermediary Companies who are actively and directly involved in the licensed activities of the Corporate Licensees are or may be required to be licensed or found suitable by the Nevada Gaming Authorities. A finding of suitability is comparable to licensing, and both require submission of detailed personal and financial information followed by a thorough investigation. The applicant for licensing or a finding of suitability must pay all the costs of the investigation. Changes in licensed positions must be reported to the Nevada Gaming Authorities, and in addition to their authority to deny an application for a finding of suitability or licensing, the Nevada Gaming Authorities have jurisdiction to disapprove a change in a corporate position. The Nevada Gaming Authorities may deny an application for licensing or finding of unsuitability for any cause they deem reasonable.

If the Nevada Gaming Authorities were to find an officer, director, or key employee unsuitable for licensing or unsuitable to continue having a relationship with the Intermediary Companies, the Corporate Licensees, or us, the companies involved would have to sever all relationships with that person. In addition, the Nevada Commission may require the Intermediary Companies, the Corporate Licensees or us to terminate the employment of any person who refuses to file appropriate applications. Licensing and suitability determinations are not subject to judicial review in Nevada.

We and the Corporate Licensees that hold non-restricted licenses are required to submit detailed financial and operating reports to the Nevada Commission. A non-restricted license is a license for an operation consisting of sixteen or more slot machines, or for any number of slot machines together with any other game, gaming device, race book, or sports pool at one establishment. Substantially all material loans, leases, sales of securities, and similar financing transactions by the Corporate Licensees that hold non-restricted licenses must be reported to or approved by the Nevada Commission.

If it were determined that a Corporate Licensee had violated the Nevada Act, the licenses it holds could be limited, conditioned, suspended, or revoked, subject to compliance with certain statutory and regulatory procedures. In addition, the Company, the Intermediary Companies, the Corporate Licensees, and the persons involved could be subject to substantial fines for each separate violation of the Nevada Act at the discretion of the Nevada Commission. Further, a supervisor could be appointed by the Nevada Commission to operate any non-restricted gaming establishment operated by a Corporate Licensee and, under certain circumstances, earnings generated during the supervisor's appointment (except for reasonable rental of the casino property) could be forfeited to the state. Limitation, conditioning, or suspension of the gaming licenses of the Corporate Licensees or the appointment of a supervisor could, and revocation of any gaming license would, materially adversely affect the gaming-related operations of the Company.

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The Gaming Authorities may, at their discretion, require the holder of any of our security to file applications, be investigated, and be found suitable to own our securities if the Nevada Commission has reason to believe that the holder's ownership would be inconsistent with the declared policies of Nevada. The applicant must pay all costs of investigation incurred by the Nevada Gaming Authorities in conducting any such investigation.

The Nevada Act requires any person who acquires more than 5 percent of any class of a Registered Corporation's voting securities to report the acquisition to the Nevada Commission. The Nevada Act requires that beneficial owners of more than 10 percent of any class of a Registered Corporation's voting securities apply to the Nevada Commission for a finding of suitability within thirty days after the chairman of the Nevada Board mails written notice requiring such filing. Under certain circumstances, an institutional investor, as defined in the Nevada Act, that acquires more than 10 percent, but not more than 15 percent (nineteen percent if such additional ownership results from a stock repurchase program conducted by the Registered Corporation, subject to certain conditions), of a class of a Registered Corporation's voting securities may apply to the Nevada Commission for a waiver of finding of suitability if the institutional investor holds the securities for investment purposes only. An institutional investor shall not be deemed to hold voting securities for investment purposes unless the voting securities were acquired and are held in the ordinary course of business as an institutional investor and not for the purpose of causing, directly or indirectly, the election of a majority of the members of the board of directors of the Registered Corporation, any change in the corporate charter, bylaws, management, policies, or operations of the Registered Corporation or any of its gaming affiliates, or any other action the Nevada Commission finds to be inconsistent with holding the Registered Corporation's voting securities for investment purposes only. Activities that are not deemed to be inconsistent with holding voting securities for investment purposes only include: (i) voting on all matters voted on by stockholders; (ii) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in Registered Corporation's management, policies, or operations; and (iii) such other activities as the Nevada Commission may determine to be consistent with investment-only intent. If the beneficial holder of voting securities who must be found suitable is a corporation, partnership, or trust, it must submit detailed business and financial information including a list of beneficial owners. The applicant is required to pay all costs of investigation.

Any person who fails or refuses to apply for a finding of suitability or a license within thirty days after being ordered to do so by the Nevada Commission or the chairman of the Nevada Board may be found unsuitable. The same restrictions apply to a record owner if the record owner, after request, fails to identify the beneficial owner. Any stockholder found unsuitable and who holds, directly or indirectly, any beneficial ownership of the common stock beyond such period of time as may be prescribed by the Nevada Commission may be guilty of a criminal offense. We are subject to disciplinary action if, after we receive notice that a person is unsuitable to be a stockholder or to have any other relationship with the Company, the Intermediary Companies, or the Corporate Licensees, we (i) pay that person any dividend or interest upon voting securities of the Company; (ii) allow that person to exercise, directly or indirectly, any voting right conferred through securities held by that person; (iii) pay remuneration in any form to that person for services rendered or otherwise; or (iv) fail to pursue all lawful efforts to require such unsuitable person to relinquish his voting securities, including, if necessary, the immediate purchase of said voting securities for cash at fair market value. Additionally, the Clark County Board has taken the position that it has the authority to approve all persons owning or controlling the stock of any corporation controlling a gaming license.

The Nevada Commission may in its discretion require the holder of any debt securities of a Registered Corporation to file applications, be investigated, and be found suitable to own the debt security if the Nevada Commission has reason to believe that such ownership would be inconsistent with the declared policies of Nevada. If the Nevada Commission determines that a person is unsuitable to own such security, then pursuant to the Nevada Act, the Registered Corporation can be sanctioned, including the loss of its approvals if, without the prior approval of the Nevada Commission, it (i) pays the unsuitable person any dividend, interest or any distribution whatsoever; (ii) recognizes any voting right by such unsuitable person in connection with such securities; (iii) pays the unsuitable person remuneration in any form; or (iv) makes any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation, or similar transaction.

