WMS INDUSTRIES INC /DE/
Form 10-Q
October 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

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.

(Exact name of registrant as specified in its Charter)

Delaware	**36-2814522**
(State or other Jurisdiction of incorporation or organization)	**(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 þ 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	þ	Accelerated filer	¨
Non-accelerated filer	¨	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 þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 58,708,588 shares of common stock, $0.50 par value, were outstanding at October 26, 2009.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

For the Three Months Ended September 30, 2009 and 2008

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

(Unaudited)

	2009	2008
REVENUES:		
Product sales	$ 88.8	$ 87.2
Gaming operations	76.5	64.2
Total revenues	165.3	151.4
COSTS AND EXPENSES:		
Cost of product sales(1)	41.8	43.5
Cost of gaming operations(1)	14.2	12.3
Research and development	26.5	22.0
Selling and administrative	34.0	32.2
Depreciation(1)	17.3	17.1
Total costs and expenses	133.8	127.1
OPERATING INCOME	31.5	24.3
Interest expense	(2.0)	(0.9)
Interest income and other income and expense, net	1.9	1.0
Income before income taxes	31.4	24.4
Provision for income taxes	11.6	8.7
NET INCOME	$ 19.8	$ 15.7
Earnings per share:		
Basic	$ 0.40	$ 0.31
Diluted	$ 0.34	$ 0.27
Weighted-average common shares:		
Basic common stock outstanding	50.0	49.9
Diluted common stock and common stock equivalents	60.1	60.0

(1) Cost of product sales and cost of gaming operations exclude the following amounts of depreciation, which are included in the depreciation line item:

Cost of product sales	$ 1.1	$ 0.9
Cost of gaming operations	$ 11.8	$ 13.2

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

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WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

September 30, 2009 and June 30, 2009

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

	September 30, 2009 (unaudited)	June 30, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 138.3	$ 135.7
Restricted cash and cash equivalents	16.9	19.0
Total cash, cash equivalents and restricted cash	155.2	154.7
Accounts and notes receivable, net	210.6	214.2
Inventories	52.5	43.1
Other current assets	56.2	38.0
Total current assets	474.5	450.0
NON-CURRENT ASSETS:		
Gaming operations equipment, net of accumulated depreciation of $221.8 and $211.3, respectively	66.6	68.0
Property, plant and equipment, net of accumulated depreciation of $79.2 and $73.9, respectively	163.2	158.8
Intangible assets, net	98.6	99.3
Deferred income tax assets	30.7	31.2
Other assets, net	54.4	48.7
Total non-current assets	413.5	406.0
TOTAL ASSETS	$ 888.0	$ 856.0
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 41.1	$ 50.4
Accrued compensation and related benefits	12.8	27.9
Other accrued liabilities	32.4	37.4
Total current liabilities	86.3	115.7
NON-CURRENT LIABILITIES:		
Deferred income tax liabilities	18.2	17.8
Long-term debt	35.6	115.0
Other non-current liabilities	15.7	16.1
Total non-current liabilities	69.5	148.9
Commitments, contingencies and indemnifications (see Note 11)		
STOCKHOLDERS EQUITY:		
Preferred stock (5.0 shares authorized; none issued)		
Common stock (100.0 shares authorized; 57.0 and 51.0 shares issued, respectively)	28.5	25.5

Additional paid-in capital	388.9	311.9
Retained earnings	315.9	296.1
Accumulated other comprehensive income	5.2	3.3
Treasury stock, at cost (0.3 and 1.8 shares, respectively)	(6.3)	(45.4)
Total stockholders equity	732.2	591.4
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 888.0	$ 856.0

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

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WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended September 30, 2009 and 2008

(in millions of U.S. dollars)

