WMS INDUSTRIES INC /DE/
Form 10-Q
February 08, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2005

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) (Zip Code)

Registrant s telephone number, including area code: (847) 785-3000

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 x NO ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 31,564,527 shares of common stock, $.50 par value, were outstanding at February 3, 2006, excluding 800,676 shares held as treasury shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED INCOME STATEMENTS

(Millions of dollars and shares, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	**2004**	**2005**	**2004**
Revenues:				
Product sales	$ 77.5	$ 69.4	$ 148.3	$ 122.8
Gaming operations	35.9	24.6	69.5	46.3
Total revenues	113.4	94.0	217.8	169.1
Costs and expenses:				
Cost of product sales	44.1	42.8	85.6	74.6
Cost of gaming operations	8.0	5.0	16.5	9.6
Research and development	12.2	13.5	23.8	25.6
Selling and administrative	22.9	19.3	42.2	34.9
Depreciation and amortization	13.0	8.7	26.5	15.5
Total costs and expenses	100.2	89.3	194.6	160.2
Operating income	13.2	4.7	23.2	8.9
Interest expense	(1.1)	(1.0)	(2.2)	(2.0)
Interest income, other income and expense, net	0.4	1.8	0.9	2.4
Income before income taxes	12.5	5.5	21.9	9.3
Provision for income taxes	4.5	1.6	7.8	3.0
Net income	$ 8.0	$ 3.9	$ 14.1	$ 6.3
Basic net income per share of common stock	$ 0.26	$ 0.13	$ 0.45	$ 0.21
Diluted net income per share of common stock and common stock equivalents	$ 0.23	$ 0.12	$ 0.40	$ 0.20
Weighted-average common shares:				

Basic common stock outstanding	31.3	30.6	31.4	30.4
Diluted common stock and common stock equivalents	37.6	37.6	37.8	31.4

See notes to condensed consolidated financial statements.

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WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Millions of dollars)

	December 31, 2005	June 30, 2005
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 43.2	$ 35.2
Restricted cash for progressive jackpots	9.0	3.5
Short-term investments		6.1
	52.2	44.8
Accounts receivable, net of allowances of $2.7 and $2.5, respectively	88.1	77.0
Notes receivable, current portion	51.9	45.3
Inventories, at lower of cost (FIFO) or market:		
Raw materials and work-in-process	56.5	71.6
Finished goods	32.8	32.7
	89.3	104.3
Other current assets	37.3	39.7
Total current assets	318.8	311.1
Gaming operations machines	154.8	133.1
Less accumulated depreciation	(97.4)	(78.7)
Gaming operations machines, net	57.4	54.4
Property, plant and equipment	97.7	90.9
Less accumulated depreciation	(41.5)	(37.5)
Property, plant and equipment, net	56.2	53.4
Other assets	58.9	59.5
Total assets	$ 491.3	$ 478.4

See notes to condensed consolidated financial statements.

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WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Millions of dollars, except share amounts)

	December 31, 2005	June 30, 2005
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 26.3	$ 31.4
Accrued compensation and related benefits	7.4	6.1
Other accrued liabilities	29.3	31.8
Total current liabilities	63.0	69.3
Deferred licensing purchase obligation	4.5	4.7
Deferred income tax liabilities	4.2	4.2
2.75% Convertible subordinated notes due 2010	115.0	115.0
Commitments and contingencies (see Notes 10 and 11)		
Stockholders equity:		
Preferred stock (5,000,000 shares authorized, none issued)		
Common stock (100,000,000 shares authorized and 32,365,203 shares issued)	16.2	16.2
Additional paid-in capital	221.2	225.0
Retained earnings	78.4	64.3
Accumulated other comprehensive income	0.7	0.6
Unearned compensation from restricted stock and performance contingent restricted units (294,848 shares and 120,368 units at June 30, 2005)		(11.5)
Treasury stock, at cost (803,451 shares at December 31, 2005 and 710,320 shares at June 30, 2005)	(11.9)	(9.4)
Total stockholders equity	304.6	285.2
Total liabilities and stockholders equity	$ 491.3	$ 478.4

See notes to condensed consolidated financial statements.

