

WMS INDUSTRIES INC /DE/
Form 10-Q
May 03, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2012

OR

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

Commission file number: 1-8300

WMS INDUSTRIES INC.

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(Exact name of registrant as specified in its Charter)

Delaware
(State or other Jurisdiction of
incorporation or organization)

36-2814522
(I.R.S. Employer
Identification No.)

800 South Northpoint Blvd.

Waukegan, IL 60085

(Address of Principal Executive Offices)

(847) 785-3000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files.) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 55,081,341 shares of common stock, \$0.50 par value, were outstanding at April 30, 2012.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****WMS INDUSTRIES INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

For the Three and Nine Months Ended March 31, 2012 and 2011

(in millions of U.S. dollars and millions of shares, except per share amounts)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
REVENUES:				
Product sales	\$ 110.6	\$ 120.2	\$ 295.2	\$ 358.6
Gaming operations	65.4	72.5	198.6	221.5
Total revenues	176.0	192.7	493.8	580.1
COSTS AND EXPENSES:				
Cost of product sales(1)	53.3	61.8	144.8	182.0
Cost of gaming operations(1)	12.6	13.9	41.3	44.0
Research and development	22.1	27.7	70.2	86.5
Selling and administrative	33.7	36.1	105.2	112.5
Impairment and restructuring	0.0	0.0	9.7	3.8
Depreciation and amortization(1)	23.1	18.4	66.9	50.5
Total costs and expenses	144.8	157.9	438.1	479.3
OPERATING INCOME				
	31.2	34.8	55.7	100.8
Interest expense	(0.4)	(0.3)	(1.2)	(0.9)
Interest income and other income and expense, net	2.6	2.7	9.5	6.6
Income before income taxes	33.4	37.2	64.0	106.5
Provision for income taxes	11.3	13.0	22.0	35.8
NET INCOME	\$ 22.1	\$ 24.2	\$ 42.0	\$ 70.7
Earnings per share:				
Basic	\$ 0.40	\$ 0.42	\$ 0.75	\$ 1.22
Diluted	\$ 0.40	\$ 0.41	\$ 0.75	\$ 1.19
Weighted-average common shares:				
Basic common stock outstanding	55.2	57.6	55.7	57.9

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Diluted common stock and common stock equivalents	55.5	58.9	56.0	59.3
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(1) Cost of product sales and cost of gaming operations exclude the following amounts of depreciation and amortization, which are included in the depreciation and amortization line item:

Cost of product sales	\$ 1.5	\$ 1.2	\$ 4.3	\$ 3.6
Cost of gaming operations	\$ 14.6	\$ 10.7	\$ 41.8	\$ 29.4

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**WMS INDUSTRIES INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions of U.S. dollars and millions of shares)

	March 31, 2012 (unaudited)	June 30, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 74.5	\$ 90.7
Restricted cash and cash equivalents	13.1	14.3
Total cash, cash equivalents and restricted cash	87.6	105.0
Accounts and notes receivable, net of allowances of \$7.1 and \$5.5, respectively	263.0	284.6
Inventories	60.2	67.1
Other current assets	38.3	40.8
Total current assets	449.1	497.5
NON-CURRENT ASSETS:		
Long-term notes receivable, net	96.4	81.6
Gaming operations equipment, net of accumulated depreciation and amortization of \$217.7 and \$270.5, respectively	107.4	86.8
Property, plant and equipment, net of accumulated depreciation and amortization of \$134.6 and \$115.7, respectively	200.4	171.5
Intangible assets, net	147.6	153.9
Deferred income tax assets	48.1	43.1
Other assets, net	19.3	11.9
Total non-current assets	619.2	548.8
TOTAL ASSETS	\$ 1,068.3	\$ 1,046.3
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 57.1	\$ 66.2
Accrued compensation and related benefits	8.2	12.3
Other accrued liabilities	63.4	73.9
Total current liabilities	128.7	152.4
NON-CURRENT LIABILITIES:		
Long-term debt	35.0	0.0
Deferred income tax liabilities	26.7	23.9
Other non-current liabilities	13.5	14.1
Total non-current liabilities	75.2	38.0
Commitments, contingencies and indemnifications (see Note 12)	0.0	0.0
STOCKHOLDERS EQUITY:		
Preferred stock (5.0 shares authorized; none issued)	0.0	0.0

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Common stock (200.0 shares authorized; 59.7 shares issued)	29.8	29.8
Additional paid-in capital	440.9	437.9
Treasury stock, at cost (4.6 and 2.9 shares, respectively)	(138.1)	(104.9)
Retained earnings	532.8	490.0
Accumulated other comprehensive income (loss)	(1.0)	3.1
Total stockholders equity	864.4	855.9
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,068.3	\$ 1,046.3

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**WMS INDUSTRIES INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the Nine Months Ended March 31, 2012 and 2011

(in millions of U.S. dollars)

(Unaudited)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 42.0	\$ 70.7
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	56.8	50.5
Amortization of intangible and other non-current assets	20.4	13.9
Share-based compensation	11.5	15.2
Other non-cash items	11.9	8.6
Deferred income taxes	(2.9)	9.5
Excess tax benefit from exercise of stock options	(0.2)	(6.8)
Change in operating assets and liabilities	(32.9)	(60.9)
Net cash provided by operating activities	106.6	100.7
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to gaming operations equipment	(58.1)	(48.3)
Additions of property, plant and equipment	(47.9)	(42.0)
Payments to acquire or license intangible and other non-current assets	(9.3)	(15.8)
Net cash used in investing activities	(115.3)	(106.1)
CASH FLOWS FROM FINANCING ACTIVITIES		
Purchase of treasury stock	(41.9)	(80.0)
Proceeds from borrowings under revolving credit facility	35.0	0.0
Debt issuance costs	(2.5)	0.0
Cash received from exercise of stock options	2.7	11.5
Excess tax benefit from exercise of stock options	0.2	6.8
Net cash used in financing activities	(6.5)	(61.7)
Effect of exchange rates on cash and cash equivalents	(1.0)	0.8
DECREASE IN CASH AND CASH EQUIVALENTS	(16.2)	(66.3)
CASH AND CASH EQUIVALENTS, beginning of period	90.7	166.7
CASH AND CASH EQUIVALENTS, end of period	\$ 74.5	\$ 100.4

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)

(Unaudited)

1. BASIS OF PRESENTATION AND BUSINESS OVERVIEW

The accompanying unaudited interim Condensed Consolidated Financial Statements of WMS Industries Inc. (WMS , we , us or the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. References to U.S. GAAP within this report cite topics within the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to those rules and regulations. The accompanying Condensed Consolidated Financial Statements should therefore be read in conjunction with our Consolidated Financial Statements and Notes thereto for the fiscal year ended June 30, 2011, included in our Annual Report on Form 10-K filed with the SEC on August 29, 2011. The accompanying unaudited interim Condensed Consolidated Financial Statements have been prepared in accordance with U.S. GAAP and reflect all adjustments of a normal, recurring nature that are, in the opinion of management, necessary for a fair presentation of results for these interim periods.

Sales of our gaming machines are generally strongest in the spring and slowest in the summer months, while gaming operations revenues are generally strongest in the spring and summer. Typically, our total revenues are lowest in the September quarter and build in each subsequent quarter with the June quarter generating our highest total quarterly revenues. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for new games from regulators than in other quarters, when a game or platform that achieves significant player appeal is introduced, if a significant number of new casinos open or existing casinos expand or if gaming is permitted in a significant new jurisdiction. Operating results for the three and nine months ended March 31, 2012, are not necessarily indicative of the results that may be expected for the fiscal year ended June 30, 2012. For further information refer to our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

We are engaged in one business segment: to serve the legalized gaming industry by designing, manufacturing and distributing games, video and mechanical reel-spinning gaming machines and video lottery terminals (VLTs) to authorized customers in legal gaming jurisdictions worldwide. We have production facilities in the United States with development and distribution offices located in the United States, Argentina, Australia, Canada, China, India, Mexico, South Africa and Spain, and an online gaming support office in the United Kingdom and through July 2011 when we sold our subsidiary, Systems in Progress GmbH (SiP), Austria. In fiscal year 2009, we integrated the manufacturing of our Orion Financement Company B.V. (Orion Gaming) products into our Spain and United States facilities, and in fiscal 2011 we closed and sold Orion Gaming 's manufacturing facility in the Netherlands and determined that we would wind down the manufacturing of the Orion Gaming product lines over fiscal 2012. We will continue to provide support for spare parts related to Orion Gaming product lines for several years. Orion Gaming and SiP were immaterial to our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows.

We market our gaming machines in two principal ways. First, product sales include the sale to casinos and other gaming machine operators of new and used gaming machines and VLTs, conversion kits (including game, hardware or operating system conversions) and parts. Second, through gaming operations we license our game content and intellectual property to third parties for distribution; we earn revenues from operating an online gaming site, offering a social game on Facebook® and selling select WMS games that have been ported to operate on mobile devices; we earn revenues from networked gaming, which is a system that links groups of networked-enabled gaming machines to a server in the casino data center, and we lease gaming machines and VLTs to casinos and other licensed gaming machine operators under operating leases where the lease payments are based upon (1) a percentage of the net win, which is the earnings generated by casino patrons playing the gaming machine, (2) fixed daily fees or (3) a percentage of the amount wagered (coin-in) or a combination of a fixed daily fee and a percentage of the coin-in. We categorize our lease arrangements into five groups: wide-area progressive (WAP) participation gaming machines; local-area progressive (LAP) participation gaming machines; stand-alone participation gaming machines; casino-owned daily fee games; and gaming machine, VLT and other leases. We refer to WAP, LAP and stand-alone participation gaming machines as participation games and when combined with casino-owned daily fee games, royalties we receive under license agreements with third parties to utilize our game content and intellectual property, gaming machine, VLT and other lease revenues, online social and mobile gaming revenues and networked gaming revenues, we refer to this business as our gaming operations.

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Data for product sales and gaming operations is only maintained on a consolidated basis as presented in our Condensed Consolidated Financial Statements, with no additional separate data maintained for product sales and gaming operations (other than the revenues and costs of revenues information included in our Condensed Consolidated Statements of Income and gaming operations equipment and related accumulated depreciation included in our Condensed Consolidated Balance Sheets).

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(Unaudited)

Reclassifications

We reclassified \$3.8 million of selling and administrative expense incurred in the nine months ended March 31, 2011, to a separate line item as impairment and restructuring charges in our Condensed Consolidated Statements of Income to conform to the current year's presentation. This reclassification did not affect the reported amounts of total costs and expenses, operating income, pre-tax income or net income in our Condensed Consolidated Statements of Income.

2. PRINCIPAL ACCOUNTING POLICIES

Principal Accounting Policies

For a complete description of our principal accounting policies see Note 2. Principal Accounting Policies, to our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011. Shown below are certain of our principal accounting policies.

Revenue Recognition

We evaluate the recognition of revenue based on the criteria set forth in the following accounting guidance: FASB ASC Topic 605, *Revenue Recognition* (Topic 605), FASB Topic 985, *Software* (Topic 985), Accounting Standards Update (ASU) No. 2009-13, *Multiple-Deliverable Revenue Arrangements* (ASU No. 2009-13) and ASU No. 2009-14 *Certain Revenue Arrangements That Include Software Elements* (ASU No. 2009-14).

ASU No. 2009-13 replaced and significantly changed the previous separation criteria for multiple-deliverable revenue arrangements, by eliminating the criteria for objective and reliable evidence of fair value for each deliverable. ASU No 2009-13 also eliminated the use of the residual method of allocation of consideration among deliverables and requires, instead, that arrangement consideration be allocated, at the inception of the arrangement, to all deliverables based on their relative selling price (the relative selling price method). When applying the relative selling price method, a hierarchy is used for estimating the selling price based first on vendor specific objective evidence (VSOE), then third-party evidence (TPE) and finally management's estimated selling price (ESP). The establishment of VSOE requires judgment as to whether there is a sufficient quantity of items sold on a stand-alone basis and whether the prices demonstrate an appropriate level of concentration to conclude that VSOE exists. In determining ESP, management considers a variety of information including historic pricing and discounting practices, competitive market activity, internal costs, and the pricing and discounting practices of products sold in bundled arrangements. At the inception of a multiple element arrangement, fees under the arrangement are allocated to the non-software deliverables and to the software deliverables as a group in accordance with the relative selling price method.