We are required to maintain in Nevada a current stock ledger, which may be examined by the Nevada Gaming Authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be

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required to disclose the identity of the beneficial owner to the Nevada Gaming Authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. We are also required to render maximum assistance in determining the identity of the beneficial owner. The Nevada Commission has the power to impose a requirement that a Registered Corporation's stock certificates bear a legend indicating that the securities are subject to the Nevada Act. The Nevada Commission has imposed this requirement on the Company.

We may not make a public offering of our securities without the prior approval of the Nevada Commission if the securities or proceeds therefrom are intended to be used to construct, acquire, or finance gaming facilities in Nevada or to retire or extend obligations incurred for such purposes. In addition, (i) a Corporate Licensee may not guarantee a security issued by a Registered Corporation pursuant to a public offering without the prior approval of the Nevada Commission; and (ii) restrictions on the transfer of an equity security issued by a Corporate Licensee or Intermediary Company and agreements not to encumber such securities (collectively, Stock Restrictions) are ineffective without the prior approval of the Nevada Commission.

Changes in control of the Company through merger, consolidation, stock or asset acquisitions, management or consulting agreements, or any act or conduct whereby a person or entity acquires control may not occur without the prior approval of the Nevada Commission. Entities seeking to acquire control of a Registered Corporation must satisfy the Nevada Board and Nevada Commission on a variety of stringent standards before assuming control of the Registered Corporation. The Nevada Commission may also require controlling stockholders, officers, directors, and other persons having a material relationship or involvement with the entity proposing to acquire control to be investigated and licensed as a part of the approval process relating to the transaction.

The Nevada Legislature has declared that some corporate acquisitions opposed by management, repurchases of voting securities, and corporate defense tactics affecting Nevada corporate gaming licensees and Registered Corporations that are affiliated with those operations may be injurious to stable and productive corporate gaming. The Nevada Commission has established a regulatory scheme to ameliorate the potentially adverse effects of these business practices on Nevada's gaming industry and to promote Nevada's policy to: (i) assure the financial stability of corporate gaming licensees and their affiliates; (ii) preserve the beneficial aspects of conducting business in the corporate form; and (iii) promote a neutral environment for orderly governance of corporate affairs. Approvals are, in certain circumstances, required from the Nevada Commission before a Registered Corporation can make exceptional repurchases of voting securities above the current market price (commonly called greenmail) and before a corporate acquisition opposed by management can be consummated. The Nevada Act also requires prior approval of a plan of recapitalization proposed by the Registered Corporation's board of directors in response to a tender offer made directly to the Registered Corporation's stockholders for the purpose of acquiring control of the Registered Corporation.

License fees and taxes, computed in various ways depending on the type of gaming or activity involved, are payable to the State of Nevada and to the counties and cities in which the licensees conduct their operations. Depending upon the particular fee or tax involved, these fees and taxes are payable, either monthly, quarterly, or annually and are based on either (i) a percentage of the gross revenues received; (ii) the number of gaming devices operated; or (iii) the number of games operated. A casino entertainment tax is also paid by casino operations where entertainment is furnished in connection with the selling of food or refreshments. The Corporate Licensees that hold gaming device route operator licenses or manufacturer or distributor licenses also pay certain fees to Nevada.

Any person who is licensed, required to be licensed, registered, required to be registered, or who is under common control with such persons (collectively, Licensees), and who proposes to become involved in a gaming venture outside of Nevada, is required to deposit with the Nevada Board and thereafter maintain a \$25,000 revolving fund to pay the expenses of investigation by the Nevada Board of the Licensee's participation in such foreign gaming. The revolving fund is subject to increase or decrease in the discretion of the Nevada Commission. Thereafter, Licensees are required to comply with certain reporting requirements imposed by the Nevada Act. Licensees are also subject to disciplinary action by the Nevada Commission if they knowingly violate any laws of the foreign jurisdiction pertaining to the foreign gaming operation, fail to conduct the foreign gaming operation in accordance with the standards of honesty and integrity required of Nevada gaming operations, engage in activities that are harmful to the

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State of Nevada or its ability to collect gaming taxes and fees, or employ a person in the foreign operations who has been denied a license or finding of suitability in Nevada on the ground of personal unsuitability.

The sale of alcoholic beverages at establishments operated by a Corporate Licensee is subject to licensing, control, and regulation by applicable regulatory agencies. All licenses are revocable and are not transferable. The agencies involved have full power to limit, condition, suspend, or revoke any such license, and any such disciplinary action could, and revocation would, have a material adverse affect on the operations of the Corporate Licensees.

*Mississippi.* The manufacture and distribution of gaming and associated equipment and the ownership and operation of casino facilities in Mississippi are subject to extensive state and local regulation, but primarily the licensing and regulatory control of the Mississippi Gaming Commission (the Mississippi Commission ).

The Mississippi Gaming Control Act (the Mississippi Act ), which legalized dockside casino gaming in Mississippi, is similar to the Nevada Gaming Control Act. The Mississippi Commission has adopted regulations that are also similar in many respects to the Nevada gaming regulations.

The laws, regulations and supervisory procedures of Mississippi and the Mississippi Commission are based on declarations of public policy that are concerned with, among other things: (i) the prevention of unsavory or unsuitable persons from having direct or indirect involvement with gaming at any time or in any capacity; (ii) the establishment and maintenance of responsible accounting practices and procedures; (iii) the maintenance of effective controls over the financial practices of licensees, including establishment of minimum procedures for internal fiscal affairs and safeguarding of assets and revenues, providing for reliable record keeping and requiring the filing of periodic reports with the Mississippi Commission; (iv) the prevention of cheating and fraudulent practices; (v) providing a source of state and local revenues through taxation and licensing fees; and (vi) ensuring that gaming licensees, to the extent practicable, employ Mississippi residents. The regulations are subject to amendment and interpretation by the Mississippi Commission. We believe our compliance with the licensing procedures and regulatory requirements of the Mississippi Commission will not affect the marketability of our securities. Changes in Mississippi law or regulations may limit or otherwise materially affect the types of gaming that may be conducted, and such changes, if enacted, could have an adverse effect on us and our Mississippi gaming operations.