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WMS INDUSTRIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Millions of dollars)

(Unaudited)

	Six Months Ended December 31,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 14.1	$ 6.3
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	26.5	15.5
Deferred income taxes	7.8	3.0
Non-cash expenses	8.2	1.6
Decrease from changes in operating assets and liabilities	(18.8)	(49.6)
Net cash provided (used) by operating activities	37.8	(23.2)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(7.1)	(4.2)
Additions to gaming operations machines	(26.9)	(24.3)
Net decrease in short-term investments	6.1	9.5
Investment and advances in other assets	(0.1)	(3.7)
Net cash used by investing activities	(28.0)	(22.7)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash received on exercise of common stock options	1.0	6.8
Tax benefit from exercise of stock options	0.1	2.7
Purchases of treasury stock	(3.0)	
Net cash provided by financing activities	(1.9)	9.5
EFFECT OF EXCHANGE RATES ON CASH	0.1	0.9
Increase (decrease) in cash and cash equivalents	8.0	(35.5)
Cash and cash equivalents at beginning of period	35.2	59.9
Cash and cash equivalents at end of period	$ 43.2	$ 24.4

See notes to condensed consolidated financial statements.

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WMS INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements of WMS Industries Inc. (WMS , we , us or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included.

Sales of our gaming machines to casinos are generally strongest in the spring and slowest in the summer months. 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 that achieves significant player appeal is introduced or if gaming is permitted in a significant new jurisdiction. Operating results for the quarter and six months ended December 31, 2005 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2006. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2005.

Data for product sales and gaming operations is only maintained on a consolidated basis as presented in our 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 the consolidated statement of income and cost of gaming machines and related accumulated depreciation included in the consolidated balance sheet).

2. PRINCIPAL ACCOUNTING POLICIES

Consolidation Policy

Our consolidated financial statements include the accounts of WMS Industries Inc., or WMS, and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Certain prior year balances have been reclassified to conform with the current year presentation.

Use of Estimates

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States. Such preparation requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents, and Restricted Cash

All highly liquid investments with maturities of three months or less when purchased are considered cash equivalents. Restricted cash of $9.0 million at December 31, 2005 and $3.5 million at June 30, 2005 is required for funding wide-area progressive or WAP, systems jackpot payments.

Short-Term Investments

All investments are recorded at cost, which approximates market value. Short-term investments consist principally of Auction Market Preferred Stocks that generally have no fixed maturity dates but have dividend reset dates generally every 49 days or more.

Accounts Receivable, Notes Receivable and Allowance for Doubtful Accounts

We carry our accounts and notes receivable at face amounts less an allowance for doubtful accounts. On a periodic 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. Our policy is to generally not charge interest on trade receivables after the invoice 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.

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Inventories

Inventories are valued at the lower of cost (determined by the first-in, first-out method) or market. We value inventory based on estimates of potentially excess and obsolete inventory after considering forecasted demand and forecasted average selling prices. However, forecasts are subject to revisions, cancellations and rescheduling. Actual demand may differ from anticipated demand, and such differences may have a material effect on our financial statements. Demand for legacy parts inventory is subject to technical obsolescence. Inventory on hand in excess of forecasted demand is written down to net realizable value.

In fiscal 2004, we introduced our new *Bluebird*® cabinet and *CPU-NXT*® gaming platform, and this has accelerated the obsolescence of existing legacy product lines. Some customers have traded in their legacy gaming machines when they purchased a new *Bluebird* gaming machine. We either sell these trade-ins as-is or renovate the legacy gaming machines before resale. We also have legacy parts inventory, which we use for renovating the trade-in gaming machines, producing new legacy gaming machines including OEM arrangements with Multimedia Games (MGAM), or selling such parts to casinos and others through our spare parts business. An active market exists mostly outside of North America for used games. We continue to support our customers installed base of legacy gaming machines and continue to review our legacy inventories for impairment.

At December 31, 2005, our inventories included $19.4 million of legacy product including $10.4 million of legacy raw materials and $9.0 million of new and used legacy finished goods. This compares to a total of $23.2 million at June 30, 2005 and $33.2 million at June 30, 2004. Demand for *Bluebird* product continues to exceed our expectations. While this higher demand is a positive development for our long-term growth, it has accelerated the transition from our legacy product line. In response to this, we took steps to address the most challenging components of the legacy inventory, including selling older model used games and used units configured with undesirable laminate colors, as well as selling back to suppliers excess quantities of certain legacy raw materials.