ASU No 2009-14 amended the scope of software revenue recognition to exclude all tangible products containing both software and non-software components that function together to deliver the product's essential functionality. Effective July 1, 2009, with the adoption of ASU No. 2009-14, we no longer applied software revenue recognition guidance from Topic 985 to our gaming machine sales as the software and non-software components of the gaming machines function together to deliver the product's essential functionality.

General

Our revenue recognition policy for both product sales and gaming operations is to record revenue when all the following criteria are met:

- Ø Persuasive evidence of an agreement exists;
- Ø The price to the customer is fixed or determinable;
- Ø Delivery has occurred, title has been transferred and any acceptance terms have been fulfilled;
- Ø No significant contractual obligations remain; and
- Ø Collectability is reasonably assured.

We recognize revenue when all of the criteria listed above are met and do not recognize revenue if all of the criteria are not met. We defer revenue for any undelivered units of accounting. Deliverables are divided into separate units of accounting if:

- Ø Each item has value to the customer on a stand-alone basis; and
- Ø Delivery of any undelivered item is considered probable and substantially in our control.

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Considerable judgment is required to determine whether an arrangement consists of multiple deliverables, whether the delivered item has value to the customer on a stand-alone basis and to determine the relative selling price used to allocate the arrangement fee to each deliverable. The fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element and is recognized as revenue. Such determination affects the amount and timing of revenue recognition. We evaluate the primary use and functionality of each deliverable in determining whether a delivered item has stand-alone value and qualifies as a separate unit of accounting.

Considerable judgment is also necessary to determine whether certain of our products are within the scope of software revenue recognition and whether the software and non-software elements of these products function together to deliver the essential functionality. Our determination dictates whether general revenue recognition guidance or software revenue recognition guidance applies and could impact the timing of revenue recognition. Topic 985 primarily impacts our networked gaming revenues because networked gaming revenues are derived from computer software applications and systems to be sold or leased. We began to recognize networked gaming revenues in the June 2011 quarter and they were an immaterial portion of our revenue in fiscal 2011 and we expect networked gaming revenues will also be an immaterial portion of our revenues in fiscal 2012. As we continue with the initial commercialization of networked gaming software applications in fiscal 2012, when we offer such applications through multiple deliverable arrangements, the application of Topic 985 requires us to obtain VSOE for undelivered networked gaming software applications in a multiple deliverable arrangement before revenue can be recognized on the subsequent delivery of a software application that is part of the multiple deliverable arrangements. This may delay the recognition of revenue and increase deferred revenues and deferred costs. Revenue for networked gaming is recognized under software revenue recognition guidance in accordance with the terms of the contract.

Product Sales

Revenues are reported net of incentive rebates, discounts, sales taxes and other taxes of a similar nature. In our product sales business, the largest portion of our revenues is sold on credit terms of 30 to 120 days. We also grant extended credit terms for product sales revenues for periods up to one year and beyond, and in some cases for terms up to three years, with interest recognized for terms greater than twelve months at market rates and in some instances such longer-term obligations may be secured by the related gaming machines. For products sold under arrangements with extended payment terms, judgment for revenue recognition is based on the revenue recognition policy stated above as well as the probability of collection and historic collection experience. We annually evaluate sales contracts with extended payment terms in excess of one year to determine if there is sufficient history to prove assurance of collectability and that pricing is fixed or determinable under the original sales contract terms. In concluding that our historical payment history is based on sufficiently similar arrangements, we consider the nature of our customers, our historic collection experience with the specific customer, the terms of the arrangement and the nature of the product being sold. In our evaluation as to whether such arrangement is probable of collection and contains prices that are fixed or determinable, we routinely analyze our domestic and foreign collection history on such arrangements, if we have not allowed customer concessions on refinancing and we evaluate the risk of technological obsolescence of the underlying gaming machines. As a result of our investigation, we have concluded that our extended payment term arrangements with original periods of 36 months or less qualify for revenue recognition at the time of sale because of our history of collecting all amounts due under such arrangements, the lack of concessions given to collect amounts owed under such arrangements, including any refinancing arrangements, and the low risk of technological obsolescence, as our product life significantly exceeds the payment terms. Our product sales contracts do not include specific performance, cancellation, termination or refund type provisions.

Our services for initial gaming machine installation, as well as standard warranty and technical support, are not separately priced components of our sales arrangements and are included in our revenues when the associated product sales revenue is recognized. Arrangements may also include spare parts sales or sales of game content conversion kits, which enable customers to replace game content without purchasing a new gaming machine, or hardware or operating system conversion kits, which include a new CPU board and operating system. Product sales arrangements do not include maintenance and product support fees beyond a standard warranty period. The recognition of revenue from the sale of gaming machines occurs when delivery occurs, title and risk of loss have passed to the customer and all other criteria described above have been satisfied. Labor costs for gaming machine installs are included in selling and administrative expenses and are incidental to the arrangement. We accrue for the cost of installing gaming machines sold to our customers at the time of sale, based on the percent of such gaming machines that we expect to install for our customers. We provide a reserve for warranty costs and our warranty expense has not been material.

Gaming Operations

We earn gaming operations revenues from leasing gaming machines, VLTs and other leased equipment, earn royalties from third parties under license agreements to use our game content and intellectual property and, beginning in fiscal 2011, earn revenues from our online casino operations and networked gaming operations, although the revenue earned in fiscal 2011 and anticipated to be earned in fiscal 2012 from such new operations is immaterial to our Consolidated Financial Statements. We capitalize the costs to install gaming operations equipment. Labor costs associated with performing routine maintenance on participation gaming machines is expensed as incurred and included in selling and administrative expenses.

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For WAP leasing agreements, revenues are recognized for each gaming machine based upon a percentage of coin-in, which is the amount of coins, currency and credits wagered on the gaming machine, or a combination of a fixed daily fee and a percentage of coin-in. WAP systems entail a configuration of numerous electronically linked gaming machines located in multiple casino properties within a single gaming jurisdiction, which are connected to our central WAP computer system via a network of communications equipment. WAP system gaming machines differ from non-linked gaming machines in that they build a progressive jackpot with every wager until a player hits the top award winning combination. We pay WAP progressive jackpots won by casino patrons. Participating casinos pay a percentage of the coin-in from WAP gaming machines directly to us for services related to the design, assembly, installation, operation, maintenance and marketing of our WAP systems and to administer the progressive jackpot funding. Revenues are recognized as earned when collectability is reasonably assured.

A LAP system electronically links gaming machines within a single casino to a site controller which builds a series of small progressive jackpots within that specific casino based on every wager made on the LAP system; whereas a WAP jackpot system links gaming machines in multiple casinos within a single gaming jurisdiction to a progressive jackpot. Each casino pays LAP progressive jackpots won by patrons of its casino.

We also offer participation gaming machines on a non-linked basis, which we call stand-alone games. Stand-alone and LAP progressive participation lease payments are based on either a pre-determined percentage of the daily net win of each gaming machine or a fixed daily rental fee, or for several specific products, a percentage of the coin-in.

VLTs may be operated as stand-alone units or may interface with central monitoring systems operated by government agencies. Our leased VLTs typically are located in places where casino-style gaming is not the only attraction, such as racetracks, bars and restaurants, and are usually operated by the lottery organization of the jurisdiction. Our lease revenues are based on a fixed percentage of daily net win of the VLTs or a fixed daily lease rate. We exclude our leased VLTs that utilize for-sale game themes from our installed base of participation gaming machines. In all cases, the daily fee entitles the customer to full use of the gaming machine and includes maintenance, licensing of the game content software and connection to a linked progressive system, where applicable. In certain markets, we also charge a daily system connection fee for the customer to connect to a central determination system and/or back-office system that determines the outcome of gaming machines. We do not consider these arrangements to have multiple revenue-generating activities as the services offered are a comprehensive solution in exchange for a daily fee and all of the products and services are delivered contemporaneously; therefore, revenue is recognized under general revenue recognition guidance as the products and services provide the customer with the right to use the gaming machines and software that is essential to the functionality of the gaming machine.

Some customers prefer to lease our standard for-sale gaming machines rather than to purchase them. In these cases, we lease the game and the gaming machine, either for a fixed daily fee or as a percentage of the net win of the gaming machine. We recognize the revenue from these operating leases over the term of the lease. We do not include leased for-sale units in our installed base of participation gaming machines.

Under agreements with licensees who are generally located in geographic areas or operate in markets where we are not active, we license our games, artwork and other intellectual property. License royalties are recorded as earned when the licensee purchases or places the game or other intellectual property, and collectability is reasonably assured. We also earn revenues from operating an online casino for residents of the United Kingdom, offering a social game on *Facebook*, selling select WMS games that have been ported to operate on mobile devices and earn revenues from networked gaming, all of which we include in our other gaming operations revenues. Currently the revenues earned from all of these arrangements are not material to our Consolidated Financial Statements.

Accounts and Notes Receivable, Allowance for Doubtful Accounts and Bad Debt Expense and Credit Quality of Notes Receivable

Accounts and Notes Receivable

Revenues from gaming operations are predominantly operating lease payments that are due monthly. For product sales, we sell gaming machines and VLTs typically with payment terms of 30 to 120 days; however in certain circumstances, we offer extended payment terms

typically for up to one year and beyond and in some cases for terms up to three years. We classify a product sale receivable as a note receivable, if at the time of sale, there are any installment payment terms regardless of whether or not a formal executed note agreement exists, or if the payment terms are beyond 12 months.

Customers consider numerous factors in determining whether to issue a sales order to us including, among others, expected earnings performance of the gaming machines (which we believe is the most significant decision factor), selling price, the value provided for any trade-in of used gaming machines, parts and conversion kit support and payment terms.

We have historically provided extended payment terms to our customers for periods from 120 days through 36 months, with interest payable at prevailing rates for terms greater than 12 months. We file Uniform Commercial Code (UCC) liens on almost all domestic trade accounts and notes receivable with terms greater than 90 days, which secures our interest in the gaming machines underlying the trade accounts and notes receivable until the receivable balance for the gaming machines is fully paid, although the value of the gaming machines, if repossessed, may be less than the receivable balance outstanding. Our recent international expansion

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(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)

(Unaudited)

has required us to provide, in certain jurisdictions, a greater amount of extended payment financing terms of 18 to 36 months. In addition, as a result of the financial market crisis, which began in 2008 and led to reduced consumer discretionary spending and a weakened global economic environment, beginning in the March 2009 quarter we began and have continued to provide a greater amount of extended payment terms to select customers. This expanded extended payment term program is expected to continue until the global economy and consumer discretionary spending improves and customer demand for extended payment terms abates. Typically, these sales result in a higher selling price and, if financed over periods longer than 12 months, incur interest at rates in excess of our borrowing rate, both of which provide added profitability to the sale.

We believe our competitors have also expanded their use of extended payment terms. In aggregate, we believe that by expanding our use of extended payment terms, we have provided a competitive response to our customers and that our revenues have been favorably impacted. We are unable to estimate the impact of this program on our revenues. If we ceased providing an expanded amount of extended payment terms, we believe we would not be competitive for some customers in the market place and that our revenues and profits would likely decrease.

The following summarizes the components of current and long-term accounts and notes receivable, net (\$ in millions):

	March 31, 2012	June 30, 2011
Current, net:		
Accounts receivable	\$ 76.3	\$ 105.3
Notes receivable	193.8	184.8
Allowance for doubtful accounts	(7.1)	(5.5)
Current accounts and notes receivable, net	\$ 263.0	\$ 284.6
Long-term, net:		
Notes receivable	\$ 96.4	\$ 81.6
Allowance for doubtful accounts	0.0	0.0
Long-term notes receivable, net	\$ 96.4	\$ 81.6
Total accounts and notes receivable, net	\$ 359.4	\$ 366.2

As of March 31, 2012, \$193.8 million or 66.8% of the notes receivable installments are due within the next 12 months.