(Unaudited)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 19.8	$ 15.7
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	17.3	17.1
Amortization of intangible and other assets	5.2	4.0
Share-based compensation	4.7	3.3
Other non-cash expenses, primarily inventory reserves and bad debt expense	0.8	3.7
Deferred income taxes	0.4	(0.6)
Tax benefit from the exercise of stock options	(11.7)	(0.2)
Change in operating assets and liabilities	(46.0)	4.9
Net cash provided by (used in) operating activities	(9.5)	47.9
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to gaming operations equipment	(10.6)	(13.5)
Purchase of property, plant and equipment	(11.6)	(11.4)
Payments to acquire or license intangible and other assets	(1.4)	(1.1)
Net cash used in investing activities	(23.6)	(26.0)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash received from exercise of stock options	26.1	0.7
Tax benefit from exercise of stock options	11.7	0.2
Debt issuance costs	(1.6)	
Purchase of treasury stock		(13.4)
Other	(0.7)	
Net cash provided by (used in) financing activities	35.5	(12.5)
Effect of Exchange Rates on Cash and Cash Equivalents	0.2	(0.7)
INCREASE IN CASH AND CASH EQUIVALENTS	2.6	8.7
CASH AND CASH EQUIVALENTS, beginning of period	135.7	100.8
CASH AND CASH EQUIVALENTS, end of period	$ 138.3	$ 109.5

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

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 for complete financial statements. The Condensed Consolidated Financial Statements should therefore be read in conjunction with the Consolidated Financial Statements and Notes thereto for the fiscal year ended June 30, 2009 included in our Annual Report on Form 10-K filed with the SEC on August 27, 2009. The accompanying unaudited interim Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles 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. This report includes subsequent events evaluated through the date of the financial statement issuance on October 30, 2009. See Note 13, Subsequent Events in this report.

Sales of our gaming machines to casinos are generally strongest in the spring and slowest in the summer months, while gaming operations revenues are generally strongest in the spring and summer. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for a new jurisdiction. Operating results for the three months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ended June 30, 2010. 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, 2009.

We are engaged in one business segment: the design, manufacture and distribution of gaming machines (video and mechanical reel type) and video lottery terminals (VLTs) for customers in legalized gaming jurisdictions worldwide. We have production facilities in the United States with development and distribution offices located in the United States, Argentina, Australia, Austria, Canada, China, Italy, the Netherlands, South Africa, Spain, and the United Kingdom.

We market our gaming machines in two principal ways. First, product sales includes the sale of new and used gaming machines and VLTs, conversion kits, parts, amusement-with-prize gaming machines, equipment manufactured under original equipment manufacturing agreements to casinos and other gaming machine operators and gaming-related systems for smaller international casino operators. Second, we license our game content and intellectual property to third parties for distribution and we lease gaming machines and VLTs to casinos and other licensed gaming machine operators for lease payments 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 or a combination of a fixed daily fee and a percentage of the amount wagered. 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 machines, 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, and gaming machine, VLT and other lease revenues we refer to this business as our gaming operations.

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).

2. PRINCIPAL ACCOUNTING POLICIES

Revenue Recognition

We evaluate the recognition of revenue based on the criteria set forth in the following accounting guidance: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605, *Revenue Recognition* (Topic 605), or FASB ASC 985, *Software* (Topic 985

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

WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

- 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 Collectibility is reasonably assured.

We recognize revenue when the product is delivered, acceptance terms have been fulfilled and the other criteria listed above are 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;
- Ø we have objective and reliable evidence of the fair value of the undelivered items; and
- Ø delivery of any undelivered item is considered probable and substantially in our control.

Product Sales

We sell gaming machines and VLTs typically with payment terms of 30 to 90 days. In certain circumstances we offer extended payment terms typically for up to one year but in limited cases up to three years, which obligation may be secured by the related gaming machines and may accrue interest recognized at market rates. In fiscal 2009, due to the slowing economy and credit availability challenges our customers experienced, we implemented a program to increase the amount of financing terms offered to select customers. We expect to continue this program throughout fiscal 2010. Revenues are reported net of incentive rebates or discounts. We annually investigate sales contracts with extended payment terms in excess of one year to determine if there is sufficient history to prove assurance of collectibility under the original sales contract payment terms. Based upon this investigation, we have concluded that adequate supporting historical documentation exists to conclude collectibility is probable for sales contracts with extended payment terms of 36 months or less. Our product sales contracts do not include specific performance, cancellation, termination, and refund type provisions.

Our services for initial 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. Labor costs for gaming machine installs and participation placements, as well as labor costs associated with performing routine maintenance on participation gaming machines are included in selling and administrative expenses. 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 capitalize the costs to install gaming operations equipment.

Gaming Operations

We earn gaming operations revenues from leasing gaming machines, VLTs and other leased equipment, and earn royalties from third parties under license agreements to use our game content and intellectual property.