The Mississippi Act provides for legalized dockside gaming in each of the fourteen counties that border the Gulf Coast or the Mississippi River, but only if the voters in the county have not voted to prohibit gaming in that county. Currently, dockside gaming is permissible in nine of the fourteen eligible counties in the state and gaming operations have commenced in seven counties. Under Mississippi law, gaming vessels must be located on the Mississippi River or on navigable waters in eligible counties along the Mississippi River, or in the waters of the State of Mississippi lying south of the state in eligible counties along the Mississippi Gulf Coast. Litigation is pending with respect to the expansion of eligible gaming sites to a site on the Big Black River in Warren County near Interstate 20 between Jackson and Vicksburg, Mississippi, where the Rainbow Casino is located. The Mississippi Commission ruled that the site was unsuitable, and the Mississippi Supreme Court upheld the Commission's decision. The landowner and the license applicant have filed a petition for rehearing, which is pending before the Mississippi Supreme Court. The Mississippi Act permits unlimited stakes gaming on permanently moored vessels on a 24-hour basis and does not restrict the percentage of space that may be utilized for gaming.

The Mississippi Act permits substantially all traditional casino games and gaming devices. The Company, RCVP, Bally Gaming, Inc. ( BGI ), and their affiliates are subject to the licensing and regulatory control of the Mississippi Commission. We are registered under the Mississippi Act as a publicly traded corporation (a Registered Corporation ) and holding company of RCVP and BGI. As a Registered Corporation, we are required periodically to submit detailed financial and operating reports to the Mississippi Commission and furnish any other information the Mississippi Commission may require. If we are unable to continue to satisfy the registration requirements of the Mississippi Act, we and our affiliates cannot own or operate gaming facilities or continue to act as a manufacturer and distributor in Mississippi. No person may become a stockholder of, or receive any percentage of profits from, a licensed subsidiary of a Registered Corporation or a holding company without first obtaining licenses and approvals from Mississippi Commission. We and our affiliates have obtained the necessary licenses and approvals from the

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Mississippi Commission. RCVP must maintain a gaming license from the Mississippi Commission to operate a casino in Mississippi and BGI must maintain a manufacturer and distributor license from the Mississippi Commission to manufacture and distribute gaming products and a wide-area progressive operator license to operate its progressive slot system. Such licenses are issued by the Mississippi Commission subject to certain conditions, including continued compliance with all applicable state laws and regulations.

There are no limitations on the number of licenses that may be issued in Mississippi. Gaming and manufacturer and distributor licenses are not transferable, are issued for a three-year period (and may be renewed for two additional three-year periods) and must be renewed or continued thereafter. In June 2003, RCVP was granted a three-year renewal of its gaming license by the Mississippi Commission, and BGI was granted three-year renewals of its manufacturer and distributor license and its wide-area progressive operator license.

Certain of our officers and employees and the officers, directors, and certain key employees of our licensed subsidiaries must be found suitable or be licensed by the Mississippi Commission. We believe we have obtained, applied for, or are in the process of applying for all necessary findings of suitability with respect to such persons affiliated with us, RCVP or BGI, although the Mississippi Commission, in its discretion, may require additional persons to file applications for findings of suitability. In addition, any person having a material relationship or involvement with us may be required to be found suitable, in which case those persons must pay the costs and fees associated with such investigation. The Mississippi Commission may deny an application for a finding of suitability for any cause it deems reasonable. Changes in certain licensed positions must be reported to the Mississippi Commission. In addition to its authority to deny an application for findings of suitability, the Mississippi Commission can disapprove a change in a licensed position. The Mississippi Commission has the power to require the Company and its registered or licensed subsidiaries to suspend or dismiss officers, directors and other key employees or sever relationships with other persons who refuse to file appropriate applications or whom the authorities find unsuitable to act in such capacities.

Determinations of suitability or questions pertaining to licensing are not subject to judicial review in Mississippi. At anytime, Mississippi Commission has the power to investigate and require the finding of suitability of any record or beneficial stockholder of the Company. The Mississippi Act requires any person who acquires more than 5 percent of any class of voting securities of a Registered Corporation, as reported to the Securities and Exchange Commission ( SEC ), to report the acquisition to the Mississippi Commission, and such person may be required to be found suitable. Also, any person who becomes a beneficial owner of more than 10 percent of any class of voting securities of a Registered Corporation, as reported to the SEC, must apply for a finding of suitability by the Mississippi Commission. The Mississippi Commission generally has exercised its discretion to require a finding of suitability of any beneficial owner of more than 5 percent of any class of voting securities of a Registered Corporation. However, the Mississippi Commission has adopted a policy that permits certain institutional investors to own beneficially up to 15 percent of a class of voting securities of a Registered Corporation without a finding of suitability. If a stockholder who must be found suitable is a corporation, partnership, or trust, it must submit detailed business and financial information including a list of beneficial owners.

Any record or beneficial stockholder required to apply for a finding of suitability must pay all investigative fees and costs of the Mississippi Commission in connection with the investigation. Any person who fails or refuses to apply for a finding of suitability or a license within 30 days after being ordered to do so by the Mississippi Commission may be found unsuitable. The same restrictions apply to a record owner if the record owner, after request, fails to identify the beneficial owner. Any person found unsuitable and who holds, directly or indirectly, any beneficial ownership of such securities beyond such time as the Mississippi Commission prescribes may be guilty of a misdemeanor. We may be subject to disciplinary action if, after receiving notice that a person is suitable to be a stockholder or to have any other relationship with us or our Mississippi gaming subsidiaries, the company involved: (i) pays the unsuitable person any dividend or other distribution on that person's voting securities; (ii) recognizes the exercise, directly or indirectly, of any voting rights conferred by securities held by the unsuitable person; (iii) pays the unsuitable person any remuneration in any form for services rendered or otherwise, except in certain limited and specific circumstances; or (iv) fails to pursue all lawful efforts to require the unsuitable person to divest himself of the securities, including, if necessary, the immediate purchase of the securities for cash at a fair market value.