Accounts and notes receivable, net from international customers in Argentina, Mexico, Peru and Canada at March 31, 2012, were approximately: \$61.8 million, \$46.4 million, \$26.4 million and \$23.0 million, respectively while accounts and notes receivable from international customers in these same countries at June 30, 2011, were approximately: \$55.9 million, \$59.6 million, \$24.5 million and \$8.5 million, respectively.

The expansion of our use of extended payment terms since 2009 has increased our current and long-term receivable balances and reduced our cash provided by operating activities. Total receivables, net decreased by \$6.8 million from \$366.2 million at June 30, 2011, to \$359.4 million at March 31, 2012. The decrease primarily reflects the reduction of total revenue by 13.4% or \$27.2 million, to \$176.0 million for three months

ended March 31, 2012 compared to \$203.2 million for three months ended June 30, 2011 partially offset by a higher amount of extended payment terms given to customers.

The fair value of notes receivable, which equals book value, is estimated by discounting expected future cash flows using current interest rates at which similar notes receivable terms would be made to customers with similar credit ratings and remaining maturities.

Allowance for Doubtful Accounts and Bad Debt Expense

We carry our accounts and notes receivable at face amounts less an allowance for doubtful accounts. On a routine basis, but at least quarterly, we evaluate our accounts and notes receivable individually and collectively, and establish the allowance for doubtful accounts based on a combination of specific customer circumstances, economic and credit conditions and our history of write-offs and collections. We consider a variety of factors to evaluate credit risk in recording the allowance for doubtful accounts or as an indicator of an impaired loan including the accounts and notes receivable aging and trends thereof for customer balances, past experience with customers who pay outside of payment terms, the probability of collection, the legal environment and regulatory landscape, the customer's solvency and news related to individual customers, especially if the news calls into question the customer's ability to fully pay balances owed.

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The gaming industry is a highly regulated industry requiring most customers to obtain and maintain a gaming operator's license and demonstrate to the applicable regulatory authority that they have the financial resources to operate a gaming establishment. Many of our customers, including new casinos that have opened in recent years, are owned by existing customers who operate multiple properties that have established a favorable payment history with us. Historic collection experience and the aging of customer balances are the primary indicators management utilizes to monitor the credit quality of our receivables. We do not segregate accounts and notes receivable by other credit quality indicators and do not use any other statistics or internal rating system to segregate our

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customer balances into subgroups with similar risk characteristics. Our aging categories are determined based on contractually agreed payment terms, which are typically the original payment terms. Invoices and expected payments are classified as past due if the payment is not received within the contractually agreed upon terms. Partial payments of account balances are also infrequent and are applied based upon the facts and circumstances related to the payment. Generally, payments are applied based upon customer direction provided with the remittance or as a result of a review of the account balance, dialogue with our customer and the aging of the remaining balance outstanding continues based on its original contractual terms.

Past due accounts receivable are monitored closely to expedite payments and to record necessary allowances. Accounts and notes receivables are evaluated individually for impairment (with specific reserves established) when collectability becomes uncertain due to events and circumstances that cause an adverse change in a customer's cash flows or financial condition, such as changes to industry and regional economic conditions. Accounts placed on specific reserve are evaluated for probability of collection, which is used to determine the amount of the specific reserve. Our bad debt expense is most significantly impacted by bankruptcy filings by our casino customers and pre-bankruptcy reported exposures of individual casino customers. Due to our successful collection experience and our continuing operating relationship with casino customers and their businesses, it is infrequent that we repossess gaming machines from a customer in partial settlement of outstanding accounts or notes receivable balances. In those unusual instances where repossession occurs to mitigate our exposure on the related receivable, the repossessed gaming machines are subsequently resold in the used gaming machine market; however, we may not fully recover the receivable from this re-sale. Uncollectible accounts or notes receivables are written off only when all reasonable collection efforts have been exhausted and we determine that there is minimal chance of any kind of recovery.

For customers in the United States, at the time a customer files for bankruptcy, we typically have a security interest in the gaming machines for that portion of the total accounts and notes receivable, but our accounts and notes receivable related to all other revenue sources are typically unsecured claims. In our gaming operations business, because we own the gaming machines and lease them to the casino operator, in a bankruptcy the customer has to either accept or reject the lease and, if rejected, our gaming machines are returned to us. Due to the significance of our gaming machines to the on-going operations of our casino customers, in a bankruptcy filing we may be designated as a key vendor, which can enhance our position above other creditors in the bankruptcy. For international customers, depending on the country and our historic collection experience with the customer, we may have pledge agreements, bills of exchange or personal guarantees or other forms of agreement to enhance our ability to collect the receivables.

During the trailing twelve months ended March 31, 2012, our bad debt expense totaled \$7.5 million representing 1.1% of revenues which was higher than the \$4.4 million of bad debt expense for the prior twelve month period, which represented 0.6% of revenues in the prior trailing twelve-month period. The higher bad debt expense in the trailing twelve-months ended March 31, 2012, was primarily due to increasing the dollar amount of bad debt reserves by \$4.3 million following government enforcement action beginning in the September 2011 quarter at certain casinos in Mexico and an increase of \$1.4 million in the June 2011 quarter related to government action to close casinos in Venezuela. Our bad debt expense for the three months ended March 31, 2012, was \$0.5 million, or 0.3% of revenues, compared to \$1.3 million, or 0.7% of revenues, for the three months ended March 31, 2011. Our bad debt expense for the nine months ended March 31, 2012, was \$6.7 million, or 1.4% of revenues, compared to \$3.1 million, or 0.5% of revenues, for the nine months ended March 31, 2011. The higher bad debt expense in the nine months ended March 31, 2012, was primarily due to increasing the dollar amount of bad debt reserves by \$4.3 million following government enforcement action beginning in the September 2011 quarter at certain casinos in Mexico. Our total bad debt reserve was \$7.1 million at March 31, 2012, compared to \$5.5 million at June 30, 2011.

Credit Quality of Notes Receivable

For notes receivable, interest income is recognized ratably over the life of the note receivable and any related fees or costs to establish the notes are charged to expense as incurred, as they are considered insignificant. Actual or imputed interest, if any, is determined based on current market rates at the time the note originated and is recorded in Interest income and other income and expense, net, ratably over the payment period. The interest rates on outstanding notes receivable ranged from 5.25% to 10.0% at March 31, 2012. Our policy is to generally recognize interest on

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notes receivables until the note receivable is deemed non-performing. A note receivable is considered non-performing if payments have not been received within 180 days of the agreed upon terms. The amount of our non-performing notes is immaterial.

The majority of our domestic customers are not rated by the credit rating agencies but for those customers who do have credit ratings, the Standard and Poor's credit ratings ranged from BBB+ to D at March 31, 2012. Where possible we seek payment deposits, collateral, pledge agreements, personal guarantees or foreign bank bills of exchange or letters of credit on international trade accounts and notes receivable. However, most of our international trade accounts and notes receivable are not collateralized. Currently we have not sold our accounts or notes receivable to third parties, so we do not have any off-balance sheet liabilities for factored receivables.

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The following summarizes the components of total notes receivable, net at March 31, 2012:

	March 31, 2012	Balances that are over 90 days past due
Notes receivable:		
Domestic	\$ 110.7	\$ 1.2
International	179.5	2.9
Notes receivable subtotal	290.2	4.1
Allowance for doubtful accounts	(4.8)	(1.0)
Total notes receivable, net	\$ 285.4	\$ 3.1

At March 31, 2012, 1.1% of our total notes receivable, net was past due over 90 days.

The following tables detail our evaluation of notes receivable for impairment at March 31, 2012 and June 30, 2011, respectively.

	March 31, 2012	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Notes receivable:			
Domestic	\$ 110.7	\$ 10.6	\$ 100.1
International	179.5	36.6	142.9
Total notes receivable	\$ 290.2	\$ 47.2	\$ 243.0

	June 30, 2011	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Notes receivable:			
Domestic	\$ 87.7	\$ 12.8	\$ 74.9
International	178.7	39.8	138.9
Total notes receivable	\$ 266.4	\$ 52.6	\$ 213.8

The following table reconciles the current and non-current allowance for doubtful notes receivable from June 30, 2011 to March 31, 2012:

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	Total	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Beginning balance at June 30, 2011	\$ 2.6	\$ 2.6	\$ 0.0
Charge-offs	(3.1)	(3.1)	0.0
Recoveries	0.0	0.0	0.0
Provision, primarily amounts recorded for Mexican customers notes receivable	5.3	5.3	0.0
Ending Balance at March 31, 2012	\$ 4.8	\$ 4.8	\$ 0.0

Modifications to original financing terms are an exception to our cash collection process and are a function of collection activities with the customer. If a customer requests a modification of financing terms during the collection process, we evaluate the

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proposed modification in relation to the recovery of our gaming machines, seek additional security and recognize any additional interest income ratably over the remaining new financing term. Additionally, we often take the opportunity to simplify the forward payments by consolidating several notes (each typically representing an individual purchase transaction) into one note. In those instances, the aging of any outstanding receivable balance would be adjusted to reflect the new payment terms. Any such modifications generally do not include a concession as they generally result only in a delay of payments from the original terms that are typically insignificant. As a result of the financial crisis that began in 2008, such modifications have increased, but in general, the modification of original financing terms have not been significant to our total accounts and notes receivable balance.

The following summarizes the notes receivable that had modification of financing terms:

	# of Customers	# of Notes	Nine Months Ended March 31, 2012	
			Pre- Modification Investment	Post- Modification Investment
Financing term modifications:				
Domestic			\$	\$
International(a)	13	46	41.1	41.1
Total financing term modifications	13	46	\$ 41.1	\$ 41.1

(a) Detailed modifications included:

- Ø One international customer with one note for \$14.8 million for which original terms were extended by five months;
- Ø One international customer in which 11 notes were consolidated into three notes aggregating \$8.0 million, with an average 14 month extension of terms;
- Ø One international customer in which 10 notes were consolidated into one note aggregating \$6.4 million, with an average 10 month extension of terms; and
- Ø The remaining 10 international customers with 24 notes were consolidated into 12 notes aggregating \$11.9 million, with an average of 11 month extension of terms.

Cost of Product Sales, Cost of Gaming Operations and Selling and Administrative Expenses

Cost of product sales consists primarily of raw materials, labor and manufacturing overhead. The cost of product sales also includes licensing and royalty charges, inbound and outbound freight charges, purchasing and receiving costs, inspection costs and internal transfer costs.

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Cost of gaming operations consists primarily of wide-area progressive jackpot expenses, licensing and royalty charges, telephone costs, gaming operations taxes and fees and parts costs.

Selling and administrative expenses consist primarily of sales, marketing, distribution, installation and corporate support functions such as administration, information technology, legal, regulatory compliance, human resources and finance. The costs of distribution were \$5.6 million and \$4.9 million for the three months ended March 31, 2012 and 2011, respectively, and \$17.6 million and \$18.0 million for the nine months ended March 31, 2012 and 2011, respectively.

Fair Value Measurements

We apply the provisions of FASB ASC 820, *Fair Value Measurements* (Topic 820) to our financial assets and financial liabilities. Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs when measuring fair value.

Topic 820 describes three levels of inputs that may be used to measure fair value:

- Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs to the valuation method include:

- Ø Quoted prices for similar assets or liabilities in active markets;
- Ø Quoted prices for identical or similar assets or liabilities in inactive markets;
- Ø Inputs other than quoted prices that are observable for the asset or liability;
- Ø Inputs that are derived principally from or corroborated by observable market data by correlation or other means;

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- Ø If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement. At March 31, 2012, our investments in various money market funds totaling approximately \$1.0 million were subject to fair value measurement in accordance with Topic 820. These money market investments are included in our cash and cash equivalents and restricted cash and cash equivalents on the accompanying Condensed Consolidated Balance Sheets and are considered Level 1 securities. In addition, the carrying amounts reflected in the accompanying Condensed Consolidated Balance Sheets for cash equivalents, total accounts and notes receivable, net, accounts payable and long-term debt approximate their respective fair values at March 31, 2012 and June 30, 2011, respectively.