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. 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 the WAP systems and to administer the progressive jackpot funding. Revenues are recognized as earned when collectibility is reasonably assured. 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 fund WAP progressive jackpots won by casino patrons.

WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

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 to a progressive jackpot within a single gaming jurisdiction. Each casino funds 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 agreements 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 one specific product, a percentage of the coin-in.

Casino-owned daily fee game lease agreements are for a fixed daily fee per day. Casino-owned daily fee games are games for which we sell the base gaming machine without a game theme to the casino at a normal sales price excluding the game theme and earn a normal product sales gross profit and then earn a lower ongoing daily fee from leasing the top box and game theme to the casino. All components or elements of the arrangement are delivered at the time of physical delivery of the gaming machine and we have no further obligation to refresh or change the game theme. Revenue recognized for casino-owned daily fee game lease arrangements is not material to our Consolidated Financial Statements. We exclude casino-owned daily fee games from our installed base of participation gaming machines.

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 the daily net win of the VLTs or a fixed daily rate. We exclude our leased VLTs from our installed base of participation gaming machines.

Some customers prefer to lease our standard for-sale gaming machines as an option rather than to purchase them. In these cases, we lease the gaming machine, either for a fixed daily fee or as a percentage of the net win of the gaming machine. 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 collectibility is reasonably assured.

Recent Updates to Topics 605 and 985

In October 2009, the FASB issued 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). As permitted under these ASU s, we early adopted both of these ASU s on a prospective basis effective July 1, 2009, the beginning of our fiscal 2010 year. While the adoption of these two ASU s changed our revenue recognition policies beginning in fiscal 2010, the impact on our Consolidated Financial Statements was not significant to either the quarter ended September 30, 2009, or had these ASU s been applied retroactively, to the fiscal years ended June 30, 2009, 2008 or 2007, as we had vendor specific objective evidence (VSOE) for all elements of our multiple deliverable arrangements.

ASU No. 2009-13 amends Topic 605 to provide that if VSOE or third party evidence (TPE) of selling price for an undelivered item in a multiple deliverable arrangement is not determinable, an entity may use the estimated selling price (ESP) of the undelivered component to allocate revenue between the elements of a multiple deliverable arrangement, as long as the arrangement is not subject to other accounting guidance. It further states that ESP shall be established consistent with the objective of determining VSOE, that is, ESP is the price at which the entity would sell the item if the undelivered item were sold regularly on a standalone basis. It also advises that the selling entity must also consider market conditions as well as entity-specific factors when estimating the selling price, including discounts offered from list price. In the September 2009 quarter, we used VSOE to value all elements in our multiple deliverable arrangements and did not use either TPE or ESP. Once revenues under a multiple deliverable arrangement are allocated to the separate components of the arrangement and we defer revenue recognition on the undelivered components, we must still establish VSOE, TPE or ESP on all undelivered components before recognizing any revenue on any subsequently delivered component of the arrangement. If we cannot objectively determine the VSOE, TPE or ESP for any undelivered units of accounting included in a multiple deliverable arrangement, all revenues are deferred until all of the items are delivered and the other criteria listed above have been satisfied, or until the VSOE, TPE or ESP can objectively be determined for any remaining undelivered units of accounting.

WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

ASU No. 2009-14 amends Topic 985 to provide that tangible products containing both software components and non-software components that function together to deliver the product s essential functionality would not be considered software deliverables and therefore would be excluded from the scope of Topic 985. We determined that our *Bluebird2* gaming machines, which contain software components (such as an operating system, game theme and third-party firmware) and hardware components function together to deliver the gaming machine s essential functionality and are not separate or non-essential software deliverables as defined under Topic 985. Prior to July 1, 2009 we applied Topic 985 to sales of certain of our products, specifically *Bluebird2* gaming machines and revenues generated from the sales of gaming related systems by our subsidiary Systems in Progress GmbH (SiP). Effective July 1, 2009, with the adoption of ASU No. 2009-14, we no longer apply Topic 985 to our *Bluebird2* gaming machine sales.

Prior to July, 1 2009, when multiple product deliverables were included under a sales contract, we allocated revenue to each unit of accounting based upon its respective fair value against the total contract value and deferred revenue recognition on those deliverables where we did not meet all of the requirements of revenue recognition. We allocated revenue to each unit of accounting, which typically consisted of gaming machines and additional game themes the customer can receive in the future, based on fair value as determined by VSOE. VSOE of fair value for all elements of a multiple deliverable arrangement is based upon the normal pricing and discounting practices for those products and services when sold individually.