Freight-out and Warehousing Costs

Freight-out and warehousing costs are included in cost of product sales in the income statement. Freight-out costs for gaming operations machines are capitalized and depreciated over the useful life of the related asset.

Software Development Costs

As a result of the gaming license requirements and regulatory approvals necessary to commercialize products in our business, our products reach technological feasibility shortly before products are released to manufacturing. Accordingly, internal research and development costs are expensed as incurred, including software development costs. We do not incur any material software development costs after we receive regulatory approval for our products.

We account for amounts paid to third parties for purchased or licensed software related to our technology improvement plan under Statement of Financial Accounting Standards No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. Under these arrangements, we have alternative future uses for purchased software related to our technology improvement plan and we generally have the right to sub-license this software to other third parties.

The ongoing implementation costs of our Oracle ERP system incurred during the preliminary project stages are expensed; costs incurred during the application development stages are being capitalized and costs incurred during the post-implementation/operation stages are being expensed. Due to the extensive use of external consultants to minimize the burden on our internal staffing, internal resources used during the application development phases are limited, and we have not capitalized internal costs.

Long-Lived Assets

Property, plant and equipment and gaming operations machines are stated at cost and depreciated using the straight-line method over their estimated useful lives. Significant replacements and improvements are capitalized. Other maintenance and repairs are expensed. The annual provision for depreciation has been computed in accordance with the following ranges of asset lives: buildings and improvements - 10 to 40 years; leasehold improvements over the lease term; machinery and equipment - three to eight years, gaming operations base machines - two to three years, gaming operations top boxes over one year and furniture and fixtures - 10 years.

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We review the carrying amount of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. When an impairment loss is to be recognized for an asset, it is measured by comparing the carrying value to the fair value. Fair value is generally measured as the present value of estimated future cash flows.

Goodwill and indefinite lived intangible assets are not amortized but are reviewed annually, or more frequently if an event occurs or circumstances change, for indications that the asset might be impaired. Any impairment loss is charged to expense in the period in which such loss is determined. Identified intangible assets with finite lives, including licensed technology and patents, are amortized using the straight-line method over their estimated useful lives. We continually evaluate the reasonableness of the useful lives of these assets, and any change in the lives assigned to amortizable assets will impact results of operations.

Other assets include royalty and licensing advances made in connection with licensing agreements we have for the use of third party intellectual property. When the products using the licensed intellectual property or technology begin to generate revenue, we begin amortization of the amount advanced. In cases where the advance represents a paid up license, the advance is amortized based on the estimated life of the asset. In those cases where the license agreement provides for a royalty to be earned by the licensor for each gaming machine sold or placed on a lease, the advance is amortized based on the royalty rates provided in the license agreement. In both cases the amortization of the advances is included in cost of sales if related to a product sale or cost of gaming operations if related to placement or lease in gaming operations. To the extent we determine that the products developed would not fully recover the guaranteed minimum amounts, we will record an immediate charge against earnings at the time of such determination.

Revenue Recognition

Product Sales

We record revenue on product sales, net of rebates, discounts, and allowances, when:

- persuasive evidence of an agreement exists,
- the sales price is fixed or determinable,
- the product is delivered and
- collectibility is reasonably assured.

We sell gaming machines through credit terms of 90 days or less or with credit terms that may extend up to two years under contracts of sale, usually secured by the related equipment, with interest recognized at market rates. Revenues are reported net of incentive rebates or discounts.

When multiple product deliverables are included under a sales contract, in accordance with EITF 00-21, Revenue Arrangements with Multiple Deliverables, we allocate revenue to each unit of accounting based upon their respective fair values against the total contract value and defer revenue recognition on those deliverables where we have not met all requirements of revenue recognition. The Company allocates revenue to each unit of accounting based upon its fair value as determined by vendor specific objective evidence. Vendor specific objective evidence of fair value for all elements of an arrangement is based upon the normal pricing and discounting practices for those products and services when sold.