Goodwill and Intangible Assets

We perform impairment tests of goodwill at our reporting unit level, which is at the consolidated level. Such impairment tests for goodwill include comparing our market capitalization based on outstanding shares to our book value as of June 30, 2011, which resulted in an excess of market value over book value of over \$0.9 billion or substantially in excess of book value.

We review the carrying value of our other intangible assets individually when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss would be recognized when the present value of estimated directly related future cash flows expected to result from the use of the other intangible asset and its eventual disposition is less than its carrying value.

Gaming Operations Equipment

As our gaming operations equipment can be relocated from one customer to another customer, we review the carrying value of gaming operations equipment for impairment by type of equipment (for base gaming machines each of: Legacy, Bluebird® mechanical reel, Bluebird video, Bluebird slant, Bluebird2 mechanical reel, Bluebird2 video, Bluebird2 widescreen, Bluebird xD mechanical reel and Bluebird xD video; for top boxes by form factor; for signage by form factor; and other equipment by category) when events or changes in circumstances indicate that the carrying value of any of these asset groups may not be recoverable. An impairment loss would be recognized when the present value of estimated directly related future cash flows expected to result from the use of the gaming operations equipment and its eventual disposition is less than its carrying value.

Property, Plant and Equipment

We review the carrying value of property, plant and equipment by office location and functional category, when events or changes in circumstances indicate that the carrying value of any of these asset groups may not be recoverable. An impairment loss would be recognized when the present value of estimated directly related future cash flows expected to result from the use of the property, plant and equipment and its eventual disposition is less than its carrying value.

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Recently Adopted Accounting Standards

In April 2010, the FASB issued ASU No. 2010-16, *Accruals for Casino Jackpot Liabilities*, (ASU No. 2010-16), which clarifies when a casino entity is required to accrue a jackpot liability. Under ASU No. 2010-16, effective July 1, 2011, we changed our accounting to not record any expense for the base jackpot liability for our progressive jackpots on our WAP gaming machines until the progressive jackpot liability is won by the casino patron. In adopting this accounting standard effective July 1, 2011, we credited retained earnings with \$0.8 million, net of related deferred income tax for deferred jackpot liability expense recorded in other current liabilities in our Consolidated Balance Sheets at June 30, 2011. We believe adoption of ASU No. 2010-16 was immaterial to our Consolidated Financial Statements, but could provide more volatility to our consolidated financial results than the previous accounting method.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurements Disclosures* (ASU No. 2011-04) which will require supplemental disclosures related to purchases, sales, issuances and settlements of fair value instruments within the Level 3 reconciliation. We adopted ASU No. 2011-04 as of January 1, 2012 and the adoption had no material impact on our Consolidated Financial Statements.

Recently Issued Accounting Standards Not Yet Adopted

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU No. 2011-05) to require other comprehensive income, including reclassification adjustments, to be presented with net income in one continuous statement or in a separate statement consecutively following net income. ASU No. 2011-05 is effective prospectively beginning July 1, 2012 and the adoption is not expected to have a material impact on our Consolidated Financial Statements.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles - Goodwill and Other (Topic 350) Testing for Impairment* (ASU No. 2011-08) to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment. ASU No. 2011-08 is effective prospectively beginning July 1, 2012 and the adoption is not expected to have a material impact on our Consolidated Financial Statements.

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities* (ASU No. 2011-11) to require new disclosures about offsetting assets and liabilities to help enable users of financial statements evaluate certain significant quantitative differences in balance sheets prepared under U.S. GAAP and IFRS. ASU No. 2011-11 is effective retrospectively beginning July 1, 2013 and the adoption is not expected to have a material impact on our Consolidated Financial Statements.

In December 2011, the FASB issued update ASC No. 2011-12, *Comprehensive Income: Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* (ASU No. 2011-12) which will require us to defer only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments, and the paragraphs in this update supersede certain pending paragraphs in ASU No. 2011-05. ASU No. 2011-12 is effective prospectively beginning July 1, 2012 and the adoption is not expected to have a material impact on our Consolidated Financial Statements.

We do not believe there is additional accounting guidance not yet effective that is relevant to the readers of our Consolidated Financial Statements. Several new Exposure Drafts and proposals are under development which may have a significant impact on our Consolidated Financial Statements once enacted.

3. IMPAIRMENT AND RESTRUCTURING

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Given the continuing lower levels of capital spending by casinos on replacing gaming machines over the last three years and with no leading indicators suggesting that demand will increase in the near-term, we conducted a thorough review of our product plans and business strategies at the end of fiscal 2011 and beginning of fiscal 2012. We still believe our long-term vision and business strategy is intact but, as a result of this review, we refined our product plans and restructured our organization. Specifically, we have streamlined our product management and product development functions, simplified our product plans and further prioritized on-time commercialization of new game themes, products and portal applications.

Some of the product, operational and other decisions made in this review led to impairment and restructuring charges of \$18.4 million, or \$0.20 per diluted share, recorded in the June 2011 quarter and \$22.2 million, or \$0.24 per diluted share, for fiscal 2011. In addition, we implemented a broader restructuring in the September 2011 quarter and recorded a \$9.7 million pre-tax charge, or \$0.12 per diluted share. These restructuring actions are expected to better direct resources and focus on near-term revenue opportunities and reduce our overall organizational staffing by approximately 10% to a level that better correlates with the current industry operating environment, while maintaining our ability to create great games that engage current players and attract new players.

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The decisions made as part of the strategy review led to additional impairment and restructuring charges, which we recorded in the September 2011 quarter, consisting of \$5.9 million of separation-related charges and \$3.8 million of costs related to the decision to close two facilities. The nine-month period ended March 31, 2011, includes charges recorded in the September 2010 quarter consisting of \$3.8 million of pre-tax impairment and restructuring charges, or \$0.04 per diluted share, that previously had been included in selling and administrative expense, which includes \$2.4 million, or \$0.03 per diluted share, of asset impairment charges related to closing WMS main facility in the Netherlands and \$1.4 million, or \$0.01 per diluted share, of pre-tax separation-related charges. We sold the Netherlands facility in June 2011. The components of the charges recorded in the nine months ended March 31, 2012 and 2011 are:

DESCRIPTION OF CHARGES	Nine Months Ended March 31, 2012		Nine Months Ended March 31, 2011	
	Pre-tax amounts	Per diluted share	Pre-tax amounts	Per diluted share
IMPAIRMENT AND RESTRUCTURING CHARGES				
Non-cash Charges				
Impairment of property, plant and equipment	\$ 0.6	\$ 0.01	\$ 2.4	\$ 0.03
Cash Charges				
Restructuring charges	9.1	0.11	1.4	0.01
Total Impairment and Restructuring Charges	\$ 9.7	\$ 0.12	\$ 3.8	\$ 0.04

We paid all of the restructuring charges from the quarter ended September 30, 2010 by June 30, 2011.

At June 30, 2011, \$1.9 million of the \$3.8 million of the separation-related charges recorded in the June 2011 quarter were unpaid. During the nine months ended March 31, 2012, \$1.5 million of these separation-related charges were paid and \$0.4 million remain unpaid at March 31, 2012. We expect all of these amounts to be paid by June 30, 2012.

Of the \$9.1 million of cash-based impairment and restructuring charges recorded in the September 2011 quarter, \$5.7 million of separation-related charges and \$0.6 million of costs relating to closing two facilities were paid by March 31, 2012. At March 31, 2012, in addition to the \$0.6 million of non-cash charges, \$0.2 million of separation-related charges and \$2.6 million costs related to closing two facilities were unpaid. We expect to pay the \$2.6 million of restructuring charges related to costs related to closing two facilities ratably through July 2015, and \$0.2 million of separation-related charges will be paid by September 2012.

4. EARNINGS PER SHARE

Earnings per share is calculated using the weighted average number of common and common stock equivalents outstanding. Restricted stock is considered participating securities and included in our calculation of earnings per share. Basic and diluted earnings per share are calculated as follows:

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	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Net income Basic and Diluted earnings	\$ 22.1	\$ 24.2	\$ 42.0	\$ 70.7
Basic weighted average common shares outstanding	55.2	57.6	55.7	57.9
Dilutive effect of stock options	0.2	0.9	0.2	1.0
Dilutive effect of restricted common stock and warrants	0.1	0.4	0.1	0.4
Diluted weighted average common stock and common stock equivalents	55.5	58.9	56.0	59.3
Basic earnings per share of common stock	\$ 0.40	\$ 0.42	\$ 0.75	\$ 1.22
Diluted earnings per share of common stock and common stock equivalents	\$ 0.40	\$ 0.41	\$ 0.75	\$ 1.19
Common stock equivalents excluded from the calculation of diluted earnings per share because their impact would render them anti-dilutive	5.6	0.8	5.6	2.1

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In fiscal 2004, our Board of Directors, as part of the inducement to Hasbro Inc. and Hasbro International, Inc. (collectively, Hasbro) to extend their license agreement with us, approved a grant of warrants (the 2003 Warrants) to purchase 375,000 shares of our common stock valued at \$3.9 million using the Black-Scholes pricing model and certain assumptions at the date of issuance of the 2003 Warrants. The warrants' exercise price is \$23.36 per share of our common stock, subject to adjustment and is currently anti-dilutive at March 31, 2012. The warrants are non-cancelable and are now fully vested. See Note 12. Stockholders' Equity - Warrants to our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

Also, included in our anti-dilutive common stock equivalents for the three months and nine months ended March 31, 2012 and 2011, are warrants to purchase 500,000 shares of our common stock that were issued to Hasbro in 2009 in connection with an amendment and extension of our agreement with them. These warrants were excluded from the calculation because the vesting criteria are contingent upon future events, which were not met at March 31, 2012. See Note 12. Stockholders' Equity -Warrants to our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

5. INVENTORIES

Inventories consisted of the following:

	March 31, 2012	June 30, 2011
Raw materials and work-in-process	\$ 37.2	\$ 40.5
Finished goods	23.0	26.6
Total inventories	\$ 60.2	\$ 67.1

Cost elements included in work-in-process and finished goods include raw materials, direct labor and overhead expenses. We recorded raw material and finished goods inventory write-downs totaling approximately \$1.1 million and \$2.2 million for three months ended March 31, 2012 and 2011, respectively, and \$4.6 million and \$3.3 million for the nine months ended March 31, 2012 and 2011, respectively. These charges are classified in cost of product sales in our Condensed Consolidated Statements of Income.

6. INTANGIBLE ASSETS**General**

Intangible assets recorded on our accompanying Condensed Consolidated Balance Sheets consisted of the following:

	March 31, 2012	June 30, 2011
Goodwill	\$ 19.1	\$ 20.3

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Finite lived intangible assets, net	135.1	136.4
Less: royalty advances and licensed or acquired technologies, short-term	(6.6)	(2.8)
Total long-term intangible assets, net	\$ 147.6	\$ 153.9

Certain of our intangible assets including goodwill are denominated in foreign currency and, as such, include the effects of foreign currency translation.