Effective July 1, 2009, with the adoption of the ASU s disclosed above, we may use TPE or ESP to allocate revenue under a multiple deliverable arrangement, including arrangements that have either or both hardware and software deliverables, when VSOE is not available. Both TPE and ESP for all elements of a multiple deliverable arrangement will be based upon the normal pricing and discounting practices for those products and services when sold individually. The effect of changes in TPE or ESP or the method or assumptions used to determine selling price for a specific unit of accounting are not expected to have a significant effect on the allocation of multiple deliverable arrangement consideration. These new revenue recognition standards will have more of a revenue impact when we launch our networked gaming system and related software applications in future quarters in fiscal 2010 and execute multiple deliverable arrangements that have hardware and software deliverables.

Effective July 1, 2009, Topic 985 primarily effects our SiP revenues and will impact future revenues in a networked gaming (NG) environment because SiP and future NG revenues derived from computer software applications and systems to be sold or leased. As we begin to commercialize NG software applications through multiple deliverable arrangements in future quarters in fiscal 2010, the application of Topic 985 will allow us to allocate revenues in a multiple deliverable arrangement using either TPE or ESP, but still require us to obtain VSOE for each undelivered NG software application 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 arrangement. The establishment of VSOE for the software applications and systems may delay the recognition of revenue and increase deferred revenues and deferred costs. NG refers to a networked gaming system that links groups of server-enabled gaming machines to a remote server in the casino data center.

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. These components of cost of product sales also include licensing and royalty charges, inbound and outbound freight charges, purchasing and receiving costs, inspection costs and internal transfer costs.

Cost of gaming operations consists primarily of wide-area progressive jackpot expenses, licensing and royalty charges, telecom 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 $6.1 million and $5.1 million for the three months ended September 30, 2009 and 2008, 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. The adoption of Topic 820 effective July 1, 2008 did not have a material impact on our financial statements.

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WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

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.
- 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.

As of September 30, 2009, the only assets subject to fair value measurement in accordance with Topic 820 were investments in various money market funds totaling approximately $90.5 million. These money market investments are included in our cash and cash equivalents and restricted cash and cash equivalents on the Consolidated Balance Sheets and are considered level 1 securities.

Accounts Receivable, Notes Receivable, 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 quarterly basis, we evaluate our receivables and establish the allowance for doubtful accounts based on a combination of specific customer circumstances, credit conditions and our history of write-offs and collections. Bad debt expense for the three months ended September 30, 2009 and 2008 was $0.6 million and $1.6 million respectively.

The following summarizes the components of current and long-term accounts and notes receivable, net;

	September 30, 2009	June 30, 2009
Current:		
Accounts receivable	$ 93.7	$ 105.6
Notes receivable	120.8	112.6
Allowance for doubtful accounts	(3.9)	(4.0)
Current accounts and notes receivable, net	$ 210.6	$ 214.2
Long-term, included in Other assets, net:		
Notes receivable	$ 46.1	$ 39.6
Allowance for doubtful accounts	(1.3)	(1.3)
Long-term notes receivable, net	$ 44.8	$ 38.3
Total accounts and notes receivable, net	$ 255.4	$ 252.5

Our policy is to generally not record interest on receivables after the invoice payment becomes past due. A receivable is considered past due if payments have not been received within agreed upon invoice terms. With regard to 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.

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WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

The fair value of notes receivable is estimated by discounting expected future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities. As of September 30, 2009 and June 30, 2009 respectively, the fair value of the accounts and notes receivable, net, approximated the carrying value.

Other Principal Accounting Standards

For a description of our other principal accounting policies see Note 2, Principal Accounting Policies, to our Consolidated Financial Statements and Notes thereto in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

Recently Issued Accounting Standards

In September 2006, the FASB issued Topic 820, *Fair Value Measurements*. Topic 820 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. Topic 820 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. Subsequent to the issuance of Topic 820, the FASB issued a provision to Topic 820, *Effective Date of FASB Statement Topic 820*. This provision delays the effective date of Topic 820 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. For the instruments subject to the effective date delay under Topic 820, the effective date to adopt the fair value provisions for us was July 1, 2009. On October 10, 2008, the FASB issued another provision under Topic 820, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This provision does not change the fair value measurement principles in Topic 820, but rather provides guidance for the application of those measurement principles in the extreme inactive markets that existed at that time. We adopted Topic 820 effective July 1, 2009 and the adoption had no material impact on our Consolidated Financial Statements.

