



2001 ANNUAL REPORT

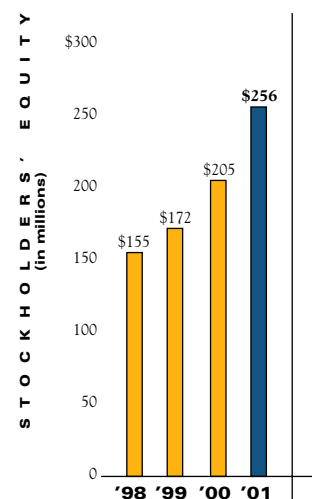
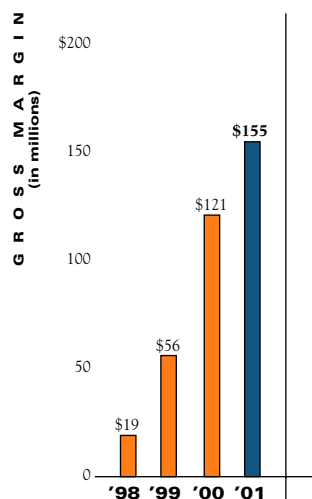
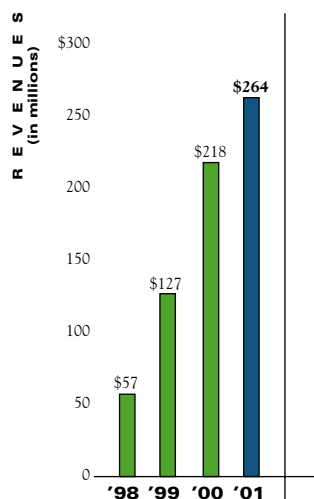


WMS INDUSTRIES INC. (NYSE: WMS) is exclusively focused on the gaming industry through the creation, design, manufacture and marketing of top-earning video and mechanical reel spinning slot machines and video lottery terminals.

WMS' mission is to create the most entertaining gaming products in the world and service its customers with an uncompromising passion for quality. All of our employees embrace our core values of innovation, tenacity, passion, quality and integrity and are guided by the fundamental principle of teamwork.

This Annual Report was completed just after the September 11, 2001 attack on America. We share with all Americans a deep sense of grief for those who lost their lives, and we extend our heartfelt sympathy to the families they left behind.

FINANCIAL HIGHLIGHTS



	Years Ended June 30,				
(In millions)	1998	1999	2000		2001
Revenues:					
Machine sales	\$ 49.3	\$102.4	\$150.0		\$173.6
Participation and leases	8.0	24.1	67.6		90.2
Total revenues	57.3	126.5	217.6		263.8
Total expenses	128.5	115.8	149.6		219.5
Operating income (loss)	(71.3)	10.7	68.0		44.2
Income (loss) from continuing operations	(43.9)	8.8	44.4		31.9
Discontinued operations, net of income taxes	21.9	(3.6)	14.6		4.4
Net income (loss)	(22.1)	5.3	29.8		36.3

To Our Shareholders: In fiscal 2001, the Company delivered solid growth and record financial results. We also achieved several important strategic milestones and successfully embarked on key initiatives to further enhance our industry position and provide for future growth.

A combination of new games, new markets and improved manufacturing processes and efficiencies led to an increase in income from continuing operations (prior to nonrecurring items) for fiscal 2001 of 36% to \$47.2 million, or \$1.47 per diluted share, compared to \$34.7 million, or \$1.11 per diluted share, in fiscal 2000. Fiscal 2001 revenues increased 21% to \$263.8 million compared with \$217.6 million last fiscal year. We continued to improve our strong balance sheet.

By year-end we had the most robust pipeline of products in our history, world-class manufacturing, warehousing and distribution facilities, and a creative development staff which continues to garner industry attention for its award-winning games. In June 2001, the MONOPOLY®, Reel ‘em In® and Jackpot Party® games were voted the first, second and third best video slot games in America by

winning

the readers of *Casino Player* magazine. This strong endorsement is a testament to our dedication to delivering the industry’s most innovative entertainment.

In fiscal 2001 we implemented a five-point strategy for success, employing a singular focus to maximize our results while continuing to achieve operating improvements and also setting the foundation for increasing market share, financial results and shareholder value:

- ◆ **Infrastructure in place for continued growth:** In December 2000 we completed the consolidation of our manufacturing, Chicago regional distribution, warehousing and corporate offices to Waukegan, Illinois. Combined with new manufacturing processes, this move allowed us to reduce our product lead times to 4-6 weeks—about half of the industry average—while also enabling us to achieve greater operating efficiencies. Currently, we are renovating our Chicago facility into a state-of-the-art technology campus for our growing development staff. These key facilities will provide the necessary infrastructure to achieve future growth.
- ◆ **Aggressively pursued the highly profitable participation business and secured key licenses:** During fiscal 2001 we successfully launched our second series of participation games: the *Puzzle Pays™* series, with the introductions of JUMBLE® and SCRABBLE® themed video slot machines. These games, combined with the launch of the newest MONOPOLY game, *Money Grab™*, helped to grow our installed base of participation games by 48%. Additionally, we focused on expanding our participation game offerings by licensing the rights to other world-class entertainment

brands, including HOLLYWOOD SQUARES™, PAC-MAN® and SURVIVOR™. In fiscal 2002, we are poised to capture additional market share in the participation market with the launch of eight new games including SURVIVOR, our first product placed on a wide-area progressive system.

- ◆ **International business launched:** We launched our international operations in fiscal 2001. By fiscal year-end we had product installations in 22 countries and recently opened a sales office in South Africa to compete in their casino and new low-payout markets. In June 2001 we installed our first games in Australia on the hardware platform of our strategic partner, Stargames Corporation Pty. Ltd. Australia is the largest gaming market outside of North America and is a 100% video slot market, which plays to our strengths. The strong initial performance of our games combined with favorable player reviews portends well for future success. We anticipate generating up to 33% of our base game revenues from international markets within three to five years.
- ◆ **Increased breadth of product line:** With the replacement market cycle shortening and more casinos favoring video products, we have expanded our pipeline of base games. We now have a game pipeline that should allow us to offer new, innovative gaming products, including our own proprietary wide-area progressive system in fiscal 2003.
- ◆ **Captured significant California market share:** The Company set an aggressive goal of 4,000 game sales for this new market. We achieved this goal in only eight months and by fiscal year-end we had exceeded that goal by 25%. We are the second largest game supplier in the state.

Finally, in June 2001 the Company announced that Brian R. Gamache would succeed me as Chief Executive Officer while continuing to serve as President. Clearly, WMS has been WINNING since Brian re-joined WMS in April 2000, and we were delighted to acknowledge his accomplishments and skills to drive the Company to further growth.

We are proud of WMS’ achievements and our evolution into a leading supplier of innovative gaming entertainment. We intend to leverage our world-class product development, manufacturing, licensing, distribution and sales resources to deliver WINNING games for players, higher earning products for our casino customers and increasing value for WMS shareholders.



It’s All About Winning,
and WMS Industries and
its shareholders were big
winners in fiscal 2001
as the Company delivered
solid growth and record
financial results.

Louis J. Nicastro

Chairman of the Board

September 15, 2001





winning

Forward thinking initiatives,
well-formed plans and
solid strategy have brought
WMS much success.

Winning Entertainment is the culmination of many elements like vibrant graphics, engaging characters, rich soundtracks and rewarding game play.



entertainment

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Winning. In the gaming business, “win” is measured in a variety of ways: the daily win of a single slot machine, the weekly win at a craps table or the monthly win of an entire casino floor. At WMS, our formula for winning encompasses a variety of diverse elements.

The WMS mission—to create the most entertaining products in the world and service the customer with an uncompromising passion for quality—is our key ingredient in the winning formula. Add to this our core values of integrity, innovation and tenacity with a dash of the guiding principle of teamwork and the winning formula is complete.

Forward thinking initiatives, well-formed plans and solid strategy have brought WMS much success. Creating the most entertaining products is the #1 way WMS wins against its competition. The *MONOPOLY*, *Reel ‘em In* and *Jackpot Party* games recently won the video slot category in *Casino Player* magazine’s “Best of Gaming 2001” poll. These games and others have helped grow our market share in the replacement market, the participation market, new markets like California

and in international jurisdictions. And just like our casino customers, we seek to increase the daily win of our participation games as part of the winning formula. All of these achievements are part of our dedication to winning. It’s all about winning.

As a shareholder of WMS, strong financial performance is your scorecard and in all respects fiscal 2001 was another winning year. With annual revenues of more than \$264 million, up 21% from fiscal 2000, and income from continuing operations prior to nonrecurring items of \$47.2 million, up 36%, our singular focus on gaming continued to pay off. Our strong balance sheet remains debt-free and our \$86 million in available cash and short-term investments provides us with great flexibility as we look to fill out our product line and continue expanding our business.

In this year’s annual report we outline our milestones and achievements over the last ten years and highlight what you can expect from us in the future.



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Throughout our fifty-year history, WMS has achieved industry-leading success in each business it entered. We applied our skills to the design and manufacture of gaming devices starting in 1992. Now, WMS has emerged as the second largest supplier of gaming devices in North America as well as a leading supplier to the rest of the world.

WMS first entered the gaming industry by working with state and provincial lotteries in North America. These lottery jurisdictions began managing gaming devices in the early 1990's known as Video Lottery Terminals (VLTs).

WMS next focused on designing a creative lineup of mechanical reel spinning slot machines. We leveraged our expertise at designing great games and broke new ground in

gaming with a state-of-the-art sound system and vibrant glass designs.

Then, the competitive landscape intensified. In 1996, a lawsuit claimed that our mechanical reel spinning games

leaders

infringed a patent for determining odds and outcomes. We refocused our energies on video slots propelling the Company, and the industry, towards this dynamic slot game category.