The Company recognizes revenue when the product is delivered and defers revenue for any undelivered units of accounting. Deliverables are divided into separate units of accounting if:

- each item has value to the customer on a stand alone basis;
- we have objective and reliable evidence of the fair value of the undelivered items; and
- delivery of any undelivered item is considered probable and substantially in our control.

If the Company cannot objectively determine the fair value of any undelivered units of accounting included in the arrangement, all revenues are deferred until all of the items are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered units of accounting.

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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 product is delivered. If the installation of the product is not considered inconsequential and perfunctory, then we would defer revenue recognition until the installation is complete.

Gaming Operations

Gaming operations revenues under operating-type lease agreements are estimated and recognized as earned when collectibility is reasonably assured.

For WAP leasing agreements revenues are recognized based upon a percentage of amounts wagered, which is the difference between coins and currency deposited into the machines and payments to customers, called coin-in, on each gaming machine and are recognized as earned when collectibility is reasonably assured. WAP systems entail a configuration of numerous electronically linked slot machines located in multiple casino properties, connecting to a WMS central computer system via a network of communications equipment. WAP system games differ from stand alone units in that they build a progressive jackpot with every wager until a player hits the top award winning combination. WAP contribution revenues are recognized based on a percentage of coin-in generated by the game. Participating casinos pay a percentage of the coin-in directly to WMS for services related to the design, assembly, installation, operation, maintenance, and marketing of the WAP systems and to administer the progressive jackpot funding.

In fiscal 2005, we began offering local-area jackpot systems and we believe demand will increase for games linked to our local-area progressive jackpot system. A local-area progressive jackpot (LAP) system links gaming devices within a single casino to a progressive jackpot for that specific casino; whereas a wide-area progressive jackpot system links gaming machines in multiple casinos to a progressive jackpot for multiple casinos within a gaming jurisdiction. We also offer gaming machines that are not linked to a progressive jackpot system that we call stand-alone games. Stand-alone and local area 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.

Casino-owned daily fee games 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 to the casino at a normal sales price 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.

Under agreements with licensees who are generally located in geographic areas or operate in markets where we are not active, we are paid royalties based upon our licensees purchase or placement of gaming machines with our licensed themes, artwork, and other intellectual property. Royalties are recorded as earned when the licensee purchases or places the game and collectibility is reasonably assured.

WAP Jackpot Liabilities and Expenses

We record a WAP jackpot liability based on the actual volume of coin-in or slot play plus the initial progressive meter liability, or reset, on each system in each jurisdiction. We defer WAP jackpot expense for the initial progressive meter liability, or reset, on each WAP jackpot linked system, which is subsequently amortized to jackpot expense as the revenues are generated from the coin-in or slot play. Our jackpot liabilities totaled $4.0 million at December 31, 2005, and $1.8 million at June 30, 2005. To fund our jackpot liabilities, we maintain restricted cash and investments aggregating $9.0 million at December 31, 2005 and $3.5 million at June 30, 2005.

Advertising Expense

The cost of advertising is charged to expense as incurred.

Research and Development Costs

As a result of the gaming license requirements and regulatory approvals necessary to commercialize products in our business, our products reach technological feasibility shortly before products are released to manufacturing. Accordingly, internal research and development expenditures relating to the development of new products, including improvements to existing products, are expensed as incurred. Employee costs associated with product development are included in research and development costs.

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Foreign Currency Translation

The local currency is the functional currency (primary currency in which business is conducted) for our operations in Canada, Spain, Australia, the United Kingdom and South Africa. Adjustments resulting from translating foreign functional currency assets and liabilities into U.S. dollars are recorded as a separate component of stockholders equity. Gains or losses resulting from transactions in other than the functional currency are reflected in net income.

Accounting for Income Taxes

We account for income taxes using the asset and liability method. Under this method, income taxes are provided for amounts currently payable and for amounts deferred as tax assets and liabilities based upon differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred income taxes are measured using the enacted tax rates that are assumed will be in effect when the differences reverse.