In April 2008, the FASB issued FASB ASC 350-30-65-1, *Determination of the Useful Life of Intangible Assets* (Topic 350-30-65-1). Topic 350-30-65-1 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under ASC 350-30, *Goodwill and Other Intangible Assets* (Topic 350-30). Previously, under the provisions of ASC 350-30, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be substantial cost or material modifications. Topic 350-30-65-1 removes the requirement of Topic 350-30 for an entity to consider whether an intangible asset can be renewed without substantial cost or material modification to the existing terms and conditions and requires an entity to consider its own experience in renewing similar arrangements. Topic 350-30-65-1 is effective for fiscal years beginning after December 15, 2008. We adopted Topic 350-30-65-1 effective July 1, 2009 and the adoption had no material impact on our Consolidated Financial Statements.

In June 2009, the FASB issued ASC 105 *Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles*, which establishes the Codification as the single source of authoritative US GAAP. This statement is effective for interim and annual statements issued after September 15, 2009 and has changed the way we reference accounting standards in this Form 10Q and in future disclosures.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements* and ASU No. 2009-14 *Certain Revenue Arrangements That Include Software Elements*. As permitted under these ASU s, we early adopted both of these ASU s on a prospective basis effective July 1, 2009, the beginning of our fiscal 2010 year and the adoption did not have a material impact on our Consolidated Financial Statements. See the Revenue Recognition section in Note 2, Principal Accounting Policies.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

3. EARNINGS PER SHARE

Basic and diluted earnings per share are calculated as follows for the three months ended September 30:

	2009	2008
Net income	$ 19.8	$ 15.7
After tax interest expense and amortization of issuance cost on convertible subordinated notes	0.5	0.5
Diluted earnings (numerator)	$ 20.3	$ 16.2
Basic weighted average common shares outstanding	50.0	49.9
Dilutive effect of stock options	1.3	1.2
Dilutive effect of restricted common stock and warrants	0.4	0.2
Dilutive effect of convertible subordinated notes	8.4	8.7
Diluted weighted average common stock and common stock equivalents (denominator)	60.1	60.0
Basic earnings per share of common stock	$ 0.40	$ 0.31
Diluted earnings per share of common stock and common stock equivalents	$ 0.34	$ 0.27
Common stock equivalents excluded from the calculation of diluted earnings per share because their impact would render them anti-dilutive	1.0	1.2

Included in our anti-dilutive common stock equivalents for the three months ended September 30, 2009 are warrants to purchase 500,000 shares of our common stock which are contingent upon future events that were issued to Hasbro Inc. and Hasbro International, Inc. These warrants were excluded from the calculation because the vesting criteria were not met. See Note 12, Equity Compensation Plan Warrants to our Consolidated Financial Statements and Notes thereto in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

4. INVENTORIES

Inventories consisted of the following:

	September 30, 2009	June 30, 2009
Raw materials and work-in-process	$ 34.5	$ 26.8
Finished goods	18.0	16.3
Total inventories	$ 52.5	$ 43.1

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 $0.2 million and $2.0 million for the three months ended September 30, 2009 and 2008, respectively. These charges are classified in cost of product sales in our Condensed Consolidated Income Statement.

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5. INTANGIBLE ASSETS

General

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

	September 30, 2009	June 30, 2009
Goodwill	$ 20.5	$ 19.9
Finite lived intangible assets, net	92.3	88.3
Indefinite lived intangible assets	3.6	3.6
Less: royalty advances and licensed or acquired technologies, short-term	(17.8)	(12.5)
Non-current intangible assets, net	$ 98.6	$ 99.3

Goodwill

The changes in the carrying amount of goodwill for the three months ended September 30, 2009 include:

Goodwill balance at June 30, 2009	$ 19.9
Foreign currency translation adjustment	0.6
Goodwill balance at September 30, 2009	$ 20.5

Other Intangible Assets

Other intangible assets consisted of the following:

		September 30, 2009			June 30, 2009		
	Useful Life (Years)	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Finite lived intangible assets:							
Royalty advances for licensed brands, talent, music and other	1 - 15	$ 86.1	$ (47.6)	$ 38.5	$ 79.8	$ (44.2)	$ 35.6
Licensed or acquired technologies	1 - 15	44.1	(10.2)	33.9	42.6	(9.6)	33.0
Patents	4 - 17	21.6	(4.5)	17.1	20.9	(4.2)	16.7
Customer relationships	6	4.7	(2.6)	2.1	4.7	(2.3)	2.4

Trademarks	4	1.2		(0.5)	0.7	1.1		(0.5)	0.6
Total		$ 157.7	$	(65.4)	$ 92.3	$ 149.1	$	(60.8)	$ 88.3
Indefinite lived intangible assets:									
Acquired brand names		$ 3.6	$		$ 3.6	$ 3.6	$		$ 3.6

The following table summarizes additions to other intangible assets during the three months ended September 30, 2009:

	Total Additions
Finite lived intangible assets:	
Royalty advances for licensed brands, talent, music and other	$ 6.3
Licensed or acquired technologies	1.5
Patents	0.7
Trademarks	0.1
Total	$ 8.6

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

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Amortization expense for our finite-lived intangible assets was $4.6 million and $3.0 million for the three months ended September 30, 2009 and 2008, respectively.

The estimated aggregate amortization expense for finite live intangible assets for each of the next five years is as follows:

2010 (remaining nine months of fiscal year)	$ 14.3
2011	11.3
2012	8.5
2013	5.7
2014	4.6
2015	2.6

The estimated aggregate future intangible asset amortization as of September 30, 2009 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 against earnings up to the full amount of these net assets or commitments in the period in which such determination is made. See Note 11, Commitments, Contingencies and Indemnifications to the Condensed Consolidated Financial Statements and Notes thereto in this report.

6. 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. 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 36.9% and 35.7% for the three months ended September 30, 2009 and 2008, respectively.

As of September 30, 2009, we had $7.3 million of gross unrecognized tax benefits, excluding accrued interest and penalties of $0.9 million. Of the total unrecognized tax benefits, including accrued interest and penalties of $0.9 million, $7.9 million (net of the federal benefit) represents the portion that, if recognized, would impact the effective tax rate.

In the September 2008 quarter, the Internal Revenue Service began an audit of our U.S. federal income tax returns for fiscal years 2004 through 2007. In addition, we are currently under audit in a major state for the same years. As a result of these audits it is reasonably possible that the total amount of the unrecognized income tax benefits will significantly change within fiscal 2010. At this time we are unable to estimate the amount of the potential change. Approximately $5.6 million of unrecognized income tax benefits are currently subject to audits referred to above. At this time we believe appropriate provisions for all outstanding issues have been made for all jurisdictions and all open years. We are no longer subject to any significant U.S. federal, state, local or foreign income tax examinations by tax authorities for years before fiscal 2004.

7. CONVERTIBLE SUBORDINATED NOTES AND REVOLVING CREDIT FACILITY

Convertible Subordinated Notes

On September 28, 2009, we issued approximately 6.0 million shares of our common stock $0.50 par value per share, upon early conversion to common stock of $79.4 million principal amount of our 2.75% Convertible Subordinated Notes due July 15, 2010 (the Notes), or approximately 70% of our outstanding Notes, by three holders of Notes. In connection with the conversion of the $79.4 million principal amount of the Notes, we paid the holders an aggregate of $1.1 million of cash consisting of $0.4 million interest earned through September 28, 2009 and $0.7 million as the inducement to convert the Notes early, which is less than the discounted present value of the remaining approximately $1.7 million of interest that would be earned on the Notes through maturity in July 2010. The impact of these transactions resulted in a charge of $0.02 per diluted share in the September 2009 quarter, consisting of the $0.7 million inducement payment coupled with a non-cash charge of approximately $0.4 million to write-off of the remaining proportional deferred financing costs related to the Notes. As a result of the conversion of the Notes into common stock, our long-term debt decreased by $79.4 million and common stock and additional-paid-in-capital increased by an aggregate of $79.4 million.