In 1997, WMS released what has become the most popular domestic video slot game, *Reel 'em In*. WMS' video game

library grew quickly. With successful games and a reputation as the innovation leader, we entered the recurring revenue sector of the business with a "participation" game.

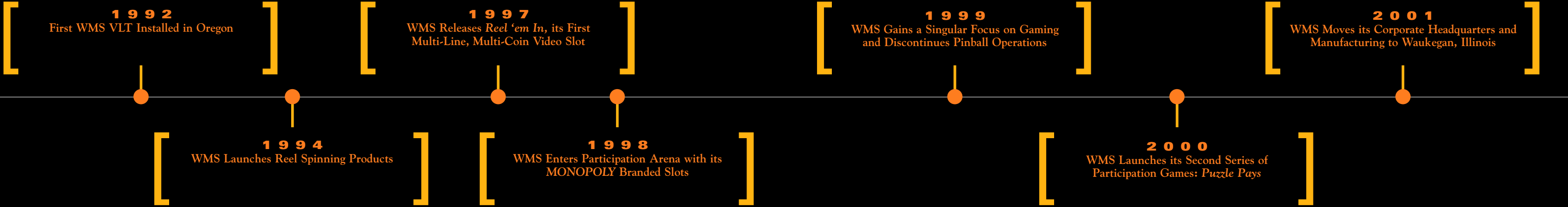
In 1998, WMS unveiled four *MONOPOLY* branded products. The daily earnings of these games transformed our financial model from entirely one-time

sales for each game to earnings from a daily lease rate or a percentage of winnings for participation games placed in casinos.

In October 1999, WMS Industries discontinued its pinball business and gained a singular focus on gaming. WMS Gaming would become the principal operating subsidiary.

WMS soon launched its second series of participation games the *Puzzle Pays* series, featuring games based on popular puzzle games, including *JUMBLE*, *SCRABBLE* and, in fiscal 2002, *PICTIONARY*® themed games. The popularity of this series drove further growth in our installed base of participation games thereby increasing our recurring revenues.

In January 2001, WMS began operating its manufacturing and corporate headquarters from its facility in Waukegan, Illinois. We consolidated our warehousing, part sales and manufacturing operations under one roof and unveiled plans to renovate our Chicago facility into a technology campus for product development positioning WMS for further growth.



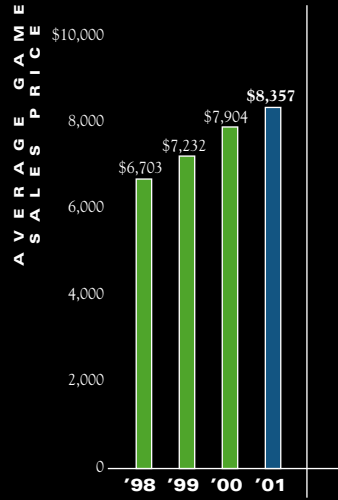
In fiscal 2001, the Company won the loyalty of casino patrons in two important markets which were new to WMS: International and California. In February 2000, the Company announced the formation of WMS Gaming International, S.L. and appointed an experienced international gaming team to direct sales and service functions. We opened an office in Barcelona, Spain from which we run our international sales and service efforts in Europe, Latin America and Southeast Asia. Licensing and regulatory processes, coupled with adapting our products to meet the needs of many countries, currencies and cultures, meant a significant dedication of our resources. Leveraging our position in North America, we expected that the universal appeal of our products would help win the interest of casino operators in international markets. We made a significant commitment to penetrate these markets and now are beginning to see the results in unit sales and revenues. As of June 2001, WMS has installed gaming products in 22 different countries. We now have a library of games available in English, Spanish, Portuguese, French and Italian.

winning in new markets

The second largest gaming market after the United States is Australia. The market is a mature 100% video market with almost 200,000 gaming devices installed throughout the country. When analyzing the market costs and time frame for entry, we concluded that a strategic alliance with an established Australian manufacturer offered us the winning formula to enter Australia on a competitive basis. That partner, Stargames, announced the approval of its new PC 3 platform in April 2001 at which time Louis Nicastro and Brian Gamache visited Australia to meet the operators, see the marketplace and stake their claim to a massive new territory for WMS' products. In May 2001, *Jackpot Party* specifically adapted for the Stargames platform and Australian players, was launched to tremendous reviews from the sophisticated Australian video slot players.

WMS Gaming has also opened an office in Johannesburg, South Africa to pursue the casino and newly authorized low payout markets in that country.

In May 2000, California legalized casino-style gaming on Native American lands thereby opening a new market for gaming suppliers. This event marked our first entrance into a new market as a proven industry leader. From the start, we set an aggressive sales goal of 4,000 units in California for fiscal 2001. In September 2000, we reported we had surpassed the halfway mark before the end of our first quarter. The initial success foreshadowed the continuing ability of WMS to win market share. We went on to exceed our annual sales goal by 25% with over 5,000 games shipped to California in fiscal 2001.



WMS Gaming has installed gaming products in 22 countries. We now have a library of games available in English, Spanish, Portuguese, French and Italian.





World-class brands bring new game opportunities, add new dimensions, and recognizability and even new players for any given game. But still, the graphics, game play, jackpot frequency and overall game experience must be exceptional to maintain player interest and keep the games earning net win at amounts above casinos' expectations.

Voted the best video slot of 2001 by more than 7,000 casino patrons, the MONOPOLY brand games embody all of the elements that players seek in a themed slot machine—a world-class brand which is immediately recognizable, entertaining game play and “rewarding” jackpots—all of which translate into an outstanding entertainment experience for casino patrons.

WMS is focused on acquiring the licensing rights to the top entertainment brands in the world. By coupling these brands with engaging game play, we maximize the brand names to create profitable participation games. In fiscal 2001, we aggressively pursued and secured the licenses to blockbuster brands for games to be launched over the next few years.

winning brands 10/11

In a licensing coup announced minutes after the airing of the season finale, WMS secured the rights to produce games based on the reality-based television phenomenon *SURVIVOR*. The first *SURVIVOR* themed game will premier in fiscal 2002 as a mechanical reel spinning product and will be the first WMS game ever to be included on a wide-area progressive platform thanks to a partnering agreement with International Game Technology (IGT). WMS will design, market and distribute the *SURVIVOR* brand gaming devices, which will be manufactured by IGT and placed on IGT's *MegaJackpots™* wide-area, progressive-linked jackpot system. WMS and IGT will share equally in the profits of these games.

Another important brand we recently licensed is the television game show, *HOLLYWOOD SQUARES*. Rich with material from nine “squares” of amusing celebrities, the *HOLLYWOOD SQUARES* brand offers our product development team countless avenues for creating entertaining interaction with the players. We also licensed another epic brand—*PAC-MAN*. The video game phenomenon of the '80s is being transformed into a video slot game. With its recognizable maze game play, chomping yellow *PAC-MAN* and distinctive game sounds, this brand will be immediately familiar to millions of players. These games will launch in fiscal 2002.

In June 2001, we announced the *Classic TV Game Show™* series of participation games, which will include branded slots based on *Password®*, *Beat the Clock®* and *Match Game®*. This series of games, which includes three of the biggest game show titles in television history, will enhance our lineup of branded participation slot machine offerings starting in fiscal 2003.

As participation games based on well-known pop culture themes increasingly command more casino floor space, WMS is well positioned to win market share in this growing segment.



Set to a country banjo theme song, the player picks some veggies from the farmer’s field before a gopher takes a bite in *Cash Crop*™.



There’s gold in that there game! Players uncover bonus awards in the mine as they play for precious metals in *Yukon Gold*™.



It’s *Off the Charts*™ with Rhythm & Blues classic hits like “Soul Man” and “Chain of Fools.” Listen to the music, see the gold records groove and dance to the sound of ch-ching!



Keep the change, ma’am. Our *Big Tippers*™ game is handing out fun with nice tokens for the cocktail waitress and player.

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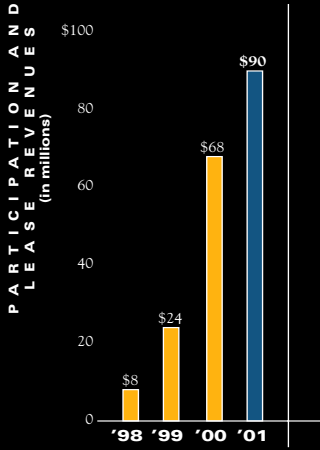
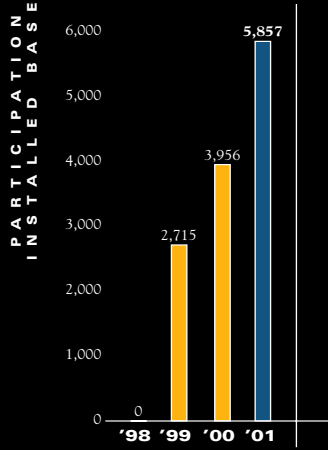
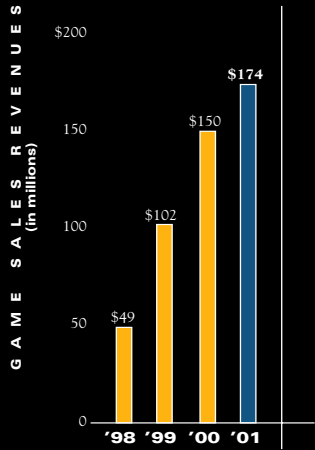
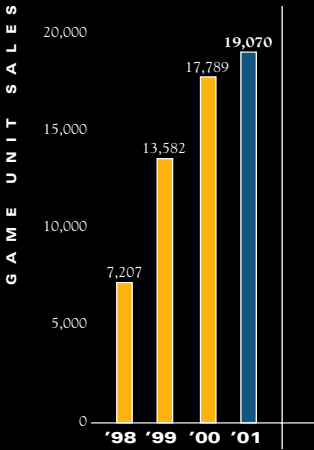
winning in the replacement market

As gaming markets mature, players become more savvy. The gaming climate in North America has changed from the “Las Vegas-centric, tourists’ only” view, to include many gaming markets where players make two to four trips to casinos each month. Instead of traveling to Las Vegas, customers now drive to their local casino. And it’s changing their expectations.