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We may be required to disclose to the Mississippi Commission on request the identities of the holders of any of our debt or other securities. In addition, under the Mississippi Act, the Mississippi Commission may in its discretion require the holders of any debt security of a Registered Corporation to file an application, be investigated, and be found suitable to own the debt security if the Mississippi Commission has reason to believe that the ownership would be inconsistent with the declared policies of the state of Mississippi. Although the Mississippi Commission generally does not require the individual holders of obligations such as notes to be investigated and found suitable, the Mississippi Commission retains the discretion to do so for any reason, including but not limited to a default or where the holder of the debt instrument exercises a material influence over the gaming operations of the entity in question. Any holder of debt securities required to apply for a finding of suitability must pay all investigative fees and costs of the Mississippi Commission in connection with the investigation. If the Mississippi Commission determines that a person is unsuitable to own a debt security, then the Registered Corporation may be sanctioned, including the loss of its approvals, if without the prior approval of the Mississippi Commission it: (i) pays to the unsuitable person any dividend, interest, or any distribution whatsoever; (ii) recognizes any voting right by the unsuitable person in connection with those securities; (iii) pays the unsuitable person remuneration in any form; or (iv) makes any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation, or similar transaction.

RCVP and BGI must maintain in Mississippi a current ledger with respect to the ownership of their equity securities, and we must maintain a current list of stockholders in the principal office of RCVP, which list must reflect the record ownership of each outstanding share of any class of our equity securities. The ledger and stockholder lists must be available for inspection by the Mississippi Commission at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to the Mississippi Commission. A failure to make such disclosure may be grounds for finding the record holder unsuitable. We must also render maximum assistance in determining the identity of the beneficial owner.

The Mississippi Act requires that the certificates representing securities of a Registered Corporation bear a legend indicating that the securities are subject to the Mississippi Act and the regulations of the Mississippi Commission. We have received from the Mississippi Commission a waiver of this legend requirement. The Mississippi Commission has the power to impose additional restrictions on the holders of our securities at any time.

Substantially all material loans, leases, sales of securities and similar financing transactions by a Registered Corporation or a licensed gaming subsidiary must be reported to or approved by the Mississippi Commission. A licensed gaming subsidiary may not make a public offering of its securities, but may pledge or mortgage casino facilities. A Registered Corporation may not make a public offering of its securities without the prior approval of the Mississippi Commission if any part of the proceeds of the offering is to be used to finance the construction, acquisition or operation of gaming facilities in Mississippi or to retire or extend obligations incurred for one or more such purposes. Such approval, if given, does not constitute a recommendation or approval of the investment merits of the securities subject to the offering.

Under the regulations of the Mississippi Commission, a Mississippi gaming subsidiary may not guarantee a security issued by an affiliated company pursuant to a public offering, or pledge its assets to secure payment or performance of the obligations evidenced by the security issued by the affiliated company, without the prior approval of the Mississippi Commission. A pledge of the stock of a Mississippi gaming subsidiary and the foreclosure of such a pledge are ineffective without the prior approval of the Mississippi Commission. Moreover, restrictions on the transfer of an equity security issued by a Mississippi gaming subsidiary and agreements not to encumber such securities are ineffective without the prior approval of the Mississippi Commission.

Changes in control of the Company through merger, consolidation, acquisition of assets, management or consulting agreements, or act or conduct by a person by which he or she obtains control, may not occur without the prior approval of the Mississippi Commission. Entities seeking to acquire control of a Registered Corporation must satisfy the Mississippi Commission in a variety of stringent standards prior to assuming control of the Registered Corporation. The Mississippi Commission may also require controlling stockholders, officers, directors, and other persons having a material relationship or involvement with the entity proposing to acquire control to be investigated and licensed as part of the approval process relating to the transaction.



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The Mississippi legislature has declared that some corporate acquisitions opposed by management, repurchases of voting securities and other corporate defense tactics that affect corporate gaming licensees in Mississippi and Registered Corporations may be injurious to stable and productive corporate gaming. The Mississippi Commission has established a regulatory scheme to ameliorate the potentially adverse effects of these business practices upon Mississippi's gaming industry and to promote Mississippi's policy to: (i) assure the financial stability of corporate gaming operators and their affiliates; (ii) preserve the beneficial aspects of conducting business in the corporate form; and (iii) promote a neutral environment for the orderly governance of corporate affairs.

Approvals are, in certain circumstances, required from the Mississippi Commission before a Registered Corporation may make exceptional repurchases of voting securities (such as repurchases that treat holders differently) in excess of the current market price and before a corporate acquisition opposed by management may be consummated. Mississippi's gaming regulations also require prior approval by the Mississippi Commission of a plan or recapitalization proposed by a Registered Corporation's board of directors in response to a tender offer made directly to the stockholders for the purpose of acquiring control of the Registered Corporation.

Neither we nor any of our subsidiaries may engage in gaming activities in Mississippi while also conducting gaming operations outside of Mississippi without approval of the Mississippi Commission. The Mississippi Commission may require determinations that, among other things, there are means for the Mississippi Commission to have access to information concerning the out-of-state gaming operations of the Company and its affiliates. We have previously obtained a waiver of foreign gaming approval from the Mississippi Commission for operations in other states and will be required to obtain the approval or a waiver of such approval from the Mississippi Commission prior to engaging in any additional future gaming operations outside of Mississippi.

If the Mississippi Commission determined that we or a licensed gaming subsidiary violated a gaming law or regulation, the Mississippi Commission could limit, condition, suspend, or revoke our approvals and the license of the subsidiary. In addition, we, the licensed subsidiary, and the persons involved could be subject to substantial fines for each separate violation. Because of such violations, the Mississippi Commission could seek to appoint a supervisor to operate our casino facilities. Limitation, conditioning or suspension of any gaming license or approval or the appointment of a supervisor could (and revocation of any gaming license or approval would) materially adversely affect us and RCVP's gaming operations or BGI's manufacturer, distributor, and wide-area progressive operations, as the case may be.