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At September 30, 2009, we had approximately $35.6 million remaining Notes outstanding, bearing interest at 2.75% maturing on July 15, 2010. The remaining Notes are exchangeable at any time into an aggregate of 2.7 million shares of our common stock at a conversion price of $13.19 per share, subject to adjustment. The Notes are subordinated in right of payment to all existing and future senior debt and are effectively subordinated to all of the indebtedness and liabilities of our subsidiaries. The Notes are not callable. We pay interest on the Notes semi-annually on January 15 and July 15 of each year. The conversion of the Notes to common stock is dependent on individual holders choices to convert, which is dependent on the spread of the market price of our stock above the conversion strike price of $13.19 per share, and such conversion would reduce our annual interest expense. Our Notes are conventional convertible debt instruments in which the holder may only realize the value of the conversion option by exercising the option and receiving a fixed number of shares of our common stock.

As of September 30, 2009, the fair value of the Notes was $120.2 million. The fair value of our convertible fixed rate debt is significantly dependent on the market price of our common stock into which it can be converted. We have classified our Notes outstanding at September 30, 2009 as a long-term liability because we have the ability and intent to refinance them under the amended and restated revolving credit agreement we entered into on September 25, 2009.

On October 2, 2009, we issued an additional 1.9 million shares of our common stock, $0.50 par value per share, upon early conversion to common stock of another $25.7 million principal amount of our Notes by one Note holder. In connection with the conversion of the $25.7 million principal amount of the Notes, we paid the holder an aggregate of approximately $0.4 million in cash consisting of approximately $0.2 million of interest earned through October 2, 2009 and approximately $0.2 million as an inducement to convert the Notes. We expect this transaction to result in a charge in our quarter ending December 31, 2009 consisting of the $0.2 million inducement payment coupled with a non-cash charge of approximately $0.1 million to write-off the remaining proportional deferred financing costs related to the converted Notes. As of October 2, 2009, we have $9.9 million of Notes outstanding.

Revolving Credit Facility

On September 25, 2009, we entered into an amended and restated revolving credit agreement with a group of five banks. The amended and restated revolving credit agreement provides for borrowings up to $150 million through September 30, 2012, with the ability to expand the facility to $200 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 negative covenants and two financial ratios: a leverage ratio and an interest coverage ratio. These negative 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 3.25x through December 31, 2010, and 3.0x thereafter, and is computed as total indebtedness outstanding at the end of each quarter divided by the trailing twelve months earnings before interest, taxes, depreciation and amortization, including share-based compensation and non-cash charges (EBITDA) as defined in the agreement. The minimum interest coverage ratio is currently 2.5x and is computed as trailing twelve months EBITDA divided by trailing twelve months interest charges as defined in the revolving credit agreement.

The agreement also defines permitted restricted payments related to cash dividends and cash repurchases of our common stock and at September 30, 2009, approximately $146.5 million was available for such purposes. The agreement also contains certain limitations on, among other items, the amount and types of additional indebtedness, liens, investments, loans, advances, guarantees and acquisitions we can enter into or incur. No amounts were outstanding under the amended and restated revolving credit facility at September 30, 2009.

8. STOCKHOLDERS EQUITY AND EQUITY COMPENSATION PLAN

General

Our authorized common stock consists of 100.0 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 3, 2009, our Board of Directors authorized the repurchase of an additional $75 million of our common stock over the following twenty-four months increasing our remaining repurchase authorization to approximately $150 million. This authorization increases the existing program, previously authorized on August 4, 2008, from $150 million to $225 million and extended the expiration date to August 3, 2011. As of September 30, 2009, we had approximately $150 million remaining of our repurchase authorization. Pursuant to the authorization, purchases may be made from time to time in the open market, through block

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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purchases or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on market conditions. During the quarter ended September 30, 2009 we did not repurchase any shares. During the quarter ended September 30, 2008 we purchased 322,645 shares for approximately $9.6 million including amounts accrued at September 30, 2008 at an average cost of $29.80 per share.

Equity Compensation Plan

A summary of information with respect to share-based compensation expense included in our Condensed Consolidated Statements of Income are as follows, for the quarters ended September 30:

	2009	2008
Cost of product sales	$ 0.1	$
Research and development	1.6	1.1
Selling, general and administrative	3.0	2.2
Share-based compensation expense included in pre-tax income	4.7	3.3
Income tax benefit related to share-based compensation	(1.8)	(1.3)
Share-based compensation expense included in net income	$ 2.9	$ 2.0