Mechanical reel spinning slots, once the reigning king of casino floors, are now sharing the spotlight with video slots popularized by WMS and others over the last few years. Although mechanical slots still represent the majority of most domestic casino floors, the make-up is rapidly changing. As more video slots are introduced, casinos are replacing reel spinners with video slots. And that’s a winning proposition for WMS.

Casinos respond to player demands. Casinos want games that satisfy their players’ desire for entertainment and interactivity. The life span for any game—video or reel spinning—has shortened. Players expect more from their gaming experience, and they expect something new more often. This factor is shortening the “replacement cycle,” a positive trend for industry participants such as WMS.

By continuing to build our game library, WMS offers its customers a myriad of options for keeping their floors fresh and satisfying for players. As casino floors change to include more video slots, WMS, which innovated this category, continues to lead the way with a great lineup of creative games with new bonuses and twists that keep players entertained.





for growth

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This year we relocated our manufacturing, warehousing, distribution and corporate headquarters to a more flexible and larger capacity owned facility in Waukegan, Illinois. We also unveiled plans to renovate our Chicago facility into a state-of-the-art technology campus for our creative product development group. The Waukegan facility, built in 1995, provides an excellent site to centralize our warehousing, Chicago regional distribution and manufacturing operations. With ample space on more than 38 acres, WMS is now well positioned for future growth and expansion.

We completed the move on schedule and on budget. Currently all worldwide manufacturing occurs in Waukegan. The cost efficiency gained through consolidating our operations and the capacity for greater production quantities were the top factors in our decision to relocate.

This year we relocated our manufacturing, warehousing, distribution and corporate headquarters to our Waukegan, Illinois facility shown below. The facility provides ample space on more than 38 acres positioning WMS for future growth and expansion.

People are our most important asset, and we recently implemented programs to achieve our long-term goal of being the employer of choice in our industry. We grew our employee base to provide for our future growth with the intent to be able to develop and launch 20 new themes in fiscal 2002: eight participation games and twelve games for sale.

With the new facilities, new processes and more creative talent, the infrastructure is now in place to help us achieve our goals for growth in fiscal 2002 and beyond.

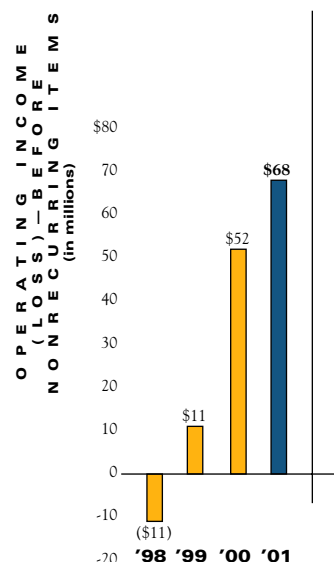
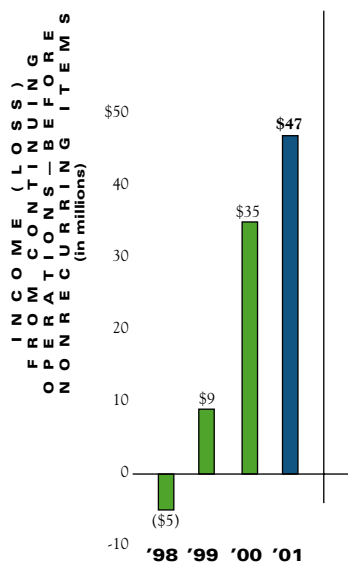
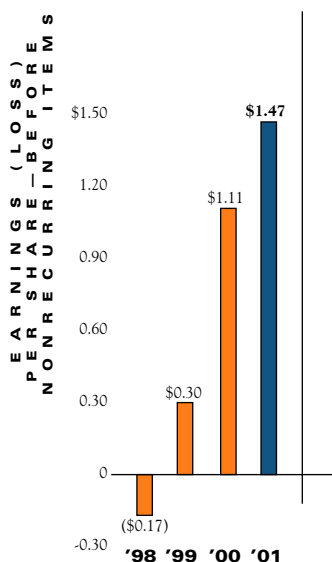


Increasing market share and achieving substantial revenue growth and cost efficiencies are all strong measurements of a company's performance. The new executive management team hired over this past year clearly has focused on improving each one of these metrics and our very favorable financial results reflect the outcome of their efforts.

The employees at WMS have adopted a bottom line adherence to winning. Their strong performance day-in and day-out drives our business forward, drives our success and creates value for our shareholders. Living by the core values of tenacity, innovation, integrity, quality and passion, and the underlying principle of teamwork, our WMS team will continue to strive for excellence. And excellence for us translates into great products for our casino customers and their patrons and strong financial performance, translating into greater shareholder value.

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winning is strong performance



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SELECTED FIVE-YEAR FINANCIAL DATA

(In thousands, except per share amounts)		Fiscal Year Ended June 30,				
		2001	2000	1999	1998	1997
Selected Statement of Operations Data:						
Revenues		\$263,772	\$217,629	\$126,524	\$ 57,281	\$ 33,890
Operating income (loss)		44,239	67,984	10,678	(71,250)	(76,319)
Income (loss) from continuing operations before income taxes		49,987	71,438	14,203	(66,840)	(74,101)
Provision (benefit) for income taxes		18,069	27,016	5,397	(22,891)	(29,123)
Income (loss) from continuing operations		31,918 ⁽¹⁾	44,422 ⁽²⁾	8,806 ⁽³⁾	(43,949) ⁽⁴⁾	(44,978) ⁽⁵⁾
Discontinued operations, net of applicable income taxes:						
Pinball and cabinet segment		4,409	(13,539)	(4,332)	(5,103)	(1,819)
Contract manufacturing segment		—	(1,077)	779	228	—
Video games segment						
Income from discontinued operations—net		—	—	—	26,746	35,804
Gain on initial public offering of subsidiary		—	—	—	—	47,771
Hotel and casino segment		—	—	—	—	3,917
Net income (loss)		\$ 36,327	\$ 29,806	\$ 5,253	\$(22,078)	\$ 40,695
Basic earnings per share of common stock:						
Income (loss) from continuing operations		\$ 1.01 ⁽¹⁾	\$ 1.45 ⁽²⁾	\$ 0.30 ⁽³⁾	\$ (1.66) ⁽⁴⁾	\$ (1.85) ⁽⁵⁾
Net income (loss)		\$ 1.15	\$ 0.97	\$ 0.18	\$ (0.84)	\$ 1.67
Basic shares outstanding		31,557	30,615	29,308	26,446	24,334
Diluted earnings per share of common stock:						
Income (loss) from continuing operations		\$ 1.00 ⁽¹⁾	\$ 1.42 ⁽²⁾	\$ 0.30 ⁽³⁾	\$ (1.66) ⁽⁴⁾	\$ (1.85) ⁽⁵⁾
Net income (loss)		\$ 1.13	\$ 0.95	\$ 0.18	\$ (0.84)	\$ 1.67
Diluted shares outstanding		32,050	31,322	29,511	26,446	24,334
Selected Balance Sheet Data at June 30:						
Total assets		\$278,482	\$239,030	\$238,079	\$207,522	\$306,915
Working capital		173,083	146,321	117,369	99,132	86,176
Long-term debt		—	—	—	—	57,500
Stockholders' equity		256,386	205,420	172,079	155,291	196,000

(1) Income from continuing operations for fiscal 2001 includes an after-tax charge of \$13.0 million, \$0.40 per diluted share, related to the executive buyout agreement and an after-tax charge of \$2.3 million, \$0.07 per diluted share, for the costs of relocating our manufacturing and executive offices to Waukegan, Illinois during the year.

(2) Income from continuing operations for fiscal 2000 includes an after-tax reversal of an excess accrual of \$9.7 million, \$0.31 per diluted share, related to patent litigation, and an after-tax charge of \$1.2 million, \$0.04 per diluted share, from our 1998 spin-off of Midway Games Inc. related to the adjustment of compensatory stock options.

(3) Income from continuing operations for fiscal 1999 includes an after-tax charge of \$1.9 million, \$0.06 per diluted share, from our 1998 spin-off of Midway Games Inc. related to the adjustment of compensatory stock options.

(4) Loss from continuing operations for fiscal 1998 includes an after-tax charge of \$39.9 million, \$1.51 per diluted share, from our 1998 spin-off of Midway Games Inc. related to the adjustment of compensatory stock options.

(5) Loss from continuing operations for fiscal 1997 includes an after-tax charge of \$37.4 million, \$1.54 per diluted share, related to patent litigation.

FISCAL 2001 SIGNIFICANT EVENTS AND TRENDS

In August 2000, we announced the operations of our contract manufacturing segment were being discontinued. We completed the windup of this segment in the second quarter of fiscal 2001. Our consolidated financial statements reflect the contract manufacturing segment as a discontinued operation.

The California marketplace for gaming machines opened in May 2000. During fiscal 2001, we sold over 5,000 gaming machines in California. At June 30, 2001, we had over 400 participation games installed in California.

In August 2000, we also announced that we would convert our 129,400 square foot corporate headquarters and manufacturing facility in Chicago to a creative technology campus where we would conduct all engineering, graphic design and game development functions. Our corporate headquarters and manufacturing, Chicago regional distribution and warehousing operations were relocated to our Waukegan, Illinois facility in the December 2000 fiscal quarter. We recorded total relocation related charges of \$3.7 million before taxes, or \$0.07 per diluted share, during fiscal 2001. We believe the move has reduced our lead times for product delivery and has begun to improve operating efficiencies related to the production of our games.