Goodwill

The changes in the carrying amount of goodwill for the nine months ended March 31, 2012 include:

Goodwill balance at June 30, 2011	\$ 20.3
Foreign currency translation adjustment	(1.2)
Goodwill balance at March 31, 2012	\$ 19.1

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Other Intangible Assets

Other intangible assets consisted of the following:

	Useful Life (Years)	Cost	March 31, 2012 Accumulated Amortization	Net	Cost	June 30, 2011 Accumulated Amortization	Net
Finite lived intangible assets:							
Royalty advances for licensed brands, talent, music and other	1 - 15	\$ 118.5	\$ (92.8)	\$ 25.7	\$ 104.2	\$ (83.1)	\$ 21.1
Developed, licensed or acquired technologies	1 - 15	116.6	(23.4)	93.2	117.2	(18.1)	99.1
Patents, trademarks and other	4 - 17	34.3	(18.1)	16.2	34.8	(18.6)	16.2
Total		\$ 269.4	\$ (134.3)	\$ 135.1	\$ 256.2	\$ (119.8)	\$ 136.4

The following table summarizes additions to other intangible assets during the nine months ended March 31, 2012:

	Total Additions
Finite lived intangible assets:	
Royalty advances for licensed brands, talent, music and other	\$ 14.3
Developed, licensed or acquired technologies	2.9
Patents, trademarks and other	2.5
Total	\$ 19.7

Amortization expense for our finite-lived intangible assets was \$6.1 million and \$3.7 million for the three months ended March 31, 2012 and 2011, respectively, and \$16.9 million and \$13.4 million for the nine months ended March 31, 2012 and 2011, respectively.

The actual amortization expense for our finite-lived intangible assets for the past three years, including \$14.4 million recorded as impairment charges in fiscal 2011, and estimated aggregate amortization expense for other intangible assets for each of the next five years and thereafter is as follows:

	Actual			Remaining	Estimated					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	Thereafter
	\$14.2	21.1	38.3	6.7	23.3	22.4	18.7	15.8	14.5	33.7

The estimated aggregate future intangible asset amortization at March 31, 2012, does not reflect the significant commitments we have for future payments for intangible assets. If we determine that we may not realize the value of any of the finite lived intangible net assets or commitments, we would record an immediate charge in our Consolidated Statements of Income up to the full amount of these net assets or commitments in the period in which such determination is made. See Note 12. Commitments, Contingencies and Indemnifications to our Condensed Consolidated Financial Statements and Notes thereto in this report.

7. INCOME TAXES

We, or one of our subsidiaries, files income tax returns in the U.S. Federal, various state, local and foreign jurisdictions. Our provision for income taxes for interim periods is based on an estimate of the effective annual income tax rate adjusted for specific items in any particular interim period. The provision differs from income taxes currently payable because certain items of income and expense are recognized in different periods for financial statement purposes than for tax return purposes. The estimated effective income tax rate was approximately 33.8% and 34.9% for the three months ended March 31, 2012 and 2011, respectively, and 34.4% and 33.6% for the nine months ended March 31, 2012 and 2011, respectively. The effective tax rate for the three and nine months ended March 31, 2012 was favorably impacted by a reduction in uncertain tax liabilities for U.S. Federal tax purposes for fiscal 2008 due to the lapse of the statute of limitations and lower net income and a higher domestic manufacturing deduction. The effective tax rate for the three months and nine months ended March 31, 2011, was favorably impacted by 5.5% and 3.0%, respectively or \$0.01 and \$0.02, respectively per diluted share as a result of the retroactive reinstatement of the U.S. Federal Research and Development tax credit for the period January 1, 2010 through December 31, 2010.

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(Unaudited)

Under the assumption that the U.S. Federal Research and Development tax credit legislation, which expired December 31, 2011, is not continued, we expect our effective tax rate will be between 36% and 37% for the remainder of our fiscal 2012.

At March 31, 2012, the total unrecognized tax benefits, including accrued interest and penalties of \$0.2 million (net of the U.S. Federal benefit), were \$3.8 million, which represent the portion that, if recognized, would reduce the effective income tax rate.

We are no longer subject to any significant U.S. Federal tax examinations by tax authorities for years before fiscal 2009, or state, local or foreign income tax examinations by tax authorities for years before fiscal 2007.

8. REVOLVING CREDIT FACILITY

On October 18, 2011, we entered into an amended and restated revolving credit agreement with a group of eight banks. This agreement provides for borrowings up to \$400 million through October 18, 2016, with the ability to expand the facility to \$500 million from the existing lenders willing to increase their commitments or from additional lenders with the consent of the administrative agent. The revolving credit facility requires that we maintain certain financial and non-financial covenants and two financial ratios: a leverage ratio and an interest coverage ratio. These financial and non-financial covenants and financial ratios could limit our ability to acquire companies, declare dividends, incur additional debt, make any distribution to holders of any shares of capital stock or purchase or otherwise acquire shares of our common stock. The maximum leverage ratio is 3.0x, and is computed as total net funded indebtedness outstanding at the end of each quarter divided by the trailing twelve-month earnings before interest, taxes, depreciation and amortization, including share-based compensation and non-cash charges, as specifically defined in the revolving credit agreement. The minimum interest coverage ratio is 3.0x and is computed as trailing twelve-month adjusted earnings before interest, taxes, depreciation and amortization and share-based compensation and non-cash charges divided by trailing twelve-months interest charges, as specifically defined in the revolving credit agreement. The amended and restated revolving credit agreement is unsecured but guaranteed by all of our significant domestic subsidiaries. In addition, the amended and restated revolving credit agreement contains certain limitations on, among other items, investments, loans, advances, and guarantees.

At March 31, 2012, based upon the leverage ratio as defined in the amended and restated revolving credit agreement, no limitations existed for restricted payment purposes. At March 31, 2012, \$35.0 million was outstanding under the amended and restated revolving credit facility. The effective interest rate on our borrowings at March 31, 2012 was 1.5%.

As of March 31, 2012, we maintained an aggregate cash balance of \$13.5 million in non-interest bearing accounts with two of the banks in our \$400 million amended and restated revolving credit agreement. We were in compliance with all of the financial and non-financial covenants and financial ratios required by our \$400 million amended and restated revolving credit agreement as of March 31, 2012.

Prior to entering into this amended and restated revolving credit agreement in October 2011, we had a \$150 million revolving credit agreement.

9. STOCKHOLDERS EQUITY AND EQUITY COMPENSATION PLAN

General

Our authorized common stock consists of 200.0 million shares at \$0.50 par value. Additionally, we have 5.0 million shares of \$0.50 par value preferred stock authorized. The preferred stock is issuable in series, and the relative rights and preferences and the number of shares in each series are to be established by our Board of Directors.

Common Stock Repurchase Program

On August 2, 2010, our Board of Directors announced it was terminating the existing share repurchase program and replacing it with a new \$300 million share repurchase program that expires on August 2, 2013. The timing and actual number of shares repurchased will depend on market conditions. During the nine months ended March 31, 2012, we purchased approximately 3.5% of our common shares outstanding, or 2,094,598 shares, in open market purchases for approximately \$43.2 million at an average cost of \$20.67 per share of which approximately \$1.3 million of common shares was settled and paid in early April 2012. During the nine months ended March 31, 2011, we purchased approximately 2,090,212 shares, in open market purchases for approximately \$80.0 million at an average cost of \$38.26 per share. At March 31, 2012, we had approximately \$155.3 million remaining of our current share repurchase authorization.

Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)****(Unaudited)*****Equity Compensation Plan***

A summary of information with respect to share-based compensation expense included in our Condensed Consolidated Statements of Income for the three and nine months ended March 31, 2012 and 2011, respectively are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Selling and administrative	\$ 2.6	\$ 2.9	\$ 7.4	\$ 9.8
Research and development	1.2	1.7	3.9	5.3
Cost of product sales	0.1	0.0	0.2	0.1
Share-based compensation expense included in pre-tax income	3.9	4.6	11.5	15.2
Income tax benefit related to share-based compensation	(1.5)	(1.8)	(4.4)	(5.8)
Share-based compensation expense included in net income	\$ 2.4	\$ 2.8	\$ 7.1	\$ 9.4
Diluted earnings per share impact of share-based compensation expense	\$ 0.04	\$ 0.05	\$ 0.13	\$ 0.16

Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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(Unaudited)

Stock Options

We grant stock options to certain of our employees, consultants and board of directors. For stock options granted in the March 2012 quarter, the number of stock options awarded to each person varied and the range in fair value on the dates of grant was from \$8.20 – \$9.36 per share based on the Black-Scholes calculation using the following range of assumptions depending on the characteristics of the stock option grant: risk-free interest rates between 0.6% – 0.9%; expected life between 3.7 – 4.0 years; expected volatility of 0.55; and 0.0% dividend yield. Stock option activity was as follows for the nine months ended March 31, 2012:

	Number of Stock Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value(1)
Stock options outstanding at June 30, 2011	4.3	\$ 30.39	4.63	\$ 17.3
Granted	1.5	20.18		
Exercised	(0.0)	14.73		
Expired or Cancelled	(0.1)	30.86		
Forfeited	(0.2)	35.72		
Stock options outstanding at March 31, 2012	5.5	\$ 27.57	4.65	\$ 10.4
Stock options exercisable at March 31, 2012	2.9	\$ 27.84	3.47	\$ 4.9

(1) Intrinsic value is defined as the amount by which the fair value of the underlying stock exceeds the exercise price of a stock option.

Restricted Stock Award Grants

We grant restricted stock and restricted stock units to certain employees and members of our Board of Directors, which vest from a range of two to four years on the grant date anniversary. Restricted stock share and restricted stock unit activity was as follows for the nine months ended March 31, 2012:

	Restricted Stock Shares	Weighted Average Grant-Date Fair Value per Share(1)
Nonvested balance at June 30, 2011	0.1	\$ 29.74
Granted	0.1	20.05
Vested	(0.1)	37.83

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Nonvested balance at March 31, 2012	0.1	\$ 22.30
	Restricted Stock Units (including Performance -based Stock Units)	Weighted Average Grant-Date Fair Value per Share(1)
Nonvested balance at June 30, 2011	0.3	\$ 36.15
Granted	0.2	20.05
Vested	(0.1)	36.36
Nonvested balance at March 31, 2012	0.4	\$ 27.39

- (1) For restricted stock and restricted stock units, grant-date fair value is equal to the closing market price of a share of our common stock on the grant date.

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(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)

(Unaudited)

Equity-Based Performance Units

In September 2011, we granted equity-based performance units to certain employees, which will vest in 2014 only upon achievement of performance goals set by our Board of Directors. The number of shares of stock ultimately issued to participants will depend upon the extent to which the financial performance goals over the three year period ended June 30, 2014, are achieved or exceeded, and can result in shares issued up to 200% of the number of shares under each grant. We record the estimated expense for equity-based performance units outstanding based on our current assessment of achievement of the performance goals. As of March 31, 2012, we concluded that the achievement of the performance goals was not probable for periods ending June 30, 2012, June 30, 2013 and June 30, 2014 and therefore, no expense related to the awards was required.

In August 2011, shares related to the equity-based performance units with a three-year measurement period ending June 30, 2011, were issued in accordance with the performance matrix approved at grant date in 2008. Equity-based performance unit activity was as follows for the nine months ended March 31, 2012:

	Equity- based Performance Units	Weighted Average Grant-Date Fair Value per Share(1)
Nonvested balance at June 30, 2011	0.3	\$ 36.79
Granted	0.2	20.05
Vested at 90% of target	(0.1)	29.35
Nonvested balance at March 31, 2012	0.4	\$ 29.53

(1) For equity-based performance units, grant-date fair value is equal to the closing market price of a share of our common stock on the grant date.

Employee Stock Purchase Plan

Effective July 1, 2010, we adopted an Employee Stock Purchase Plan (ESPP) as defined under Section 423 of the Internal Revenue Code allowing eligible employees to elect to make contributions through payroll deductions which will be used to purchase our common stock at a purchase price equal to 85% of the fair value of a share of common stock on the date of purchase. We have reserved 500,000 shares for issuance under the ESPP. For the nine months ended March 31, 2012, an aggregate of 72,988 shares were purchased under this plan at an average cost of \$17.25 compared to an aggregate of 45,536 shares that were purchased under this plan at an average cost of \$32.80 for the nine months ended March 31, 2011.

10. COMPREHENSIVE INCOME

Comprehensive income consists of the following:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Net income	\$ 22.1	\$ 24.2	\$ 42.0	\$ 70.7
Foreign currency translation adjustment	1.3	2.9	(4.1)	8.2
Total comprehensive income	\$ 23.4	\$ 27.1	\$ 37.9	\$ 78.9

11. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The net amount of gaming operations and engineering machines transferred to inventory, a non-cash investing activity, was \$3.5 million and \$4.0 million for the nine months ended March 31, 2012 and 2011, respectively.