Recent Accounting Pronouncements

FSP FAS13-1

In October 2005, the Financial Accounting Standards Board (FASB) issued FSP FAS13-1, Accounting for Rental Costs Incurred during a Construction Period, stipulating that rental costs associated with operating leases should be: (a) recognized as rental expense, (b) included in income from continuing operations, and (c) allocated over the lease term according to guidance in FAS 13, Accounting for Leases, and FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases. FAS 13-1 is effective for the first reporting period beginning after December 15, 2005. We anticipate that adoption of this Statement will not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

FSP FAS143-1

In June 2005, the FASB issued FSP FAS143-1, Accounting for Electronic Equipment Waste Obligations, to address accounting for obligations associated with the European Union s Directive 2002/96/EC on Waste Electrical and Electronic Equipment. The Directive, enacted in 2003, requires EU-member countries to adopt legislation to regulate the collection, treatment, recovery, and environmentally sound disposal of electrical and electronic waste equipment. The Directive distinguishes between products put on the market after August 13, 2005 as new waste and before that date as historical waste. FSP FAS143-1 only addresses accounting for historical waste and is required to be applied the later of the first reporting period ending after June 8, 2005 or the date of adoption of the law by the applicable European Union member country. We anticipate that adoption of this Statement will not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

FIN 47

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations, an Interpretation of FAS 143. FIN 47 requires recognition of a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. When sufficient information exists, uncertainty about the amount and/or timing of future settlement should be factored into the liability measurement. The interpretation is effective for the end of fiscal years ending after December 15, 2005. The adoption of this Statement will not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

SFAS 123R

In December 2004, the FASB revised SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123R), to address accounting for transactions in which an entity obtains employee services in share-based payment transactions. The provisions of this Statement are effective as of the beginning of the annual reporting period that begins after June 15, 2005. We implemented this SFAS on July 1, 2005 using the modified-prospective transition method. The impact of adopting this Statement was a pre-tax charge of $3.0 million and $5.8 million or an after-tax decrease in net income of $0.06 and $0.12 per diluted share for the three and six month periods ending December 31, 2005, respectively. Adoption of SFAS 123R for share-based payments also impacted our consolidated balance sheet as we reclassified $11.5 million of Unearned Compensation from Restricted Stock and Performance Contingent Restricted Units at June 30, 2005 to Additional Paid-in Capital as of July 1, 2005.

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SFAS 151

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4, clarifying the accounting for some circumstances in which items, such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Adoption of this Statement did not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

SFAS 153

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions, stipulating the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Adoption of this Statement did not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

SFAS 154

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections, requiring retrospective application to prior-period financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also redefines restatement as the revising of previously issued financial statements to reflect correction of errors made. SFAS 154 is effective for accounting charges and corrections of errors made in fiscal years beginning after December 15, 2005. We anticipate that adoption of this Statement will not have a significant effect on the Company s consolidated results of operations, cash flows, or financial position.

3. EARNINGS (LOSS) PER SHARE

The reconciliation of the numerators and denominators of the basic and diluted earnings per share was

(in millions, except per share amounts):

	Three Months Ended December 31, 2005			Six Months Ended December 31, 2005		
	Net Income	**Shares**	**Per Share Amount**	**Net Income**	**Shares**	**Per Share Amount**

Basic earnings per share:						
Net income applicable to common stock	$ 8.0	31.3	$ 0.26	$ 14.1	31.4	$ 0.45
Effect of dilutive securities:						
- options		0.4	(0.01)		0.5	(0.01)
- warrants						
- convertible notes	0.6	5.8	(0.02)	1.2	5.8	(0.04)
- restricted stock		0.1			0.1	
Diluted earnings per share:						
Net income applicable to common stock	$ 8.6	37.6	$ 0.23	$ 15.3	37.8	$ 0.40

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	Three Months Ended December 31, 2004			Six Months Ended December 31, 2004		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic earnings per share:						
Net income applicable to common stock	$ 3.9	30.6	$ 0.13	$ 6.3	30.4	$ 0.21
Effect of dilutive securities:						
- options		1.1			0.9	(0.01)
- warrants						
- convertible notes	0.6	5.8	(0.01)			
- restricted stock		0.1			0.1	
Diluted earnings per share:						
Net income applicable to common stock	$ 4.5	37.6	$ 0.12	$ 6.3	31.4	$ 0.20

For the six months ended December 31, 2004, if sufficient income had been earned, the total diluted shares outstanding would have assumed the conversion of our 2.75% convertible subordinated notes.