In September 2000, we introduced *JUMBLE*®, the first game in our new *Puzzle Pays*™ series of participation games that will also include *SCRABBLE*® and *PICTIONARY*®. We launched our first *SCRABBLE* participation game in June 2001. We anticipate the next game in our *Puzzle Pays* series, *PICTIONARY*, will be released in the December 2001 quarter.

In March 2001, we announced a licensing agreement whereby we secured the exclusive worldwide rights to develop, manufacture and market gaming machines based on *PAC-MAN*® and *MS. PAC-MAN*®. We anticipate submitting the first *PAC-MAN* themed game to regulatory agencies for approval in Fall 2001. We also announced a licensing agreement whereby we secured the exclusive worldwide rights to develop, manufacture and market gaming machines based on the television show *HOLLYWOOD SQUARES*™. We submitted the *HOLLYWOOD SQUARES* game for regulatory approval in August 2001.

In April 2001, we announced an agreement to develop games based on *SURVIVOR*™, a reality-based television series, to be placed on a wide-area progressive jackpot system operated by International Game Technology. We will design and market the games, which will be manufactured by International Game Technology, and we have agreed to split the profits with them equally. We expect the game will be submitted for regulatory approval in the March 2002 quarter.

In June 2001, we announced the first installations of our *Jackpot Party*™ games in Australia. These games are manufactured by Stargames Corporation Pty. Ltd. using their PC 3 hardware platform under our agreement with them. We have also received approval from the Australian testing authorities for other games, including the first version of the *MONOPOLY*® themed games. We estimate that the Australian gaming device market totals just under 200,000

gaming machines, making it the largest gaming market outside of the United States.

Our fiscal 2001 results include a nonrecurring pre-tax charge of \$20.3 million, or \$0.40 per diluted share, related to an executive buyout agreement with our former Chief Executive Officer, Louis J. Nicastro. This charge is recorded as part of selling and administrative expense in our financial statements. Mr. Nicastro remains as our nonexecutive Chairman of the Board of Directors.

Recent incidents of terrorism in the United States have caused increased security measures for domestic airline flights and reduced overall levels of business and leisure airline travel. The reduced travel will likely have an adverse effect on the casino and gaming industry. We expect reduced game play in the near term, particularly in Las Vegas, which may negatively impact our revenues.

LIQUIDITY AND CAPITAL RESOURCES

We believe that cash and cash equivalents and short-term investments of \$86.5 million at June 30, 2001, along with our \$50.0 million bank revolving line of credit that extends to May 1, 2002, and cash flow from operations will be adequate to fund our anticipated level of capital expenditures, cash to be invested in participation games, and increases in the levels of inventories and receivables required in the operation of our business.

Cash provided by continuing operating activities before changes in operating assets and liabilities was \$64.6 million for fiscal 2001, as compared to cash provided of \$31.4 million for fiscal 2000. The increase was due to \$6.5 million of increased net income, \$4.2 million of greater depreciation and amortization and \$5.3 million of higher tax benefits from the exercise of more common stock options in the current fiscal year, while the prior year's activities included a litigation settlement payment of \$27.0 million and a non-cash reversal of excess accruals related to that litigation of \$15.6 million, partially offset by deferred income taxes of \$11.4 million and a non-cash loss from discontinued operations of \$14.6 million.

The changes in operating assets and liabilities resulted in \$40.6 million of cash outflow for fiscal 2001, compared with a cash inflow of \$3.8 million during the prior fiscal year. Cash outflow for fiscal 2001 was primarily due to an increase in inventories and other assets, together with an increase in current refundable taxes and a decrease in current liabilities due to payments of liabilities of discontinued operations from the comparable balances at June 30, 2000, partially offset by a smaller increase in accounts receivable. The increase in inventories is due to the increased overall level of business including game production to support the anticipated increase in participation game placements. The increase in other assets reflects increases in deferred tax assets, non-current notes receivable and advance royalty payments related to future game development. The cash inflow for fiscal 2000 was primarily due to a decrease in inventories from the comparable balances at June 30, 1999, and income taxes refundable due to the litigation settlement. We have not experienced significant bad debt expense in any of the periods discussed.

Cash used by investing activities was \$37.7 million for fiscal 2001, compared with cash used of \$72.7 million for fiscal 2000. Cash used for the purchase of property, plant and equipment for fiscal 2001 was \$8.1 million, compared with \$3.1 million for fiscal 2000. This increase resulted from the improvements made to our Waukegan, Illinois headquarters and manufacturing facility and the first phases of our Chicago product development facility renovation. Cash used for additions to participation games was \$18.8 million and \$8.9 million for fiscal 2001 and 2000, respectively. The increase in fiscal 2001 resulted from an increase of 1,901 participation games from June 30, 2000 to June 30, 2001 compared to 1,241 units from June 30, 1999 to June 30, 2000 coupled with higher component costs for the latest participation games. Net cash of \$10.7 million was used for the purchase of short-term investments for fiscal 2001, compared to \$60.8 million in fiscal 2000.

Cash provided by financing activities, which was from the exercise of common stock options, was \$7.4 million for fiscal 2001 compared with \$1.6 million for the prior fiscal year due to a greater number of option exercises.

For fiscal 2001, the discontinued pinball and cabinet segment provided \$2.8 million of cash, and the discontinued contract manufacturing segment used \$1.4 million of cash. The cash provided by the pinball and cabinet segment reflects refundable income taxes due to a tax deduction for the write-off of goodwill associated with this business. For fiscal 2000, the pinball and cabinet segment used \$5.1 million of cash, and the contract manufacturing segment provided \$2.2 million of cash.

RESULTS OF OPERATIONS

Fiscal 2001 Compared with Fiscal 2000

Consolidated revenues increased 21.2% to \$263.8 million in fiscal 2001 from \$217.6 million in fiscal 2000. Total revenue increased \$46.1 million: \$23.5 million from increased machine sales and \$22.6 million from increased participation game revenue. We shipped 19,070 video and mechanical reel type gaming devices in the current fiscal year, resulting in product and parts sales of \$173.6 million versus 17,789 gaming devices shipped and \$150.0 million of product and parts sales in the prior fiscal year due to the continued market acceptance of new models, the impact of the opening of the California market and the launch of product sales outside of North America, partially offset by a decline in new casino openings from the prior fiscal year. In addition, the average sales price increased from \$7,904 in the prior fiscal year to \$8,357 in the current fiscal year primarily due to a price increase implemented in August 2000 and a change in sales mix to higher priced products.

The increase in participation game revenue was due to an increase in the installed base of participation games to a total of 5,857 units installed at June 30, 2001, compared to 3,956 units installed at June 30, 2000. The installed base increased due to

continued growth in MONOPOLY games and the introduction of our second series of participation games in fiscal 2001 with JUMBLE and SCRABBLE brand games as the first games in this series. We introduced *Money Grab*[™], the eighth version of the MONOPOLY product, in February 2001. Average net win per day per machine decreased from \$47.32 in fiscal 2000 to \$43.76 in the current fiscal year. This decrease resulted primarily from the higher mix of games in lower net win jurisdictions in the current fiscal year. The backlog for our participation games stood at over 550 units as of June 30, 2001.

Consolidated gross profit in fiscal 2001 rose 28.0% to \$155.0 million from \$121.1 million in fiscal 2000. The gross margin percentage increased from 55.6% in fiscal 2000 to 58.8% in fiscal 2001. The increase in gross margin percentage resulted from higher gross profit margins on gaming machine sales and the impact of higher margin participation game revenues being a slightly higher portion of total revenues. The gross margin on gaming machine sales increased from 41.2% in fiscal 2000 to 44.7% in fiscal 2001 due to the increase in average sales price and the mix of products to higher margin products, including higher game conversion revenues, coupled with realizing benefits from consolidating manufacturing, warehousing and distribution operations in Waukegan, Illinois in December 2000. The gross profit margin on participation game revenues decreased slightly from 87.7% in fiscal 2000 to 85.8% in fiscal 2001 due to higher replacement part costs on fully depreciated machines still in service and the lower average net revenue per day per machine.

Research and development expenses increased \$6.2 million, or 52.8%, in the current fiscal year to \$17.8 million from \$11.7 million in fiscal 2000 as we continued to invest in people and technologies to develop new games, product platforms and operating systems. The increase was primarily due to higher engineering expenditures and increased headcount, and included costs to adapt our games for distribution to international markets. We anticipate higher staffing levels will allow us to increase the number of new games we introduce in the coming year. During fiscal 2001, we introduced five new games for sale and four new participation games, including SCRABBLE and the latest version of MONOPOLY, *Money Grab*.

Selling and administrative expenses increased 65.7% from \$42.7 million in fiscal 2000 to \$70.8 million in the current fiscal year. The fiscal 2001 amount includes a \$20.3 million pre-tax charge for the executive buyout agreement. Excluding this nonrecurring charge, selling and administrative expenses increased 18.3%, as we increased our cost structure to support our 21.2% revenue growth.

Corporate relocation expenses of \$3.7 million, or \$0.07 per diluted share, in the current fiscal year represent costs associated with the relocation and centralization of our corporate headquarters, manufacturing, Chicago regional distribution and warehousing facilities to Waukegan, Illinois.

Depreciation and amortization increased during the current fiscal year to \$18.5 million from \$14.3 million in the prior fiscal year due to the increase in the installed base of participation games. The average installed base was 4,850 units for fiscal 2001, compared to 3,414 units for fiscal 2000. The 28.9% increase in depreciation and amortization expense reflects the 42.1% increase in the average installed base of participation games partially offset by a reduction in depreciation on those participation games originally installed in fiscal 1999 that have been depreciated to net realizable value.