License fees and taxes, computed in various ways depending on the type of gaming involved, are payable to the State of Mississippi and to the counties and cities in which a licensed gaming subsidiary's operations are conducted. Depending on the particular fee or tax involved, these fees and taxes are payable either monthly, quarterly, or annually and are based on (i) a percentage of the gross gaming revenues received by the casino operation; (ii) the number of gaming devices operated by the casino; or (iii) the number of table games operated by the casino. The license fee payable to the State of Mississippi is based upon gaming receipts (generally defined as gross receipts less payouts to customers as winnings), and the current maximum tax rate imposed is 8 percent of gaming receipts in excess of \$134,000 per month. The foregoing license fees we pay are allowed as a credit against our Mississippi income tax liability paid for the year. The gross revenue fee imposed by the City of Vicksburg, Mississippi, where RCVP's casino operations are located, equals approximately 4 percent of gaming receipts.

The Mississippi Commission's regulations require as a condition of licensing or license renewal that an existing licensed gaming establishment's plan include a 500-car parking facility in close proximity to the casino complex and infrastructure facilities that amount to at least 25% of the casino cost. We believe the Rainbow Casino is in compliance with this requirement. The Mississippi Commission adopted a change to this regulation increasing the infrastructure requirement to 100 percent; however, the regulation grandfathers existing licensees and applies only to new casino projects and casinos that are not operating at the time of acquisition or purchase by new owners.

In recent years, certain anti-gaming groups proposed for adoption, through the initiative and referendum process, certain amendments to the Mississippi Constitution that would prohibit gaming in the state. The proposals were declared illegal by the Mississippi courts on constitutional and procedural grounds. The latest ruling was appealed to

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the Mississippi Supreme Court, which affirmed the decision of the lower court. If another such proposal were to be offered and if a sufficient number of signatures were to be gathered to place a legal initiative on the ballot, it is possible for the voters of Mississippi to consider such a proposal in November 2003. While we are unable to predict whether such an initiative will appear on a ballot or the likelihood of such an initiative being approved by the voters, if such an initiative were passed and gaming were prohibited in Mississippi, it would have a significant adverse effect on us and our Mississippi gaming operations.

The sale of alcoholic beverages by the Rainbow Casino owned and operated by RCVP is subject to the licensing, control and regulation by both the City of Vicksburg and the Alcoholic Beverage Control Division (the "ABC") of the Mississippi State Tax Commission. The Rainbow Casino area has been designated as a special resort area, which allows the Rainbow Casino to serve alcoholic beverages on a 24-hour basis. The ABC has the full power to limit, condition, suspend or revoke any license for the serving of alcoholic beverages or to place such a licensee on probation with or without conditions. Any such disciplinary action could (and revocation would) have a material adverse effect on the RCVP's operations. Certain officers and managers of RCVP must be investigated by the ABC in connection with its liquor permits, and changes in certain positions must be approved by the ABC.

*New Jersey.* BGI is licensed by the New Jersey Casino Control Commission (the "New Jersey Commission") as a gaming-related casino service industry ("CSI") in accordance with the New Jersey Casino Control Act (the "Casino Control Act"). We are a holding company of BGI, as that term is defined by the Casino Control Act, and thus are a qualifier in connection with BGI's CSI license and have been approved as such by the New Jersey Commission.

The New Jersey Commission requires the officers, directors, key personnel, financial sources, and stockholders (in particular those with holdings in excess of 5 percent) of a CSI license holder and its holding and intermediary companies to qualify in accordance with the Casino Control Act. BGI is required to notify the New Jersey Commission of any appointment, nomination, election, resignation, termination, incapacitation, or death of any person or entity otherwise required to qualify pursuant to the Casino Control Act. Such persons and entities may be investigated and may be required to make certain regulatory filings and to disclose and/or to provide consents to disclose personal and financial data. The costs associated with such investigation are typically borne by the applicant.

*Federal Registration.* The operating subsidiaries of the Company that are involved in gaming activities are required to register annually with the Attorney General of the United States in connection with the manufacture, sale, distribution, or operation of gaming machines. All currently required filings have been made.

From time to time, certain legislators have proposed the imposition of a federal tax on gross gaming revenues. No specific proposals for the imposition of such a federal tax are currently pending. However, no assurance can be given that such a tax will not be imposed in the future. Any such tax could have a material adverse effect on our businesses, financial conditions, or results of operations.

*Additional Jurisdictions.* We, in the ordinary course of our business, routinely consider business opportunities to expand our gaming operations into additional jurisdictions. Although the laws and regulations of the various jurisdictions in which we operate or into which we may expand our gaming operations vary in their technical requirements and are subject to amendment from time to time, virtually all of those jurisdictions require licenses, permits, documentation of qualification, including evidence of financial stability, and other forms of approval for companies engaged in the manufacture, distribution and operation of gaming machines as well as for the officers, directors, major stockholders, and key personnel of such companies.

We and our key personnel have obtained, or applied for, all government licenses, registrations, findings of suitability, permits, and approvals necessary for the manufacture, distribution and, where permitted, operation of gaming machines in the jurisdictions in which we do business. We and the holders of our securities may be subject to the provisions of the gaming laws of each jurisdiction where we or our subsidiaries are licensed or conduct business, including, without limitation, Arizona, California, Colorado, Connecticut, Delaware, Illinois, Indiana, Iowa, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Jersey, New Mexico, New York, South Dakota, Washington, West Virginian, Wisconsin, and the local regulatory authorities within each such

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state, as well as Australian, Canadian, and other foreign gaming jurisdictions in which Bally Gaming International, Inc. ( BGII ) and its subsidiaries are licensed or conduct business.

Holders of common stock of an entity licensed to manufacture and sell gaming machines, and in particular those with holdings in excess of 5 percent, should note that local laws and regulations may affect their rights regarding the purchase of such common stock and may require such persons or entities to make certain regulatory filings or seek licensing, findings of qualification, or other approvals. In some cases this process may require the holder or prospective holder to disclose or provide consents to disclose personal and financial data in connection with necessary investigations, the costs of which are typically borne by the applicant. The investigative and approval process can take three to six months to complete under normal circumstances.