The following table describes the number of additional shares that would have been included in the total diluted shares outstanding assuming the hypothetical exercise of stock options and warrants under the treasury stock method and the conversion of our 2.75% convertible subordinated notes (in millions):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
If WMS had recognized income in excess of $0.10 and $0.20 per share, respectively:				
Common stock issuable upon conversion of the 2.75% convertible subordinated notes	not applicable	not applicable	not applicable	5.8
Excluded anti-dilutive common stock equivalents due to the grant price exceeding the market price for WMS common stock:				
Stock options, restricted stock and warrants	2.6	0.6	2.1	0.8

4. STOCK OPTION COMPENSATION AND EARNINGS PER SHARE

Prior to July 1, 2005, we elected to follow the intrinsic value based method prescribed by APB Opinion 25 to account for stock options granted to employees and directors, as allowed by SFAS No. 123, Accounting for Stock Based Compensation. Under APB No. 25, we did not recognize compensation expense upon the issuance of stock options because the option terms were fixed and the exercise price equals the market price of the underlying stock on the grant date. After July 1, 2005, we now recognize compensation expense for stock options determined using the fair value method in accordance with SFAS 123R.

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The following tables present a comparison of the actual three and six months ended December 31, 2005 and 2004 reported net income, net income per share and compensation cost of restricted stock and options granted to employees to the pro forma amounts that would have been reported if compensation expense had been determined using the fair value method required by SFAS No. 123R for the periods ended December 31, 2004 (in millions of dollars, except per share data):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
	Actual	Pro forma/ Actual	Actual	Pro forma/ Actual
As Reported:				
Net income	$ 8.0	$ 3.9	$ 14.1	$ 6.3
Income per share:				
Basic	$ 0.26	$ 0.13	$ 0.45	$ 0.21
Diluted	$ 0.23	$ 0.12	$ 0.40	$ 0.20
Stock based employee compensation cost, net of related tax effects, included in the determination of net income	$ 2.5	$ 0.4	$ 4.7	$ 0.6
Actual and pro forma amounts if the fair value method had been applied to all stock compensation awards:				
Actual and pro forma net income	$ 8.0	$ 2.5	$ 14.1	$ 2.3
Actual and pro forma net income per share:				
Basic	$ 0.26	$ 0.08	$ 0.45	$ 0.07
Diluted	$ 0.23	$ 0.08	$ 0.40	$ 0.07
Stock based employee compensation cost, net of related tax effects, that would have been included in the determination of net income	$ 2.5	$ 1.8	$ 4.7	$ 4.6

The following weighted average assumptions were used to value the options in the periods indicated:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Risk-free interest rate	7.00%	4.75%	6.75%	4.75%
Expected life	6.25 years	6 years	6.25 years	6 years
Expected volatility	0.39	0.36	0.39	0.36
Expected dividend yield				

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At December 31, 2005 and 2004, the Company had approximately 4.5 million and 4.4 million stock options and warrants outstanding, respectively. The following summarizes the stock options exercised during the periods indicated (in millions except per share data):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Stock options exercised	0.1	0.4	0.1	0.5
Weighted average exercise price per share	$ 19.08	$ 14.22	$ 17.65	$ 14.35

5. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION (in millions)

	Six Months Ended December 31,	
	2005	2004
Supplemental Disclosure of Cash Flow Information:		
Income taxes paid	$ 1.5	$
Income tax refunds received		0.1
Interest paid	1.6	1.6
Investment income received	0.6	0.7
Schedule of Non Cash Investing Activities:		
Gaming operations machines transferred to inventory	1.3	0.5
Accretion of deferred licensing purchase obligation	0.3	

6. COMPREHENSIVE INCOME

Comprehensive income consists of net income and foreign currency translation adjustments and totaled net income of $7.9 million and $4.9 million for the three months ended December 31, 2005 and 2004, respectively, and totaled net income of $14.2 million and $7.3 million for the six months ended December 31, 2005 and 2004, respectively.

7. INTANGIBLE ASSETS

At December 31, 2005 and June 30, 2005 intangible assets were (in millions):

	December 31, 2005	June 30, 2005

Prepaid royalties and licensing advances	$ 70.9	$ 68.2
Accumulated amortization	(21.1)	(18.4)