Operating income was \$44.2 million in the current fiscal year, compared to \$68.0 million in the prior fiscal year. The financial results of the current fiscal year reflect the pre-tax charge of \$20.3 million from the costs associated with the executive buyout agreement and \$3.7 million of costs associated with our relocation to Waukegan, Illinois, while the financial results for fiscal 2000 include a \$15.6 million gain from reversal of an excess accrual due to settlement of patent litigation. Excluding these items, operating income increased 30.2% from \$52.4 million in fiscal 2000 to \$68.1 million in fiscal 2001 as revenue and gross margin increases were partially offset by higher research and development, selling and administrative and depreciation and amortization expenses.

The provision for income taxes on continuing operations decreased to \$18.1 million in the current fiscal year from \$27.0 million in the prior fiscal year. The decrease was due to lower pre-tax income in the current fiscal year. The effective tax rate was 36.1% in fiscal 2001, compared to 37.8% in fiscal 2000. This lower effective rate reflects the beneficial tax treatment of foreign sourced income and dividend investment income, and higher tax credits in the current year.

Income from continuing operations was \$31.9 million, or \$1.00 per diluted share, in the current fiscal year, compared to \$44.4 million, or \$1.42 per diluted share, in the prior fiscal year. The financial results of the current fiscal year reflect after-tax charges of \$13.0 million, or \$0.40 per diluted share, from the costs associated with the executive buyout agreement and \$2.3 million, or \$0.07 per diluted share, for costs associated with our relocation to Waukegan, Illinois, while the financial results for fiscal 2000 include a one-time after-tax gain of \$9.7 million, or \$0.31 per diluted share, from the reversal of the excess accrual related to the settlement of patent litigation. Excluding these items, income from continuing operations increased 36.2% from \$34.7 million, or \$1.11 per diluted share, in fiscal 2000 to \$47.2 million, or \$1.47 per diluted share, in fiscal 2001 as revenue and gross margin increases were partially offset by higher research and development, selling and administrative and depreciation and amortization expenses.

Net income, which includes continuing operations and discontinued operations, was \$36.3 million, or \$1.13 per diluted share, for the current fiscal year compared to \$29.8 million, or \$0.95 per diluted share, for the prior fiscal year.

Fiscal 2000 Compared with Fiscal 1999

Consolidated revenues increased to \$217.6 million, or 72.0%, in fiscal 2000 from \$126.5 million in fiscal 1999. Total revenue increased \$91.1 million; \$47.6 million from increased machine sales and \$43.5 million from increased participation game revenue. The increase in revenue from machine sales results primarily from the sale of 17,789 video and mechanical reel type gaming devices in fiscal 2000 compared to 13,582 gaming devices in fiscal 1999, due to the continued market acceptance of new models introduced. In addition, the average sales price increased from \$7,232 in fiscal 1999 to \$7,904 in fiscal 2000 primarily due to a price increase implemented in August 1999 and a change in product mix to sales of higher priced products.

The increase in participation game revenue was from an increase in the installed base of MONOPOLY themed gaming devices which were introduced in fiscal 1999 and had a total of 2,715 units installed at June 30, 1999 and 3,956 units installed at June 30, 2000. Average net win per day for MONOPOLY themed machines decreased from \$50.77 in fiscal 1999 to \$47.32 in fiscal 2000 due to an expansion of the installed base to lower performing locations in gaming jurisdictions where we participate in the net win of the location.

Consolidated gross profit for fiscal 2000 rose to \$121.1 million, or 117.5%, from \$55.7 million in fiscal 1999. The gross margin percentage increased from 44.0% in fiscal 1999 to 55.6% in fiscal 2000. The increase in gross margin resulted from higher average sales prices, a greater percentage of higher margin participation game revenues included in total revenues in the June 2000 fiscal year, the impact of higher utilization of our manufacturing facility and lower material costs.

Research and development expenses increased during fiscal 2000 to \$11.7 million from \$8.7 million in fiscal 1999 as we continued to invest in enhancing our product pipeline and product platform. The increase was due to higher engineering expenditures, including costs to adapt our games for distribution to international markets. During fiscal 2000, we introduced six new games for sale and two new versions of the MONOPOLY participation games. Research and development expenses in fiscal 2000 also were incurred for a new participation game, JUMBLE, which was introduced in the first quarter of fiscal 2001. During fiscal 1999, we introduced seven new games for sale and the first four versions of the MONOPOLY participation games.

Selling and administrative expenses increased 40.6% from \$30.4 million in fiscal 1999 to \$42.7 million in fiscal 2000 as we increased our cost structure to support our 72.0% revenue growth. The increase in expenses included a higher number of sales and administrative staff and expenses associated with opening our international sales office in Barcelona, Spain.

Depreciation and amortization increased during fiscal 2000 to \$14.3 million from \$5.9 million in fiscal 1999 due to the increase in the installed base of MONOPOLY machines under lease. The average installed base was 3,414 units for fiscal 2000, compared to 895 units for fiscal 1999.

Operating income was \$68.0 million in fiscal 2000, compared to \$10.7 million in fiscal 1999. The financial results of fiscal 2000 reflect a one-time pre-tax gain of \$15.6 million from the reversal of the excess accrual due to the settlement of patent litigation. The balance of the increase was a result of higher revenues and margins, partially offset by the increases in research and development, depreciation and amortization and selling and administrative expenses.

The provision for income taxes increased \$21.6 million, to \$27.0 million in fiscal 2000 from \$5.4 million in fiscal 1999. The increase was due primarily to higher pre-tax income. The effective rate was 37.8% in fiscal 2000 compared to 38.0% in fiscal 1999 due to a lower effective state tax rate in fiscal 2000.

Income from continuing operations was \$44.4 million, or \$1.42 per diluted share, in fiscal 2000, compared to \$8.8 million, or \$0.30 per diluted share, in fiscal 1999. The financial results of fiscal 2000

reflect a one-time after-tax gain of \$9.7 million, or \$0.31 per diluted share, from the reversal of the excess accrual due to settlement of patent litigation. The balance of the increase was a result of higher revenues and margins, partially offset by the increases in research and development, depreciation and amortization, selling and administrative expenses and income tax expense.

Net income, which includes continuing operations and discontinued operations in fiscal 2000 and 1999, was \$29.8 million, or \$0.95 per diluted share, for fiscal 2000 compared to \$5.3 million, or \$0.18 per diluted share, for fiscal 1999. Adjustments to previously outstanding WMS stock options that subsequently vested reduced net income for fiscal 2000 and 1999 by \$1.2 million and \$1.9 million respectively, or \$0.04 and \$0.06 per diluted share, respectively.

IMPACT OF INFLATION

During the past three years, the general level of inflation affecting us has been relatively low. Our ability to pass on future cost increases in the form of higher sales prices will continue to be dependent on the prevailing competitive environment and the acceptance of our products in the marketplace.

Our common stock, \$.50 par value, is traded publicly on the New York Stock Exchange under the symbol "WMS." The following table shows the high and low sales prices of our common stock for the two most recent fiscal years, as reported on the NYSE:

	High	Low
Fiscal Year Ended June 30, 2001		
First Quarter	\$23.38	\$14.38
Second Quarter	23.88	13.44
Third Quarter	20.89	15.65
Fourth Quarter	32.64	16.63
Fiscal Year Ended June 30, 2000		
First Quarter	\$16.81	\$10.88
Second Quarter	13.56	10.38
Third Quarter	16.00	9.75
Fourth Quarter	15.44	7.75

No cash dividends were declared or paid during fiscal 2001 or 2000. The payment of future cash dividends will depend upon, among other things, our earnings, anticipated expansion and capital requirements and financial condition.

At September 15, 2001, there were approximately 1,000 holders of record of our common stock.

REPORT OF INDEPENDENT AUDITORS

To the Stockholders and Board of Directors
WMS Industries Inc.

We have audited the accompanying consolidated balance sheets of WMS Industries Inc. and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended June 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the

overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of WMS Industries Inc. and subsidiaries at June 30, 2001 and 2000, and the consolidated results of their operations and cash flows for each of the three years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Chicago, Illinois
August 8, 2001

CONSOLIDATED BALANCE SHEETS

	June 30,	
	2001	2000
<i>(In thousands, except share amounts)</i>		
Assets		
Current assets:		
Cash and cash equivalents	\$ 14,963	\$ 19,869
Short-term investments	71,524	60,800
	86,487	80,669
Receivables, net of allowances of \$3,931 in 2001 and \$3,592 in 2000	46,218	45,190
Notes receivable, current portion	13,857	9,076
Income tax receivable	10,431	—
Inventories:		
Raw materials and work in progress	16,656	10,152
Finished goods	16,290	19,121
	32,946	29,273
Assets of discontinued operations	—	5,246
Deferred income taxes	3,162	9,279
Other current assets	2,078	1,198
Total current assets	195,179	179,931
Gaming machines on participation or lease, net	32,409	20,454
Property, plant and equipment, net	31,973	30,465
Other assets	18,921	8,180
Total assets	\$278,482	\$239,030
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 6,659	\$ 8,352
Accrued compensation and related benefits	5,753	3,735
Income taxes payable	—	2,956
Liabilities of discontinued operations	—	8,242
Other accrued liabilities	9,684	10,325
Total current liabilities	22,096	33,610
Stockholders' equity:		
Preferred stock (5,000,000 shares authorized, none issued)	—	—
Common stock (32,236,380 shares issued in 2001 and 30,920,042 shares issued in 2000)	16,118	15,460
Additional paid-in capital	198,276	184,278
Retained earnings	42,391	6,064
Accumulated other comprehensive income—translation adjustment	(17)	—
Treasury stock, at cost (77,312 shares in 2001 and 2000)	(382)	(382)
Total stockholders' equity	256,386	205,420
Total liabilities and stockholders' equity	\$278,482	\$239,030