During the nine months ended March 31, 2012, we retired \$77.2 million of gaming operations equipment, which had zero net book value.

12. COMMITMENTS, CONTINGENCIES AND INDEMNIFICATIONS

We routinely enter into license agreements with others for the use of brands, intellectual properties and technologies in our products. These agreements generally provide for royalty advances and license fee payments when the agreements are signed and minimum commitments, which are cancellable in certain circumstances.

Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)****(Unaudited)**

At March 31, 2012, we had total royalty and license fee commitments, advances and payments made and potential future royalty and license fee payments as follows:

	Minimum Commitments
Total royalty and license fee commitments	\$ 216.5
Advances and payments made	(142.0)
Potential future payments	\$ 74.5

At March 31, 2012, we estimate that potential future royalty payments in each fiscal year will be as follows:

	Minimum Commitments
2012 (remaining three months of fiscal year)	\$ 0.7
2013	16.8
2014	18.3
2015	15.6
2016	15.1
2017	8.0

Non-Cancelable Raw Material Purchase Orders

Commitments under non-cancelable raw materials purchase orders were approximately \$3.9 million at March 31, 2012, and \$6.2 million at June 30, 2011.

Performance Bonds

We have performance bonds outstanding of \$5.3 million at March 31, 2012, related to product sales, and we are liable to the issuer in the event of exercise due to our non-performance under the contract. Events of non-performance do not include the financial performance of our products.

Indemnifications

We have agreements under which we may be obligated to indemnify other parties with respect to certain matters. Generally, these indemnification provisions are included in sales orders and agreements arising in the normal course of business under which we customarily agree to hold the indemnified party harmless against claims arising from a breach of representations related to matters such as title to assets sold and licensed, defective equipment or certain intellectual property rights. Payments by us under such indemnification provisions are generally conditioned on the other party making a claim. Such claims are typically subject to challenge by us and to dispute resolution procedures specified in the particular sales order or contract. Further, our obligations under these agreements may be limited in terms of time and/or amount and, in some instances, we may have recourse against third parties. It is not possible to predict the maximum potential amount of future payments under these indemnification agreements due to the conditional nature of the obligations and the unique facts of each particular agreement. Historically, we have not made any payments under these agreements that have been material individually or in the aggregate. At

March 31, 2012, we were not aware of any obligations arising under indemnification agreements that would require material payments.

We have agreements with our directors and certain officers that require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We have also agreed to indemnify certain former officers and directors of acquired companies. We maintain director and officer insurance, which may cover our liabilities arising from these indemnification obligations in certain circumstances. As of March 31, 2012, we were not aware of any obligations arising under these agreements that would require material payments, except we are providing indemnification of officers and directors named in securities claims lawsuits described in Note 13. Litigation , but it is too early in these claims to ascertain the extent of any such indemnification.

Special Purpose Entities and Derivative Instruments

We do not have any special purpose entities for investment or the conduct of our operations. We have not entered into any derivative financial instruments, although we have granted stock options, restricted stock, equity based performance units and deferred stock units to our employees, officers, directors and consultants and warrants to a licensor.

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Letters of Credit

Outstanding letters of credit issued under our revolving credit facility to ensure payment to certain vendors and government agencies totaled \$0.7 million at March 31, 2012. As of March 31, 2012, there was approximately \$365.0 million of available borrowings under the revolving credit facility. Availability under the revolving credit facility is reduced by the outstanding letters of credit.

WMS Licensor Arrangements

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

Self-Insurance

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

Product Warranty

We generally warrant our new gaming machines sold in the U.S. for a period of 365 days, while we generally warrant our gaming machines sold internationally for a period of 180 days to one year. Our warranty costs, net have not been significant.

13. LITIGATION

Securities Claims

On May 25, 2011, a putative class action was filed against us and certain of our executive officers in the U.S. District Court for the Northern District of Illinois by Wayne C. Conlee (the "Conlee lawsuit"). On October 13, 2011, the lead plaintiff filed an amended complaint in the Conlee lawsuit. As amended, the lawsuit alleges that, during the period from September 21, 2010 to August 4, 2011, (the date the Company announced its fiscal 2011 financial results), the Company made material misstatements and omitted material information related to its fiscal year 2011 guidance. Plaintiff seeks to certify a class of stockholders who purchased stock between these dates. The lawsuit specifically alleges violations of (i) Section 10(b) of the Securities Exchange Act of 1934, as amended (the "34 Act"), and Rule 10b-5 promulgated thereunder and (ii) Section 20(a) of the 34 Act. The amended complaint seeks unspecified damages. Defendant's filed a motion to dismiss the amended complaint on December 8, 2011, which has since been fully briefed. It is not certain when the court will rule on the motion.

On June 29, 2011, a derivative action was filed in the U.S. District Court for the Northern District of Illinois by David Garay against the current board of directors of the Company as well as a former director (the "Garay lawsuit"). The Company is named as a nominal defendant. The complaint asserts essentially the same allegations that were made in the Conlee lawsuit about the Company's fiscal year 2011 guidance, and alleges the following causes of action: (i) breach of fiduciary duty, (ii) gross mismanagement, (iii) contribution and indemnification from the individual defendants in the event future claims are made against the Company as a result of the individual defendants' alleged misconduct,

(iv) abuse of control, and (v) waste of corporate assets. The complaint seeks unspecified damages.

On July 22, 2011, an additional derivative action was filed in the U.S. District Court for the Northern District of Illinois by the Plumbers & Pipefitters Local 152 Pension Fund and UA Local 152 Retirement Annuity Fund against the Company's current board of directors, a former director, and certain of our officers (the Pipefitters lawsuit and, collectively with the Conlee and Garay lawsuits, the Securities Litigation). The Company is named as a nominal defendant. The facts alleged in the Pipefitters lawsuit are similar to those alleged in the Conlee and Garay lawsuits, but also include allegations of insider trading in connection with alleged sales of WMS stock made by certain officers and directors in the November 2010 period. The Pipefitters lawsuit specifically alleges the following causes of action: (i) breach of fiduciary duty, (ii) waste of corporate assets, (iii) unjust enrichment, and (iv) indemnification and contribution from the individual defendants in the event future claims are made against the Company as a result of the individual defendants' alleged misconduct. In addition to unspecified damages, the Pipefitters lawsuit seeks injunctive relief requiring the Company to adopt strengthened corporate governance policies and measures to prevent insider trading, as well as disgorgement of the alleged wrongful profits. The Garay and Pipefitters lawsuits have been consolidated and reassigned to the judge who is presiding over the Conlee lawsuit. In addition, both the Pipefitters lawsuit and the Garay lawsuit have been stayed pending the resolution of the motion to dismiss that was filed in the Conlee lawsuit.

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Although we believe that we have meritorious defenses to the claims made in the Securities Litigation, and intend to contest the lawsuits vigorously, it is too early in these proceedings to predict the outcome of the Securities Litigation or to reasonably estimate the range of possible loss, if any, related to these lawsuits.

Pursuant to our Bylaws and the indemnification agreements with each member of the Board of Directors and officers, the Company is indemnifying and defending each of the individual defendants named in the Securities Litigation.

B Plus & Related Party Claims

On April 9, 2010, B Plus Giocolegale Ltd. (B Plus) filed an action against WMS Gaming International SL (Spain), WMS International SL (Italy) and WMS International SL (the Netherlands) in the tribunal civil court in Rome, Italy. WMS Gaming International SL is an indirect, wholly owned subsidiary of the Company. The complaint contains two counts, alleging (i) breach of contract arising from the termination by WMS Gaming Inc. (WMS Gaming) of a sales order to supply certain slot machines and (ii) pre-contractual liability arising from WMS Gaming s decision to terminate negotiation relating to potential distribution of WMS products in the Italian market (the Italian Proceedings). The claim for breach of contract was subsequently withdrawn, and the complaint, as amended, seeks aggregate damages of 127.2 million or such other amount, which the court may award. On May 25, 2011, the Judge for the tribunal civil court in Rome ruled that no further evidence is required for a decision and further noting that the entity with which B Plus contemplated a business arrangement was solely the U.S. company, WMS Gaming Inc., which was not named as a defendant in the Italian Proceedings. The judge s ruling also set a hearing for closing arguments on July 10, 2013. No further activity is expected in the Italian Proceeding prior to that date.

On February 21, 2011, WMS Gaming initiated an action in the Commercial Court of the High Court of Justice, Queen s Bench Division, in London, England against B Plus for declaratory relief of no liability for the alleged breach of contract or pre-contractual liability claims of B Plus. On April 25, 2011, B Plus counterclaimed in the London proceedings asserting claims for breach of contract in connection with the termination of the sales order (the counterclaim, together with WMS Gaming s claims before the Commercial Court are referred to as the UK Proceedings). Following a September 8, 2011, hearing for B Plus motion to postpone or stay the UK Proceedings pending resolution of the Italian Proceedings, the Commercial Court denied the motion and set a schedule for exchange of further pleadings (including allowing B Plus to counterclaim in respect of the pre-contractual liability claim for damages for the wrongful termination of negotiations for distribution of product in Italy) and witness statements and a pre-trial review in mid-September, 2012. Trial is currently scheduled to commence November 12, 2012.

On May 23, 2011, St. Maarten Games N.V. (SMG) filed an action against WMS Gaming in the Court of First Instance in Sint Maarten, alleging, in principal, that it is a party or third party beneficiary of the sales order entered into between WMS Gaming and B Plus and claiming relief for the alleged wrongful cancellation and/or breach of that agreement by WMS Gaming (the Sint Maarten Proceedings). SMG also alleges that it is an affiliate of B Plus. The claim seeks equitable relief through the delivery of the gaming machines and accessories covered by the sales order plus damages for each day of delay and payment of damages in the amount of U.S. \$19.7 million plus costs. WMS Gaming has filed a motion to decline jurisdiction and an initial response to this claim. The parties have since reached an agreement to stay further proceedings in this action pending a final and conclusive ruling in the UK proceedings.

While the outcome of the Italian Proceedings cannot be predicted, we believe that we have meritorious defenses to the claims in that proceeding and do not currently expect an adverse ruling in that action that would be material to WMS. With respect to both the UK Proceedings and the Sint Maarten Proceedings, it is too early in each of these cases to predict the outcome or to reasonably estimate the possible range of losses, if any. We believe, however, that we have meritorious defenses to the counterclaims in the UK Proceeding and to the claims in the Sint Maarten Proceeding and intend to defend these proceedings vigorously.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K filed with the SEC on August 29, 2011 (Form 10-K). This discussion and analysis also contains forward-looking statements and should also be read in conjunction with the disclosures and information contained in Cautionary Note and Item 1A. Risk Factors in our Form 10-K and our more recent reports filed with the U.S. Securities and Exchange Commission. The following discussion and analysis is intended to enhance the reader's understanding of our business environment.

As used in this Report, the terms we, us, our, and WMS mean WMS Industries Inc., a Delaware corporation, and its subsidiaries. All references to years, unless otherwise noted, refer to our fiscal year, which ends on June 30. All references to quarters, unless otherwise noted, refer to the quarters of our fiscal year.