*Louisiana.* The manufacture, distribution, servicing, and operation of video draw poker devices ( Devices ) in Louisiana are subject to the Louisiana Video Draw Poker Devices Control Law and the rules and regulations promulgated thereunder (the Louisiana Act ). Licensing and regulatory control is maintained by a single gaming control board for the regulation of gaming in Louisiana. This Board, created on May 1, 1996, is called the Louisiana Gaming Control Board (the Louisiana Board ) and oversees all licensing for all forms of legalized gaming in Louisiana (including all regulatory enforcement, and supervisory authority that exists in the state as to gaming on Native American lands). The Video Gaming Division of the Gaming Enforcement Section of the Office of State Police within the Department of Public Safety and Corrections (the Division ) performs the investigative functions for the Louisiana Board. The laws and regulations of Louisiana are based on policies of maintaining the health, welfare, and safety of the general public and protecting the video gaming industry from elements of organized crime, illegal gambling activities, and other harmful elements, as well as protecting the public from illegal and unscrupulous gaming to ensure the fair play of devices.

VSI and SVS, the indirect operating subsidiaries for our gaming operations in Louisiana, have each been granted a license as a device owner by the Division. These gaming subsidiaries are Louisiana Licensees (the Louisiana Licensees ) under the terms of the Louisiana Act. The licenses held by the Louisiana Licensees expire at midnight on June 30, 2004, and are subject to renewal for five-year terms thereafter. Annual fees must be paid on or before July 1 in each year regardless of the license expiration date.

The Louisiana Board may deny, impose a condition on, or suspend or revoke a license, renewal, or application for a license for violations of any rules and regulations of the Louisiana Board or any violations of the Louisiana Act. In addition, fines for violations of gaming laws or regulations may be levied against the Louisiana Licensees and the persons involved for each violation of the gaming laws. The license is deemed a pure and absolute privilege and issuance, condition, denial, suspension or revocation of a license is at the discretion of the Louisiana Board under the provisions of the Louisiana Act. A license is not property or a protected interest under the constitution of either the United States or Louisiana.

The Division has the authority to conduct overt and covert investigations of any person involved directly or indirectly in the video gaming industry in Louisiana. These investigations have extended to information regarding a prospective licensee s and his or her spouse s immediate family and relatives and their affiliations with certain organizations or other business entities. The investigation may also extend to any person who has or controls more than a 5 percent ownership of, or interest in income or profits in, an applicant for or holder of a license or who is a key employee or who has the ability to exercise significant influence over the licensee. All persons or entities investigated must meet all suitability requirements and qualifications for a licensee. The Louisiana Board may deny an application for licensing for any cause it may deem reasonable. The applicant for licensing must pay a filing fee, which applies to the cost of the investigation.

In order for a corporation to be licensed as an operator or distributor of video poker gaming devices by the Louisiana Board, a majority of the stock of the corporation must be owned by persons who have been domiciled in Louisiana for at least two years prior to the date of the application.

Bally Gaming has an application pending to renew our license as a manufacturer of devices under the Louisiana Gaming Law. In the past, a manufacturer would have to obtain a separate permit to do business with video poker,

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riverboat, and land-based casino licensees. However, recent changes have been enacted to Louisiana's Gaming Law to allow manufacturers to apply for and obtain one permit to be able to conduct business in the different gaming venues.

**ITEM 2. PROPERTIES**

The following table sets forth information regarding our leased properties for our continuing operations (exclusive of space leases in connection with our gaming device routes) as of June 30, 2003, all of which are fully utilized unless otherwise noted (dollars in 000's):

<u>Location</u>	<u>Use</u>	<u>Building Square Feet</u>	<u>Annual Rental Payments</u>
Sparks, NV	Administrative offices and warehousing	38,300	\$ 345
Las Vegas, NV (1)	Ground lease		365
Sparks, NV	Sales offices and warehousing	11,000	132
Atlantic City, NJ	Sales offices and warehousing	15,800	136
Biloxi, MS	Sales offices	5,000	47
Westchester, IL	Sales offices	4,900	44
Hollywood, FL	Sales offices	3,400	8
Temecula, CA	Sales offices	2,000	20
Atlantic City, NJ	Administrative offices	750	10
San Juan, P R	Sales offices	1,000	12
Las Vegas, NV	Warehousing	86,300	549
Vicksburg, MS	Administrative offices	2,700	19
Vicksburg, MS	Administrative offices	1,200	9
Shropshire, England	Administrative offices	1,550	14
Shropshire, England	Administrative offices	1,550	14
Graz, Austria	Administrative offices	1,184	11
Nice, France	Administrative offices	4,305	60
Montevideo, Uruguay	Administrative offices	1,238	28
Lima, Peru	Administrative offices	1,076	13
Absecon, NJ	Direct mail office	5,300	63
Egg Harbor Township, NJ	General and research and development office	15,500	257
Sparks, NV (2)	Ground lease		5
Sparks, NV	Warehousing	3,600	23
Hannover, Germany	Administrative offices and warehousing	13,292	84

(1) Lease consists of ground lease for parking.

(2) Lease consists of long-term land lease for parking at Rail City Casino.

The following table sets forth information regarding properties owned by us as of June 30, 2003 for our continuing operations, all of which are fully utilized unless otherwise noted:

<u>Location</u>	<u>Use</u>	<u>Building Square Feet</u>
Las Vegas, NV	Administrative offices and manufacturing (a)	150,000
Reno/Sparks, NV	Casino (a)	35,000
Vicksburg, MS	Casino	33,000

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Vicksburg, MS	Entertainment facility	20,000
Vicksburg, MS	Administrative offices	3,200
Vicksburg, MS	Vacant-Land	
North Las Vegas, NV	Land/Parking	

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(a) These facilities are mortgaged collateral for our Credit Facility. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.

See Note 9 to the Consolidated Financial Statements for information as to our lease commitments with respect to the foregoing rental properties. We believe our facilities are suitable for our needs and we have no future expansion plans that would make these properties inadequate.