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended June 30,		
	2001	2000	1999
<i>(In thousands, except per share amounts)</i>			
Revenues:			
Machine sales	\$173,572	\$150,033	\$102,463
Participation and lease	90,200	67,596	24,061
Total revenues	263,772	217,629	126,524
Costs and expenses:			
Cost of sales	96,006	88,217	68,316
Cost of participation and lease revenue	12,772	8,342	2,547
Research and development	17,815	11,658	8,665
Selling and administrative	70,791	42,713	30,377
Depreciation and amortization	18,496	14,346	5,941
Corporate relocation	3,653	—	—
Reversal of excess accrual due to settlement of litigation	—	(15,631)	—
Total costs and expenses	219,533	149,645	115,846
Operating income	44,239	67,984	10,678
Interest and other income	5,748	3,454	3,525
Income from continuing operations before income taxes	49,987	71,438	14,203
Provision for income taxes	18,069	27,016	5,397
Income from continuing operations	31,918	44,422	8,806
Discontinued operations, net of applicable income taxes:			
Pinball and cabinet segment			
Loss from discontinued operations	—	(469)	(4,332)
Income (costs) related to discontinuance	4,409	(13,070)	—
Contract manufacturing segment			
Income from discontinued operations	—	598	779
Costs related to discontinuance	—	(1,675)	—
Income (loss) from discontinued operations	4,409	(14,616)	(3,553)
Net income	\$ 36,327	\$ 29,806	\$ 5,253
Basic per share of common stock:			
Income from continuing operations	\$ 1.01	\$ 1.45	\$ 0.30
Net income	\$ 1.15	\$ 0.97	\$ 0.18
Diluted per share of common stock:			
Income from continuing operations	\$ 1.00	\$ 1.42	\$ 0.30
Net income	\$ 1.13	\$ 0.95	\$ 0.18
Average number of shares outstanding—basic	31,557	30,615	29,308
Average number of shares outstanding—diluted	32,050	31,322	29,511

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

<i>(In thousands, except share amounts)</i>	Common stock	Additional paid-in capital	Retained earnings (deficit)	Cumulative translation adjustment	Treasury stock, at cost	Total stockholders' equity	Comprehensive income
Balance as of June 30, 1998	\$ 14,016	\$ 170,418	\$(28,995)	\$ —	\$(148)	\$ 155,291	
Net income for the year ended June 30, 1999	—	—	5,253	—	—	5,253	\$ 5,253
Issuance of 2,395,855 shares of common stock through exercise of stock options	1,198	6,893	—	—	—	8,091	
Tax benefit from common stock options	—	3,678	—	—	—	3,678	
Received 25,000 treasury shares in lieu of cash from exercise of stock options	—	—	—	—	(234)	(234)	
Balance as of June 30, 1999	15,214	180,989	(23,742)	—	(382)	172,079	5,253
Net income for the year ended June 30, 2000	—	—	29,806	—	—	29,806	29,806
Issuance of 491,421 shares of common stock through exercise of stock options	246	1,333	—	—	—	1,579	
Tax benefit from common stock options	—	1,956	—	—	—	1,956	
Balance as of June 30, 2000	15,460	184,278	6,064	—	(382)	205,420	29,806
Net income for the year ended June 30, 2001	—	—	36,327	—	—	36,327	36,327
Issuance of 1,316,338 shares of common stock through exercise of stock options	658	6,770	—	—	—	7,428	
Tax benefit from common stock options	—	7,228	—	—	—	7,228	
Foreign currency translation adjustment	—	—	—	(17)	—	(17)	(17)
Balance as of June 30, 2001	\$16,118	\$198,276	\$42,391	\$(17)	\$(382)	\$256,386	\$36,310

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years ended June 30,		
	2001	2000	1999
Cash Flows From Operating Activities			
Net income	\$ 36,327	\$ 29,806	\$ 5,253
Adjustments to reconcile net income to net cash provided by operating activities:			
Discontinued operations:			
Loss from pinball and cabinet segment	—	469	4,332
Income from contract manufacturing segment	—	(598)	(779)
(Income) costs related to discontinuance	(4,409)	14,745	—
Depreciation and amortization	18,496	14,346	5,941
Provision for bad debts	815	1,943	2,979
Non-cash loss on asset disposals	1,206	—	—
Non-cash loss on corporate relocation	1,971	—	—
Reversal of excess accrual due to settlement of litigation	—	(15,631)	—
Payment in settlement of litigation	—	(27,000)	—
Deferred income taxes	2,974	11,376	147
Tax benefit from exercise of common stock options	7,228	1,956	3,678
Increase (decrease) resulting from changes in operating assets and liabilities:			
Receivables	(6,623)	(18,529)	(14,011)
Income taxes	(13,253)	10,422	6,857
Inventories	(11,804)	4,022	(5,375)
Other current assets	(880)	(563)	(207)
Other assets	(7,600)	(808)	2,854
Accounts payable and accruals	(449)	9,250	9,826
Net cash provided by operating activities	23,999	35,206	21,495
Cash Flows From Investing Activities			
Purchase of property, plant and equipment	(8,124)	(3,079)	(9,140)
Additions to gaming machines on participation or lease	(18,844)	(8,860)	(20,201)
Net change in short-term investments	(10,724)	(60,800)	26,000
Net cash used by investing activities	(37,692)	(72,739)	(3,341)
Cash Flows From Financing Activities			
Cash received on exercise of stock options	7,428	1,579	7,857
Cash Flows From Discontinued Operations			
Pinball and cabinet segment	2,766	(5,073)	(5,904)
Contract manufacturing segment	(1,390)	2,227	1,619
Net cash provided (used) by discontinued operations	1,376	(2,846)	(4,285)
Effect of Exchange Rates on Cash	(17)	—	—
Increase (decrease) in cash and cash equivalents	(4,906)	(38,800)	21,726
Cash and cash equivalents at beginning of year	19,869	58,669	36,943
Cash and cash equivalents at end of year	\$ 14,963	\$ 19,869	\$ 58,669

See notes to consolidated financial statements.

NOTE 1: BUSINESS OVERVIEW

WMS Industries Inc. ("WMS") is now engaged in one business segment: the design, manufacture and marketing of slot machines (video and mechanical reel type) and video lottery terminals. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles. 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.

On October 25, 1999, WMS announced the closing of its pinball and cabinet segment and on August 10, 2000, WMS announced the discontinuance of its contract manufacturing segment with operations ceasing on September 30, 2000. Accordingly, the financial position, results of operations and cash flows of these segments have been reported as discontinued operations in the consolidated financial statements.

NOTE 2: PRINCIPAL ACCOUNTING POLICIES**Consolidation Policy**

The consolidated financial statements include the accounts of WMS and its majority-owned subsidiaries (the "Company"). All significant intercompany accounts and transactions have been eliminated. Certain prior year balances have been reclassified to conform with the current year presentation.

Cash Equivalents

All highly liquid investments with maturities of three months or less when purchased are considered to be cash equivalents.

Short-Term Investments

All investments are designated as available-for-sale and are recorded at market value with the holding gain or loss, if any, reflected in stockholders' equity. Short-term investments consist principally of money market preferred stocks that generally have no fixed maturity dates but have dividend reset dates generally every 49 days or less.

Inventories

Inventories are valued at the lower of cost (determined by the first-in, first-out method) or market.

Property, Plant and Equipment and Gaming Machines on Participation or Lease

Property, plant and equipment and gaming machines on participation or lease are stated at cost and depreciated by the straight-line method over their estimated useful lives. Significant replacements and improvements are capitalized. Other maintenance and repairs are expensed.

Revenue Recognition

Revenue is recognized from product sales when the title to product and the risk and rewards of ownership transfer to the customer. Participation and lease revenue under operating type lease agreements are recognized when earned. Participation agreements are based on a pre-determined percentage of the daily net win of each machine. Lease agreements specify a fixed daily rental fee.

Advertising Expense

The cost of advertising is charged to earnings as incurred and for fiscal 2001, 2000 and 1999 was \$824,000, \$614,000 and \$1,011,000, respectively.

Research and Development

Research and development costs are expensed as incurred.

Foreign Currency Translation

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

Reconciliation of Numerators and Denominators of the Basic and Diluted Earnings Per Share from Continuing Operations

Year ended June 30, 2001				Per-Share
<i>(in thousands, except per share amounts)</i>		Income	Shares	Amount
Basic EPS				
Income available to common stockholders	\$31,918	31,557		\$1.01
Effect of Dilutive Securities—Options	—	493		0.01
Diluted EPS				
Income available to common stockholders	\$31,918	32,050		\$1.00
Year ended June 30, 2000				Per-Share
<i>(in thousands, except per share amounts)</i>		Income	Shares	Amount
Basic EPS				
Income available to common stockholders	\$44,422	30,615		\$1.45
Effect of Dilutive Securities—Options	—	707		0.03
Diluted EPS				
Income available to common stockholders	\$44,422	31,322		\$1.42
Year ended June 30, 1999				Per-Share
<i>(in thousands, except per share amounts)</i>		Income	Shares	Amount
Basic EPS				
Income available to common stockholders	\$ 8,806	29,308		\$0.30
Effect of Dilutive Securities—Options	—	203		0.00
Diluted EPS				
Income available to common stockholders	\$ 8,806	29,511		\$0.30

Options to purchase 290,000 shares of common stock at a weighted average price of \$12.33 per share were outstanding during the last quarter of the year ended June 30, 2000 but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares for the quarter. The options, which expire on June 30, 2010, were still outstanding as of June 30, 2000.

Options to purchase 45,000 shares of common stock at a weighted average price of \$14.87 per share were outstanding during the last quarter of the year ended June 30, 1999 but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares for the quarter. These options, which expire on June 30, 2009, were still outstanding as of June 30, 1999.

Accounting Policy Change

In July 2000, the Emerging Issues Task Force issued EITF Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." The Company adopted the provisions of Issue 00-10 for the year ended June 30, 2001 and reclassified the prior years' presentation accordingly. This Issue required that the costs the Company bills to its customers for shipping and handling in a sale transaction be classified as revenue. In addition, all shipping and handling costs incurred by the Company are to be recorded as cost of goods sold. Prior to the adoption of EITF 00-10, the Company netted shipping and handling billings and costs and recorded them in cost of sales. There was no effect on the Company's net income as a result of the adoption of this pronouncement.