Product names mentioned in this Report are trademarks of WMS Gaming Inc., except for the following: BATTLESHIP, CLUE and MONOPOLY are trademarks of Hasbro. Used with permission. ©2012 Hasbro. All rights reserved. FACEBOOK is a registered trademark of Facebook, Inc. G2S and S2S are registered trademarks of the Gaming Standards Association. THE WIZARD OF OZ and all related characters and elements are trademarks of and © Turner Entertainment Co. (s12) Judy Garland as Dorothy from THE WIZARD OF OZ. (s12)

OVERVIEW

Our mission is: through imagination, talent and technology, we create and provide the world's most compelling gaming experiences. We serve the legalized gaming industry by designing, manufacturing and distributing games, video and mechanical reel-spinning gaming machines and video lottery terminals (VLTs) to authorized customers in legal gaming venues worldwide. Our products are installed in all of the major regulated gaming jurisdictions in the United States, as well as in approximately 140 international gaming jurisdictions. We generate revenue in two principal ways: product sales and gaming operations, as further described below. In fiscal 2010, we expanded the markets where we directly distribute our products by launching directly into Class II gaming markets in the United States and entering the Mexico and New South Wales, Australia markets and we continue to further penetrate these markets. We had previously served these markets through content licensing agreements with third parties for our game themes. In the December 2010 quarter, we launched an online casino site for residents in the United Kingdom, although we did not begin to market the site until February 2011. In the June 2011 quarter, we received the first regulatory approval for our WAGE-NET® networked gaming system, the first family of portal applications, the Ultra Hit Progressive® (UHP) family, and the first game in the UHP family, the Jackpot Explosion® theme, and since then we have received additional approvals for these products and other networked gaming products in other gaming jurisdictions. In fiscal 2012 and fiscal 2013, we expect to further penetrate each of the new markets and businesses we have entered over the last two years and look to further expand our distribution channels.

The recession and financial market crisis that began in 2008 has continued to disrupt the economy worldwide, reduced consumer discretionary spending and has led to a weakened global economic environment, all of which have created significant challenges for our industry. In calendar 2008 and 2009, some gaming operators delayed or canceled construction projects, resulting in fewer new casino openings and expansions in calendar 2010 and even fewer in calendar 2011, coupled with many customers reducing their annual capital budgets for replacing gaming machines. We do expect new unit demand for new casino openings and casino expansion to increase in calendar 2012. The economic crisis reduced disposable income for casino patrons resulting in fewer patrons visiting casinos, although this has recently improved, and lower spending by those patrons who did visit casinos. The economic crisis and increased competition from our competitors lowered the number of new units we sold in fiscal 2010, and this continued in fiscal 2011 and thus far in fiscal 2012.

With no leading indicators showing any significant increase in replacement demand for gaming machines for calendar 2011 or the rest of calendar 2012, we conducted a thorough review of our business strategies and product plans late in fiscal 2011 and early fiscal 2012. As a result of the strategic review, we refined our product plans and restructured our organization to sharpen emphasis on our game content and product development strengths. Specifically, we have streamlined our product management and product development functions, simplified product plans and further prioritized on-time commercialization of new game themes, products and portal gaming applications for our core product sales and gaming operations businesses. As part of our restructuring we implemented a 10% reduction in our workforce.

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Based upon our decisions stemming from our product, strategy and cost structure reviews, in the three-month period ended June 30, 2011, we recorded \$24.0 million of net pre-tax charges, or \$0.26 per diluted share, which included \$18.4 million, or \$0.20 per diluted share, of pre-tax impairment and restructuring charges. These charges were comprised of \$16.0 million or \$0.17 per diluted share for non-cash asset impairments (including \$11.0 million for impairment of technology licenses, \$3.4 million for impairment of the *Orion* brand name and \$1.4 million of impairment of receivables related to government action to close casinos in Venezuela) and \$2.4 million or \$0.03 per diluted share for restructuring charges (primarily separation-related costs), along with \$9.6 million of pre-tax charges, or \$0.10 per diluted share, for asset write-downs and other charges (including inventory charges related to winding down the *Orion* and original *Bluebird* product lines), partially offset by \$4.0 million or \$0.04 per diluted share from cash proceeds of litigation settlement.

In the nine months ended March 31, 2012, we recorded \$9.7 million of net pre-tax charges or \$0.12 per diluted share, which includes \$9.1 million, or \$0.11 per diluted share of cash-based restructuring charges, primarily separation-related charges and costs related to the decision to close two facilities, along with \$0.6 million, or \$0.01 per diluted share, of non-cash impairment charges related to closing two facilities. In addition, during the nine months ended March 31, 2012, we recorded \$4.3 million or \$0.05 per diluted share of non-cash charges to write-down receivables following government enforcement actions at certain casinos in Mexico. After an attack that burned down a casino in the Monterrey province in late August 2011, various Mexican government agencies have been inspecting fire and safety preparations, import paperwork on gaming machines and other facets of casino operations. As a result, some casinos have closed permanently and some temporarily, and some gaming machines have been seized until the proper paperwork has been submitted and approved. Because of these actions, fewer people have been visiting the Mexican casinos and overall demand for new units has declined. This situation has been very dynamic and while government actions continued to diminish in the March 2012 quarter, we continue to closely monitor the situation.

We had expected that with our launch of the network gaming-enabled *Bluebird2* gaming machines in the December 2008 quarter, concurrent with certain of our competitors launching their networked gaming-enabled products, the industry would experience an improvement in the replacement cycle, which had been at an abnormally low level. However, as discussed above, the economy slowed just as the new gaming machines were being launched, so we did not see the expected improvement in the replacement cycle. We believe that as the economy improves and gaming operators see meaningful improvements in their profitability and cash flows, they will increase their annual capital budgets for replacement units, which will improve the replacement demand in future years, although we cannot predict when this will occur or the rate of increase in their capital budgets. In addition, based on our discussions with customers, we expect to experience higher demand from casino expansions and new casino openings in new and expanding gaming jurisdictions in calendar 2012 than in calendar 2011.

We believe several recent developments fueled by the challenging economic situation could expand our revenue opportunities over the long term. In the United States, legislators have passed or are considering enabling new or expanded gaming legislation in Ohio, Illinois, Kansas, Kentucky, Iowa, Maryland, California, New Hampshire, New York, Florida, Maine and Massachusetts. Internationally, Singapore opened as a new market in fiscal 2010 and a new VLT market in Italy has opened in fiscal 2011, although the growth of this market has been delayed due to regulatory requirements. In addition, legislation has been passed or discussed in Greece, Brazil, Japan and Taiwan that could open new market opportunities although the timing for any such openings is uncertain. In the United States, federal legislators and certain state legislators and governments in Canada and Europe are considering legalizing certain forms of online gaming, which if passed could expand our revenue opportunities. The breadth and timing of these opportunities remain uncertain due to the political process in each of these jurisdictions, as well as the difficult credit environment facing our customers and the risk of continued economic uncertainty.

We review certain financial measures in assessing our financial condition and operating performance not only in connection with creating our forecasts and in making comparisons to financial results from prior periods, but also in making comparisons to our competitors' financial results and our internal plans. We focus on fluctuations in revenue, number of new units sold, average selling price, average participation installed base and average revenue per day, cost and gross margin on both products sales and gaming operations and also pay close attention to our operating income, operating margin, effective tax rate, net income, diluted earnings per share, total cash, total accounts and notes receivable, inventories and accounts payable and cash flows from operations as they are key indicators of our performance. We also measure changes in selling and administrative (S&A) expenses as a percent of revenue, which indicate management's ability to control costs, as well as changes in research and development (R&D) costs as a percent of revenue, which demonstrate investment in technology and product development. Finally, we measure depreciation expense as a percentage of revenues as an indicator of the current cost of capital expenditures, primarily in our gaming operations business. The measures listed above are not a comprehensive list of all factors considered by us in assessing our financial condition and operating performance, and we may consider other individual measures as required by trends and discrete events arising in a specific period, but they are the key indicators and these measures are discussed herein.

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Product Sales

Product sales revenue includes the sale to casinos and other gaming machine operators of new and used gaming machines and VLTs, parts and conversion kits (including game theme, hardware or operating system conversions). We derive product sales revenue from the sale of the following:

- Ø Multi-line, multi-coin video gaming machines, in our *Bluebird*, *Bluebird2*, *Bluebird2e* and *Bluebird xD* and Orion Gaming *Twinstar* , *Twinstar2* and *Helios* branded gaming machines;
- Ø Mechanical reel-spinning gaming machines in our *Bluebird*, *Bluebird2* and *Bluebird xD* branded gaming machines;
- Ø Replacement parts and conversion kits for our *Bluebird*, *Bluebird2*, *Bluebird xD*, *Twinstar*, *Twinstar2*, *Helios* and *CPU-NXT®* and *CPU-NXT2* upgrade kits; and
- Ø Used gaming machines manufactured by us or our competitors that are acquired on a trade-in basis or that we previously leased to casinos as participation gaming machines.

In September 2010, we closed our Orion Financement Company (Orion Gaming) manufacturing facility and, in June 2011, we sold this facility and began winding down the manufacturing of our Orion Gaming product lines, which will occur over fiscal 2012. We will continue to provide support for spare parts related to Orion Gaming product lines for several years. In July 2011, we sold our Systems In Progress GmbH subsidiary (SiP). These two subsidiaries were immaterial to our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows. In fiscal 2011, we also notified our customers that we were winding down the support for our *Bluebird* gaming machines with no new game content available after July 1, 2012 but we would continue to service and supply replacement parts through July 2015.

Gaming Operations

We earn gaming operations revenues from leasing participation games, gaming machines and VLTs, earn royalties that we receive from third parties under license agreements to use our game content and intellectual property and, beginning in fiscal 2011, earn revenues from operating an online casino in the United Kingdom and network gaming revenues and, beginning in fiscal 2012, earn revenues from offering a social game on *Facebook* and selling select WMS games that have been ported to operate on mobile devices.

Our gaming operations include the following product lines:

- Ø Participation gaming machines, which are gaming machines owned by us that we lease under an operating lease based upon any of the following payment methods: (1) a percentage of the net win, which is the casino's earnings generated by casino patrons playing the gaming machine; (2) fixed daily fees; or (3) a percentage of the amount wagered (coin-in) or a combination of a fixed daily fee plus a percentage of the amount wagered. We have the ability to lease these gaming machines on a participation basis because of the superior performance of the game and/or the popularity of the brand, which generates higher wagering and net win to the casinos or gaming machine operators than the gaming machines we sell outright. Participation games include:
 - Ø Wide-area progressive (WAP) participation games;
 - Ø Local-area progressive (LAP) participation games; and

- Ø Stand-alone participation games.

- Ø Casino-owned daily fee games, where the casino or gaming machine operator purchases the base gaming machine and pays a lower daily lease fee for the top box and game;

- Ø Gaming machines with for-sale game themes placed at casinos under operating lease arrangements;

- Ø VLTs;

- Ø Revenues from licensing our game content and intellectual properties to third parties;

- Ø Revenues from our online gaming casino in the United Kingdom, which was launched in November 2010, and beginning in fiscal 2012 revenues from our *Lucky Cruise* social game on *Facebook* and revenues from the sale of select WMS games that have been ported to operate on mobile devices; and

- Ø Beginning in June 2011, networked gaming revenues where the casinos or other gaming machine operators use our *WAGE-NET* networked gaming system to link groups of gaming machines to servers in their casino's data center that allows casinos and other gaming machine operators to purchase new applications and system-wide features for distribution over the *WAGE-NET* system.

OUR FOCUS

We continue to operate in a challenging economic environment and the combination of economic uncertainty, lower demand for replacement products and reduced opportunities from new or expanded casinos has negatively impacted our industry. We expect to benefit from certain new and expansion projects currently in process in calendar 2012, but the breadth and timing of such opportunities remains uncertain due to the difficult credit environment facing our customers and the risk of continued economic uncertainty.

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As we navigate these difficult macroeconomic challenges, we remain focused on five key strategic priorities: 1) grow our United States and Canadian market share by innovating differentiated products; 2) expand the breadth and profitability of our international business; 3) drive growth in our gaming operations business, while selectively investing our capital deployed in that business; 4) improve our gross margins and operating margins; and 5) increase our cash flow from operations.

1. *Strategic Priority:* Grow our United States and Canadian market share by innovating differentiated products.