The following table sets forth information regarding our discontinued operations leased properties (exclusive of space leases in connection with our gaming device routes, and excluding the Berlin building which was included in the sale of Bally Wulff in July 2003) as of June 30, 2003, all of which are fully utilized unless otherwise noted (dollars in 000 \$):

<u>Location</u>	<u>Use</u>	<u>Building Square Feet</u>	<u>Annual Rental Payments</u>
Las Vegas, NV	Nevada route operations	23,800	\$ 286
Las Vegas, NV	Warehousing	15,000	113
Elko, NV	Sales office and route operations	4,200	9
Sparks, NV	Route operations	12,100	96
Carson City, NV	Route operations	2,500	10
Winnemucca, NV	Route operations	1,200	5
Pahrump, NV	Route operations	750	6
New Orleans, LA	Louisiana route operations	6,000	65
Metairie, LA	OTB operation	5,000	59
LaPlace, LA	OTB operation	2,500	105
Harahan, LA	OTB operation	2,300	72

In addition, we lease 19 bar and tavern properties that have been subleased to other operators in connection with our Nevada route operations. The properties range in size from approximately 1,750 square feet to 7,700 square feet. The remaining terms of the leases range from 6 months to 8 years with monthly payments ranging from approximately \$2,500 to \$13,500.

**ITEM 3. LEGAL PROCEEDINGS*****Litigation***

On September 25, 1995, BGII was named as a defendant in a class action lawsuit filed in Federal District Court in Nevada, by Larry Schreier on behalf of himself and all others similarly situated. The plaintiffs filed suit against BGII and approximately 45 other defendants. Each defendant is involved in the gaming business as a gaming machine manufacturer, distributor, or casino operator. The class action lawsuit arises out of alleged fraudulent marketing and operation of casino video poker machines and electronic slot machines. The plaintiffs allege that the defendants have engaged in a course of fraudulent and misleading conduct intended to induce people into playing their gaming machines based on a false belief concerning how those machines actually operate as well as the extent to which there is actually an opportunity to win on any given play. The plaintiffs allege that the defendants' actions constitute violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) and give rise to claims of common law fraud and unjust enrichment. The plaintiffs are seeking monetary damages in excess of \$1.0 billion, and are asking that any damage awards be trebled under applicable Federal law. In June 2002, the Federal district court denied the plaintiffs' motion for class action certification. Plaintiffs' appeal of that decision is pending. Management believes the plaintiffs' lawsuit to be without merit. We will continue to pursue all legal defenses available to us.

We are also a party to various lawsuits relating to routine matters incidental to our business. Management does not believe that the outcome of such litigation, including the matters above, in the aggregate, will have a material adverse effect on us.



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Not applicable.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS**

On December 12, 2002 our common stock became listed on the New York Stock Exchange under the symbol **AGI**. Formerly our common stock was traded on the NASDAQ Index under the symbol **ALLY**. The following table sets forth the high and low closing bid price of the Common Stock as reported by the NYSE or NASDAQ for the periods indicated.

	<b>Price Range of Common Stock</b>	
	<b>High</b>	<b>Low</b>
<b>Fiscal Year Ended June 30, 2002</b>		
1st Quarter	\$ 9.90	\$ 5.50
2nd Quarter	14.93	7.03
3rd Quarter	17.14	13.72
4th Quarter	15.25	11.65
<b>Fiscal Year Ended June 30, 2003</b>		
1st Quarter	\$ 16.06	\$ 11.55
2nd Quarter	18.01	13.31
3rd Quarter	17.30	13.38
4th Quarter	19.03	14.50

As of August 1, 2003, we had approximately 1,000 holders of record of our Common Stock.

There is currently no established public trading market for our Series E Special Stock.

We have never declared or paid cash dividends on our Common Stock. The indenture for the Company's existing 10% Senior Subordinated Notes (the "Indenture") and the loan agreement for our bank credit facility each restrict our ability to pay any dividends or make any other payment or distribution of any of our Restricted Subsidiaries' Equity Interests (as defined). We intend to follow a policy of retaining earnings, if any, to finance growth of our business and do not anticipate paying any cash dividends in the foreseeable future. The declaration and payment of future dividends on the Common Stock will be at the sole discretion of the Board of Directors and will depend on our profitability, our ability to pay dividends under the terms of the Indenture and our financial condition, capital requirements, statutory and contractual restrictions, future prospects and other factors deemed relevant.



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The following table sets forth information as of June 30, 2003 with respect to our equity compensation plans that provides for the issuance of stock options to purchase Alliance Gaming Corporation common stock:

<b>Plan Category</b>	<b>Number of Securities to be issued upon exercise of outstanding options</b>	<b>Wt. average exercise price of outstanding options</b>	<b>Number of Securities available for future issuance under equity compensation plans (excluding securities reflected in the first column)</b>
Equity compensation plans approved by security holders	3,309,626	\$ 9.51	2,450,000
Equity compensation plans not approved by security holders			
Total	3,309,626	\$ 9.51	2,450,000

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The following selected financial data has been derived from our audited consolidated financial statements. The table should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes thereto. The amounts shown below have been restated to conform to present the route operations and Bally Wulff business units as discontinued operations.

	<b>Fiscal Years Ended June 30,</b>				
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
	(In 000 s, except per share amounts)				
<b>Statements of Operations Data</b>					
Total revenues	\$ 188,501	\$ 203,233	\$ 235,035	\$ 296,074	\$ 407,560
Unusual items (1)		2,164	6,489		
Operating income	5,193	9,677	33,922	57,108	89,936
Income (loss) from continuing operations before income taxes	(26,607)	(24,350)	(3,163)	28,557	62,745
Income tax expense (benefit) (2)	(1,033)	(940)	(1,313)	(38,440)	22,316
Net income (loss) from continuing operations	(25,574)	(23,410)	(1,850)	66,997	40,429
Special stock dividends	(1,697)				
<b>Discontinued Operations:</b>					
Loss on sale of wall machines and amusement games unit, net of tax benefit (3)					(25,358)
Income (loss) from discontinued operations of wall machines and amusement games unit, net (4)	4,354	(5,740)	2,453	(17,167)	(895)
Income from discontinued operations of Nevada Route, net	9,740	11,677	12,339	12,580	4,059
Income from discontinued operations of Louisiana Route, net	2,653	2,438	1,540	1,439	1,288
Income (loss) from discontinued operations	16,747	8,375	16,332	(3,148)	(20,906)
Net income (loss)	\$ (10,524)	\$ (15,035)	\$ 14,482	\$ 63,849	\$ 19,523
<b>Basic earning (loss) per share:(5)</b>					
Continuing operations	\$ (0.70)	\$ (0.57)	\$ (0.04)	\$ 1.45	\$ 0.82
Discontinued operations	\$ 0.43	\$ 0.20	\$ 0.39	\$ (0.07)	\$ (0.42)
Total	\$ (0.27)	\$ (0.37)	\$ 0.35	\$ 1.38	\$ 0.40
<b>Diluted earning (loss) per share:(5)</b>					
Continuing operations	\$ (0.70)	\$ (0.57)	\$ (0.04)	\$ 1.41	\$ 0.81
Discontinued operations	\$ 0.43	\$ 0.20	\$ 0.38	\$ (0.07)	\$ (0.42)
Total	\$ (0.27)	\$ (0.37)	\$ 0.34	\$ 1.34	\$ 0.39