NOTE 3: DISCONTINUED OPERATIONS

As discussed in Note 1, on October 25, 1999, WMS announced the closing of its pinball and cabinet segment and on August 10, 2000, WMS announced the discontinuance of its contract manufacturing segment with operations ceasing effective September 30, 2000. Accordingly, the financial position, results of operations and cash flows of these businesses have been reported as discontinued operations in the consolidated financial statements.

In fiscal 2000, the Company recorded a \$21.3 million pre-tax loss for the closing of the pinball and cabinet operations, including cash expenses of \$10.1 million, for projected operating losses through the disposal date, severance pay, and shut down expenses. The loss on disposal included \$11.2 million of non-cash losses for the write-downs of receivables, inventory, plant and equipment to net realizable value. Tax benefits related to the loss on disposal were estimated to be \$8.1 million.

In fiscal 2001, WMS recorded an after-tax gain of \$1.3 million, which reflects the final adjustments to the Company's fiscal 2000 estimated loss on the disposal and the related tax expense. In addition, the Company recorded a tax benefit of \$3.1 million related to the write-off for tax purposes of \$8.6 million of goodwill associated with the original acquisition of the pinball business.

The condensed statement of operations for the pinball and cabinet segment for the fiscal years ended June 30, 2000 and 1999 is as follows:

(in thousands)	2000	1999
Revenues	\$25,499	\$46,109
Costs and expenses	26,255	53,097
Loss before tax provision	(756)	(6,988)
Benefit for income taxes	(287)	(2,656)
Net loss	\$ (469)	\$ (4,332)

In fiscal 2000, the Company recorded a \$2.8 million pre-tax loss for the closing of its contract manufacturing business, including cash expenses of \$1.2 million, for severance pay and shut down expenses. The loss on disposal included \$1.6 million in non-cash losses for write-downs of receivables, inventory, plant and equipment to net realizable value. Tax benefits related to the loss on disposal were estimated to be \$1.1 million.

The condensed statement of operations for the contract manufacturing segment for the fiscal years ended June 30, 2000 and 1999 is as follows:

(in thousands)	2000	1999
Revenues	\$ 11,118	\$ 15,225
Costs and expenses	10,153	13,968
Income before tax provision	965	1,257
Provision for income taxes	367	478
Net income	\$ 598	\$ 779

NOTE 4: PROPERTY, PLANT AND EQUIPMENT AND GAMING MACHINES ON PARTICIPATION OR LEASE

At June 30, net property, plant and equipment were:

(in thousands)	2001	2000
Land	\$ 2,985	\$ 2,985
Buildings and improvements	25,116	25,926
Machinery and equipment	16,147	18,426
Furniture and fixtures	4,483	2,548
	48,731	49,885
Less accumulated depreciation	(16,758)	(19,420)
Net property, plant and equipment	\$ 31,973	\$ 30,465

At June 30, net gaming machines on participation or lease were:

(in thousands)	2001	2000
Gaming machines	\$ 64,967	\$ 39,371
Less accumulated depreciation	(32,558)	(18,917)
Net gaming machines on participation or lease	\$ 32,409	\$ 20,454

The Company reclassified \$8.1 million and \$3.6 million of inventory to gaming machines on participation or lease for the years ended June 30, 2001 and 2000, respectively.

NOTE 5: OTHER ASSETS

At June 30, other assets were:

(in thousands)	2001	2000
Deferred tax asset—non-current	\$ 4,861	\$ 1,718
Notes receivable	5,637	1,770
Other	8,423	4,692
Total other assets	\$ 18,921	\$ 8,180

NOTE 6: OTHER ACCRUED LIABILITIES

At June 30, other accrued liabilities were:

(in thousands)	2001	2000
Accrued property taxes	\$ 1,034	\$ 1,024
Royalties payable	2,534	1,931
Sales taxes payable	1,652	1,195
Liability under tax sharing agreement	—	2,800
Other accrued liabilities	4,464	3,375
Total other accrued liabilities	\$ 9,684	\$ 10,325

NOTE 7: INCOME TAXES

Significant components of the provision (benefit) for income taxes for the years ended June 30, 2001, 2000 and 1999 were:

(in thousands)	2001	2000	1999
Current			
Federal	\$11,064	\$11,828	\$ 1,490
State	2,570	1,856	82
Foreign	161	—	—
Total current	13,795	13,684	1,572
Deferred			
Federal	(2,721)	10,478	(356)
State	(233)	898	(34)
Foreign	—	—	—
Change in state allocations	—	—	537
Total deferred	(2,954)	11,376	147
Provision for tax benefit resulting from stock options	7,228	1,956	3,678
Provision for income taxes on continuing operations	18,069	27,016	5,397
Benefit for income taxes on discontinued operations	(1,807)	(9,246)	(2,178)
Income tax provision, net	\$16,262	\$17,770	\$ 3,219

Deferred income taxes reflect the net tax effects of temporary differences between the amount of assets and liabilities for financial reporting purposes and the amounts used for income taxes. Significant components of the Company's deferred tax assets and liabilities at June 30 were:

(in thousands)	2001	2000
Deferred tax assets resulting from:		
Inventory valuation	\$1,265	\$ 1,702
Receivables valuation	1,553	1,512
Book over tax depreciation	4,861	2,092
Discontinued operations	—	5,517
Accrued items not currently deductible	619	303
Other	57	476
Total deferred tax assets	\$8,355	\$11,602
Deferred tax liabilities resulting from:		
Federal tax benefit of deferred state taxes	\$ 255	\$ 605
Other	77	—
Total deferred tax liabilities	332	605
Net deferred tax assets	\$8,023	\$10,997

The provision for income taxes on continuing operations differs from the amount computed using the statutory federal income tax rate for the years ended June 30, 2001, 2000 and 1999 as follows:

	2001	2000	1999
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.9	2.9	8.7
Dividend received deduction on investment income	(1.3)	(0.4)	(5.1)
Foreign sales corporation tax benefit	(1.0)	—	—
Other, net	0.5	(0.3)	(0.6)
	36.1%	37.8%	38.0%

Taxes paid in the years ended June 30, 2001, 2000 and 1999 were \$20,316,000 and \$5,900,000 and \$31,000, respectively. Refunds received in the years ended June 30, 2001, 2000 and 1999 were \$1,031,000 and \$2,080,000, and \$4,642,000, respectively.

NOTE 8: LINE OF CREDIT

The Company has an unused line of credit for \$50,000,000 under a revolving credit agreement for a one-year term to May 1, 2002 which contains usual credit terms for a bank line. No borrowing occurred on the line in the years ended June 30, 2001 and 2000.

NOTE 9: STOCKHOLDERS' EQUITY AND COMMON STOCK PLANS

Authorized common stock of the Company consists of 100,000,000 shares of \$.50 par value. At June 30, 2001, 3,933,627 shares of common stock were reserved for possible issuance under stock option plans. Additionally, there are 5,000,000 shares of \$.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 the Board of Directors.

On April 6, 1998, the WMS Rights Agreement became effective. Under the Rights Agreement, each share of WMS common stock has an accompanying Right to purchase, under certain conditions, one one-hundredth of a share of the Company's Series A Preferred Stock at an exercise price of \$100, permitting each holder to receive \$200 worth of the Company's common stock valued at the then current market price. The rights become exercisable if any person or entity that did not, before the Plan was adopted, own 15% or more of our common stock, acquires beneficial ownership of 15% or more of our common stock. The Rights are redeemable by the Company at \$.01 per Right, subject to certain conditions, at any time and expire in 2007.

Under the stock option plans, the Company may grant both incentive stock options and nonqualified options on shares of common stock through the year 2011. Options may be granted to employees and under certain conditions to non-employee directors and consultants. The stock option committee has the authority to fix the terms and conditions upon which each employee option is granted, but in no event shall the term exceed ten years or generally be granted at less than 100% of the fair market value of the stock on the date of grant.

On September 30, 1997, the Company entered into an agreement with each of the holders of all of the common stock options then outstanding, which were exercisable into 4,089,011 shares of WMS common stock, regarding an option adjustment in connection with our spin-off of Midway Games Inc. in 1998, to compensate the holders for the lost opportunity value represented by the shares of Midway distributed in the spin-off which option holders did not participate in. Expense related to the adjustment of stock options that were not vested as of June 30, 1998 was recorded and paid consistent with the options' vesting schedule. During fiscal 2001, 2000 and 1999, \$196,000, \$1,962,000 and \$3,037,000 of such expense was recorded, respectively. As of June 30, 2001, all obligations under this agreement had been paid.

The Company accounts for stock options for purposes of determining net income in accordance with APB No. 25.

A summary of the status of the Company's stock option plans for the three years ended June 30, 2001 was as follows:

	Shares (In thousands)	Weighted Average Exercise Price
Outstanding at June 30, 1998	4,406	\$ 3.65
Granted	456	9.93
Exercised	(2,396)	3.38
Forfeited	(137)	3.67
Outstanding at June 30, 1999	2,329	5.16
Granted	1,103	9.62
Exercised	(491)	3.21
Forfeited	(261)	6.56
Outstanding at June 30, 2000	2,680	6.97
Granted	1,626	18.40
Exercised	(1,316)	5.69
Forfeited	(667)	15.95
Outstanding at June 30, 2001	2,323	13.03

The following tables summarize information about stock options outstanding at June 30, 2001:

Range of Exercise Prices	Options outstanding			Options exercisable	
	Number Outstanding (000)	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number Outstanding (000)	Weighted Average Exercise Price
\$ 2.51–\$ 3.75	245	3.1	\$ 3.40	217	\$ 3.35
4.32– 5.25	88	6.9	4.49	24	4.40
7.13– 10.50	672	8.5	8.84	45	9.38
10.75– 15.00	260	8.6	12.22	190	12.19
17.31– 22.88	1,058	9.4	18.83	—	—
2.51– 22.88	2,323	8.3	13.03	476	7.51

At June 30, 2001, 1,611,000 shares were available for future grants under the plans. At June 30, 2000, 1,386,000 options with a weighted average exercise price of \$5.38 per share were exercisable. At June 30, 1999, 1,566,000 options with a weighted average exercise price of \$4.03 per share were exercisable.