Quarter Ended March 31, 2012, Result: The United States and Canadian replacement cycle has been abnormally low for several years and the challenges facing our industry and the overall economy have continued, all of which have reduced overall industry demand from previous levels. We believe capital budgets for replacing gaming machines were flat for calendar 2011 compared to calendar 2010; however, new casino openings and casino expansions declined over prior calendar year levels. We expect new unit demand from new casino openings and expansions to be higher in calendar 2012, which increased new unit sales in the March 2012 quarter and should continue to benefit our June 2012 quarter results. Although, this is a challenging environment, our year-over-year new unit shipments on which we recognized revenues was up 23.6% from the prior-year period for U.S. and Canadian shipments. We believe our share of new units shipped amongst our competitive set was flat in the March 2012 quarter compared to the March 2011 quarter. To further diversify our revenue streams, we directly entered the Class II and central determinant market in fiscal 2010 following expiration of our previous licensing agreements for those markets. Through an agreement with Bluberi Gaming Technologies Inc. (Bluberi), a Canadian-based technology firm, over time we expect to combine our existing library of for-sale games with the proven system capabilities that we acquired from Bluberi for the Class II and central determinant markets. We shipped our first gaming machines to a Class II market in the September 2009 quarter, and we have continued to penetrate this market in subsequent quarters as we received additional regulatory approvals, and we expect that shipments to these markets in fiscal 2012 will exceed shipments in fiscal 2011. We launched our *Bluebird xD* gaming machine late in the June 2010 quarter and, given initial customer response, we expect strong demand for this product throughout fiscal 2012. For the three months ended March 31, 2012, *Bluebird xD* gaming machines accounted for 31.4% of our new unit sales in the U.S and Canada. We launched an enhanced version of our *Bluebird2* product, the *Bluebird2e* cabinet, in the March quarter which contains an emotive lighting feature and we expect that most of our future shipments of *Bluebird2* product will be the new *Bluebird2e* product. During the March quarter, the new *Bluebird2e* product represented 33.0% of new unit sales in the U.S. and Canada. We are dependent, in part, on innovative new products, casino openings and expansions, continued market penetration and new market opportunities to generate growth. We have continued to invest in research and development activities to be able to offer creative and high earning products to our customers and in the three months ended March 31, 2012, such expenses totaled \$22.1 million or 12.6% of revenues, down \$5.6 million, or 20.2%, compared to the prior-year period primarily due to the realignment of our product plan beginning this past summer and our cost containment and restructuring initiatives. Expansion and new market opportunities may come from political action as governments look to gaming to provide tax revenues in support of public programs and view gaming as a key driver for tourism.

2. *Strategic Priority:* Expand the breadth and profitability of our international business.

Quarter Ended March 31, 2012, Result: Shipments to international markets represented 23.3% of our total new unit shipments in the three months ended March 31, 2012, compared with 38.6% for the prior-year period, as economic challenges are evident in several regions, principally in Western Europe, and demand from Mexican and Australian customers also declined due to unique circumstances in each market. Demand from Mexican customers was lower following government enforcement actions at certain casinos in Mexico that began in the September 2011 quarter and demand from Australian customers was lower as they await enablement of national vs. state gaming standards regulation. Also, we believe the higher-priced *Bluebird2*, *Bluebird xD* and *Bluebird2e* units had an impact on the unit volume customers were able to buy with fixed capital budgets. In fiscal 2010, we directly entered the new market in Singapore and entered two international markets new to WMS, as we had previously served them through content licensing arrangements: New South Wales, Australia and Mexico. In the March 2010 quarter in New South Wales, Australia, we began shipping products as our distributor received regulatory approval for our *Bluebird2* video gaming machine and the first three game themes. We have since received additional game theme approvals, approvals for our *Bluebird2* mechanical reel gaming machine and, in the March 2012 quarter, approval for our *Bluebird xD* gaming machine. Recent requirements of new national gaming technology standards for Australia will require us to modify our products, although we are allowed to continue to sell previously approved products during a transition period. We began shipping product into Mexico in the September 2009 quarter and have continued to penetrate this market, although as discussed above, recent government enforcement action against casinos resulted in lower demand since the September 2011 quarter and may impact demand in the future. We are still preparing to launch our products in the new VLT market in Italy in the future. Although much effort is still needed before the first revenue-earning WMS gaming machines are placed in Italy, we will have additional development work to complete as a result of new requirements that the regulator has mandated in Italy that will be effective after a transition period. In addition, we continue to achieve benefits from the opening of new

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international offices and the addition of new geographically dispersed sales account executives. We also launched the *Bluebird xD* gaming cabinet in late June 2010, which will continue to benefit our shipments into the international markets in fiscal 2012 and in the March 2012 quarter launched the new *Bluebird2e* gaming machine.

3. *Strategic Priority:* Drive growth in our gaming operations business, while selectively investing our capital deployed in that business. *Quarter Ended March 31, 2012, Result:* Gaming operations revenues were down \$7.1 million in the March 2012 quarter compared to the prior-year period, reflecting a 9.0% decrease in the average installed base to 9,115 participation units compared to 10,021 in the March 2011 quarter and average daily revenue of \$68.06 compared with \$76.14 a year ago and \$67.62 in the December 2011 quarter. The decline in the installed base resulted from certain game series reaching the end of life and us not having enough new participation games approved to replace those older games. Our focus in fiscal 2012 and fiscal 2013 is to obtain a more normal flow of new product approvals beginning in the second half of fiscal 2012 and increase the percentage of the installed base whose revenues are based on a percentage of coin-in, as they generate the highest gross profit dollars of our three operating lease pricing models. We were successful in this effort as coin-in gaming machines grew from 38.3% of the installed base at March 31, 2011, to 39.4% of the installed base at March 31, 2012, although the actual number of such units declined from a year-ago period as our overall installed base had declined. Near the end of the September 2011 quarter, we received initial approvals from the first jurisdiction for four unique, new participation games *BATTLESHIP*, *THE WIZARD OF OZ Journey to Oz*, *Leprechaun's Gold*[®] and *Pirate Battle*[®] themes. Although the regulatory approval and commercial launch of these games occurred too late in the quarter to provide meaningful benefit in the installed footprint and revenue per day, the additional jurisdictional approvals we have subsequently received and the recent roll-out of these four high profile game themes, along with the recent initial approval of our new *Epic MONOPOLY* and *CLUE* games are expected to provide us with the opportunity to refresh and stabilize the installed base. In the March 2012 quarter, with a larger number of participation games to deploy, we were able to increase the participation installed base as it was up 107 units from December 31, 2011 and we expect with more approvals for new participation games that we will be able to increase the installed base of participation games in the June 2012 quarter. Our strategy is to focus on return on investment of our gaming operations assets, which includes limiting the number of gaming machines for a new theme at each casino and re-deploying gaming machines from casinos generating lower revenue per day to casinos generating higher revenue per day. By controlling the initial placement of participation products, we continued to limit the capital invested in gaming operations. In fiscal 2011 and continuing into fiscal 2012, we are investing more capital into our gaming operations business to convert our existing installed base of *Bluebird* gaming machines to our newer *Bluebird2*, *Bluebird xD* and *Bluebird2e* gaming machines.

4. *Strategic Priority:* Improve our gross margins and operating margins. *Quarter Ended March 31, 2012, Result:* Our operating margin decreased 40 basis points to 17.7% for the three months ended March 31, 2012, from 18.1% for the prior-year period. Our total gross margin increased to 62.6% from 60.7%. Our product sales gross margin increased to 51.8% in this year's period from 48.6% last year due to ongoing cost reduction efforts and the mix of business in the quarter, partially offset by the impact of a lower average selling price. The gross margin benefit from higher-margin conversion kit revenue was partially offset by lower parts sales and the lower margin on used gaming machine sales. Our gaming operations gross margin was essentially flat at 80.7% in the March 2012 quarter compared with 80.8% in the March 2011 quarter. As a result of our reduction in force in the September 2011 quarter, coupled with other cost savings measures, our research and development expenses decreased year-over year by \$5.6 million, or 20.2% and our selling and administrative expenses decreased year-over year by \$2.4 million, or 6.6%. Our depreciation and amortization expense increased by \$4.7 million, or 25.5%, due to higher capital spending in our gaming operations business to upgrade our installed base to new *Bluebird2* and *Bluebird xD* gaming machines and with the launch of our online and networked gaming businesses in fiscal 2011, we have begun to amortize the related capitalized software development costs. We are still implementing our lean sigma and strategic sourcing initiatives, and we continue to realize positive results. We believe these initiatives will continue to drive margin improvement in future years, especially with the *Bluebird xD* and new *Bluebird2e* product line, where we expect to improve gross margins to be comparable to our *Bluebird2* product line. Longer term, we expect to benefit from higher average selling prices coupled with an expanded volume of business that should result in greater volume discounts from our raw material suppliers and enable us to spread our manufacturing overhead costs over a larger number of units thereby reducing the cost per unit. We also expect our gaming operations business will continue to expand with both the installed base and revenue per day increasing in the second half of fiscal 2012 and fiscal 2013. In addition, through disciplined cost management, we continue to expect to realize operating leverage from higher revenues as our total operating costs are not expected to grow at the same percentage as revenues. Our research and development spending decreased to 12.6% as a percentage of revenues from 14.4% of revenues in the prior-year period primarily caused by our product plan refinement and cost containment and restructuring initiatives. We expect that our annual research and development expenses will be around 13% to 14% as a percentage of revenue for fiscal 2012. We believe our product development capabilities, combined with additional functionalities and enhanced features of our advanced technologies and gaming platforms, enable us to optimize the entertainment value of our products and improve our gross margins and operating margins. Our selling and administrative expenses increased by 40 basis points as a percentage of revenues to 19.1% in the three months ended March 31, 2012, as the impact from our cost containment and restructuring initiatives did not offset

the impact from lower revenues. Our depreciation and amortization expense increased by 360 basis points as a percentage of revenue for the three months ended March 31, 2012, due to higher depreciation stemming

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from the increased investment in gaming operations machines to upgrade our installed base to new products coupled with higher amortization of capitalized software development costs a result of the launch of the network gaming and online gaming businesses over the last 12 months. We expect selling and administrative expenses to decline as a percentage of revenues in fiscal 2012, but due to higher capital spending in our gaming operations business and the launch of both the networked gaming and our online gaming business in fiscal 2011, that depreciation and amortization expense will increase as a percentage of revenues in comparison over the prior-year periods.

5. *Strategic Priority:* Increase our cash flow from operations.

Quarter Ended March 31, 2012, Result: For the three months ended March 31, 2012, cash flow provided by operating activities was \$40.9 million, a \$15.3 million, or 27.2%, decrease from cash provided in operating activities of \$56.2 million in the March 2011 quarter. The quarterly results reflect a year-over-year: (1) decrease in net earnings partially offset by an increase in depreciation and amortization; (2) lower other non-cash items and share-based compensation expense partially offset by an increase in deferred taxes; and (3) a higher negative impact of changes in operating assets and liabilities, primarily related to a larger increase in total accounts receivable and other current assets partially offset by a lower year-over-year impact from lower current liabilities. Our cash used from investing activities were higher compared to the prior period due to increases in investment in both gaming operations capital and property, plant and equipment partially offset by lower payments to license or acquire intangible and other assets.

The priorities for the utilization of our cash flow are to: continue to enhance stockholder value by emphasizing internal and external investments to create and license advanced technologies and intellectual property; seek acquisitions or licensing deals that can extend our presence and product lines, increase our distribution channels, enhance our intellectual property portfolio and expand our earnings potential; and, when appropriate, repurchase shares in the open market or in privately negotiated transactions. For the three months ended March 31, 2012, our research and development spending decreased \$5.6 million compared to the prior year to \$22.1 million and we spent \$16.8 million on property, plant and equipment and \$22.5 million on additions to gaming operations equipment, and we funded approximately \$4.8 million of common stock repurchases.

Networked Gaming

We believe that server-enabled networked gaming (NG) will be the next significant technology development in the gaming machine industry. NG refers to a networked gaming system that links groups of server-enabled gaming machines to a server or servers in each casino's data center. Once the gaming machines are connected to the server-enabled network, data can transfer between the servers and the gaming machines in real time and new applications, game functionality and system-wide features can be enabled on the gaming machines from the server.