As of June 30,

	1999	2000	2001	2002	2003
(In 000 s)					
<b>Balance Sheet Data</b>					
Cash and cash equivalents	\$ 2,460	\$ 11,878	\$ 30,657	\$ 33,240	\$ 40,158
Working capital (6)	46,375	57,120	54,116	102,745	156,109
Total assets	356,307	352,930	371,017	459,880	525,165
Total long term debt, including current maturities	297,694	321,601	339,559	341,799	345,215
Total stockholders equity (deficiency)	(30,408)	(50,795)	(39,205)	45,986	91,630

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**ALLIANCE GAMING CORPORATION  
FORM 10-K**

**Year Ended June 30, 2003**

- (1) The Company has recorded the following unusual items:

During the year ended June 30, 2000, restructuring and related charges totaled approximately \$8.1 million. The restructuring and related costs were incurred pursuant to a plan adopted by the Company for staff reductions throughout the Company. Included in the restructuring costs is a \$1.9 million charge for a valuation reserve for certain inventory for the Australian market, which was a market we exited in 2000.

During the year ended June 30, 2000, gains for the sale of certain gaming management and development rights totaling \$4.0 million.

During the year ended June 30, 2001, the Company incurred costs and expenses to sell the Nevada Route Operations totaling \$6.5 million consisting primarily of the break-up fee paid by the Company to terminate the sale.

- (2) During the year ended June 30, 2002 we recorded a tax benefit resulting from the reduction of previously recorded valuation reserves against net deferred tax assets, primarily net operating loss carry forwards, totaling \$37 million (included in the income tax provision).
- (3) In June 30, 2003, we entered into a definitive agreement for the sale of Bally Wulff and we wrote down the carrying value of the remaining net assets of Bally Wulff to the sale price of \$16.5 million, resulting in a charge of \$25.4 million, net of tax (included in discontinued operations).
- (4) During the year ended June 30, 2002, we recorded a non-cash charge to write-down goodwill and other long-lived assets of Bally Wulff, totaling \$24.1 million (included in discontinued operations).
- (5) The earnings per share amounts have been restated for all periods presented to reflect the two-for-one stock splits effective August 21, 2001 and April 9, 2002.
- (6) Excludes assets and liabilities of discontinued operations held for sale.

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

**Liquidity and Capital Resources**

As of June 30, 2003, we had \$40.2 million in cash and cash equivalents. In addition we had net working capital of approximately \$156.1 million, an increase of approximately \$53.4 million from June 30, 2002, which is explained in the working capital section below. Consolidated cash and cash equivalents at June 30, 2003, includes approximately \$3.8 million of cash utilized in our Casino Operations that is held in vaults, cages or change banks. Additionally, pursuant to various state gaming regulations, we maintain certain cash accounts to ensure availability of funds to pay wide-area progressive jackpot awards, which totaled approximately \$14.5 million at June 30, 2003.

In September 2003, we completed a refinancing of our senior bank credit facility, which now consists of a \$275.0 million term loan, and a \$125.0 million revolving credit facility (which can be increased by up to \$75.0 million upon the consent of the bank group, any time during the term of the agreement) (the Refinancing). Proceeds from the term loan were used to repay our existing bank term loans totaling approximately \$188 million, repay \$150.0 million of our 10% Senior Subordinated Notes and to pay transaction fees and expenses. The new term loan has a 1% per year mandatory principal amortization, with a 6 year maturity and bears interest at LIBOR plus 2.75%. The revolving credit facility commitment decreases ratably over the 5 year term of the commitment to a 60% balloon and bears interest at LIBOR plus 2.50%. The bank loan contains certain financial and operational covenants, however there are no borrowing base requirements. As of the initial borrowing date on September 5, 2003 we are in compliance with the covenants.

**Table of Contents****ALLIANCE GAMING CORPORATION  
FORM 10-K****Year Ended June 30, 2003**

As a result of the Refinancing described above, the Company will record a pre-tax charge in the September 2003 period of approximately \$12.0 million, which includes \$5.0 million for the early extinguishment of the Subordinated Notes, and \$7.0 million for the non-cash write off of deferred financing costs.

Management believes that cash flows from operating activities, cash and cash equivalents held and the availability of the revolving credit facility commitment will provide us with sufficient capital resources and liquidity. At June 30, 2003, we had no material commitments for capital expenditures.

**Working Capital**

The following table presents the components of consolidated working capital at June 30, 2002 and 2003, excluding assets and liabilities of discontinued operations (dollars in 000 s):

	<b>Balance at June 30,</b>		<b>Change</b>
	<b>2002</b>	<b>2003</b>	
Cash and cash equivalents	\$ 33,240	\$ 40,158	\$ 6,918
Accounts and notes receivable, net	60,274	98,408	38,134
Inventories, net	30,434	32,172	1,738
Deferred tax assets, net	27,586	44,821	17,235
Other current assets	8,333	8,516	183
	<hr/>	<hr/>	<hr/>
Total current assets	159,867	224,075	64,208
	<hr/>	<hr/>	<hr/>
Accounts payable	14,323	22,912	8,589
Jackpot liabilities	5,855	10,604	4,749
Accrued liabilities	32,954	30,913	(2,041)
Current maturities of long-term debt	3,990	3,537	(453)
	<hr/>	<hr/>	<hr/>
Total current liabilities	57,122	67,966	10,844
	<hr/>	<hr/>	<hr/>