The Company has a Treasury Share Bonus Plan for key employees covering all the shares of common stock held in the treasury. The vesting and other terms of the awards are flexible. No awards of treasury stock were outstanding at June 30, 2001 or 2000.

SFAS No. 123 regarding stock option plans permits the use of APB 25 but requires the inclusion of certain pro forma disclosures in the footnotes. Pro forma net income and net income per share adjusted for the pro forma expense provisions of SFAS No. 123 for the years ended June 30, 2001, 2000 and 1999 were:

(in thousands, except per share amounts)	2001	2000	1999
Pro forma net income	\$33,230	\$28,646	\$4,784
Pro forma net income per share:			
Basic	\$ 1.05	\$ 0.94	\$ 0.16
Diluted	\$ 1.04	\$ 0.91	\$ 0.16

The pro forma fair value of each option grant is estimated on the date of grant or modification using the Black-Scholes option-pricing model with the following weighted average assumptions used for modifications and grants in fiscal 2001, 2000 and 1999: dividend

yield 0% for all three years; expected volatility of .60 in fiscal 2001, .75 in fiscal 2000 and .80 for fiscal 1999; risk-free interest rates of 5.00% in 2001, 6.00% in 2000 and 5.95% in 1999; and expected life of the options of 6 years for fiscal 2001, 2000 and 1999. The weighted average pro forma fair value, using the Black-Scholes assumptions noted above, of the options granted during fiscal 2001, 2000 and 1999 was \$11.25, \$6.75 and \$7.22, respectively.

NOTE 10: CONCENTRATION OF CREDIT AND MARKET RISK AND FAIR VALUE DISCLOSURES OF FINANCIAL INSTRUMENTS

Financial instruments which potentially subject the Company to concentrations of credit and market risk consist primarily of cash equivalents, short-term investments and trade notes and accounts receivable. By policy, the Company places its cash equivalents and short-term investments only in high credit quality securities and limits the amounts invested in any one security. The accounts and notes receivable from the sale of gaming devices are generally from a large number of customers with no significant concentration other than in Nevada.

In fiscal year 2000, one domestic customer accounted for approximately 10.3% of consolidated sales. No customers accounted for more than 10% in fiscal years 2001 and 1999.

The amount reported for cash equivalents and short-term investments is considered to be a reasonable estimate of their fair value.

NOTE 11: COMMITMENTS

The Company leases certain of its office facilities and equipment under non-cancelable operating leases with net future lease commitments for minimum rentals at June 30, 2001 as follows:

(in thousands)

2002	\$ 986
2003	767
2004	708
2005	667
2006	256
Thereafter	23
	<u>\$3,407</u>

Rent expense for fiscal 2001, 2000 and 1999 was \$1,730,000, \$1,340,000 and \$1,332,000, respectively.

The Company has commitments for minimum royalty payments related to licensed brand names and other intellectual property that aggregate \$8.7 million at June 30, 2001 and are payable over five years.

NOTE 12: RETIREMENT PLANS

The Company sponsors 401(k) defined contribution plans within the United States. The plans cover full time employees and provide for Company contributions of up to 3 percent of covered employees' compensation as defined in the plans. The Company's expense for the defined contribution plans totaled \$385,000, \$437,000 and \$303,000 in fiscal years 2001, 2000 and 1999, respectively.

NOTE 13: QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial information for fiscal 2001 and 2000 is as follows, and has been restated to reflect discontinued operations of the pinball and cabinet segment and the contract manufacturing segment:

	Sept. 30	Dec. 31	Mar. 31	June 30
(in thousands, except per share amounts)	2000	2000	2001	2001
Fiscal 2001 Quarters				
Revenues	\$59,842	\$67,408	\$70,748	\$65,774
Gross profit	34,183	38,226	41,581	41,004
Net income	9,463	11,033	12,671	3,160
Per share of common stock:				
Basic:				
Net income	\$ 0.30	\$ 0.35	\$ 0.40	\$ 0.10
Shares used	31,087	31,601	31,646	31,898
Diluted:				
Net income	\$ 0.30	\$ 0.34	\$ 0.39	\$ 0.10
Shares used	31,766	32,324	32,275	32,586

The September 30, 2000, December 31, 2000, March 31, 2001 and June 30, 2001 quarters include an after-tax charge of \$0.3 million, \$0.01 per diluted share, \$1.6 million, \$0.04 per diluted share, \$0.2 million, \$0.01 per diluted share and \$0.2 million, \$0.01 per diluted share, respectively, for the relocation of manufacturing operations and corporate headquarters during the fiscal year. The December 31, 2000 and June 30, 2001 quarters include after-tax earnings of \$1.6 million, \$0.05 per diluted share, and \$2.8 million, \$0.09 per diluted share, respectively, for the final adjustments related to the discontinued pinball and cabinet business. The June 30, 2001 quarter includes an after-tax charge of \$13.0 million, \$0.40 per diluted share, for an executive buyout agreement.

	Sept. 30	Dec. 31	Mar. 31	June 30
(in thousands, except per share amounts)	1999	1999	2000	2000

Fiscal 2000 Quarters

Revenues	\$48,302	\$52,025	\$49,331	\$67,971
Gross profit	27,806	28,457	28,416	36,391
Net income (loss)	(4,720)	15,558	7,709	11,259

Per share of common stock:

Basic:

Net income (loss)	\$ (0.15)	\$ 0.51	\$ 0.25	\$ 0.37
Shares used	30,488	30,573	30,726	30,780

Diluted:

Net income (loss)	\$ (0.15)	\$ 0.50	\$ 0.25	\$ 0.36
Shares used	30,488	31,305	31,361	31,401

The December 31, 1999, March 31, 2000 and June 30, 2000 quarters include an after-tax charge of \$0.6 million, \$0.02 per diluted share, \$0.5 million, \$0.02 per diluted share and \$0.1 million, nil per diluted share, respectively, for the spin-off related adjustment to WMS outstanding common stock options vesting during each quarter. The December 31, 1999 and June 30, 2000 quarters include an after-tax reversal of an excess accrual of \$8.2 million, \$0.26 per diluted share, and \$1.5 million, \$0.05 per diluted share, related to the settlement of patent litigation. The September 30, 1999 quarter includes an after-tax charge of \$13.6 million, \$0.44 per diluted share, for the discontinuance of the pinball and cabinet business. The June 30, 2000 quarter includes an after-tax charge of \$1.7 million, \$0.05 per diluted share, for the discontinuance of the contract manufacturing segment. The September 30, 1999, December 31, 1999, March 31, 2000 and June 30, 2000 quarters include after-tax earnings of \$0.1 million, nil per diluted share, \$0.1 million, nil per diluted share, \$0.2 million, \$0.01 per diluted share, and \$0.1 million, nil per diluted share, respectively, for the discontinued contract manufacturing segment.

CORPORATE DATA

DIRECTORS

Louis J. Nicastrò
Chairman of the Board
WMS Industries Inc.

Norman J. Menell
Vice Chairman of the Board
WMS Industries Inc.

Brian R. Gamache
President and Chief Executive Officer
WMS Industries Inc.

William C. Bartholomay*
President
Near North National Group
(Insurance Brokers)
Vice Chairman
Turner Broadcasting—a division of
AOL Time Warner Inc.

William E. McKenna*
General Partner
MCK Investment Company
(Private Investment Company)

Donna More
Partner
More Law Group
(Attorneys-at-Law)

Neil D. Nicastrò
*Chairman of the Board, Chief Executive
Officer, Chief Operating Officer and President*
Midway Games Inc.

Harvey Reich
Attorney-at-Law

David M. Satz, Jr.
Partner
Saiber Schlesinger Satz & Goldstein
(Attorneys-at-Law)

Ira S. Sheinfeld*
Partner
Squadron, Ellenoff, Plesent & Sheinfeld LLP
(Attorneys-at-Law)

**Members of Audit and Ethics Committee*

EXECUTIVE OFFICERS

Brian R. Gamache
President and Chief Executive Officer

Scott D. Schweinfurth
*Executive Vice President,
Chief Financial Officer and Treasurer*

Orrin J. Edidin
*Executive Vice President, Chief Operating
Officer, General Counsel and Secretary*

Seamus M. McGill
Executive Vice President—Sales and Marketing

Robert R. Rogowski
Vice President—Finance and Controller

EXECUTIVE OFFICE

800 S. Northpoint Blvd.
Waukegan, IL 60085
(847) 785-3000

AUDITORS

Ernst & Young LLP
233 South Wacker Drive
Chicago, IL 60606

COUNSEL TO THE COMPANY

Shack Siegel Katz Flaherty & Goodman P.C.
530 Fifth Avenue
New York, NY 10036

TRANSFER AGENT AND REGISTRAR

Shareholder Inquiries:
The Bank of New York
Shareholder Relations
Department-11E
P.O. Box 11258
Church Street Station
New York, NY 10286
(800) 524-4458

Certificate Transfers and Address Changes:
The Bank of New York
Receive and Deliver
Department-11W
P.O. Box 11002
Church Street Station
101 Barclay Street
New York, NY 10286

COMMON STOCK

WMS Industries Inc. common stock is listed
on the New York Stock Exchange under the
symbol WMS.

SHAREHOLDER RELATIONS

(847) 785-3760

PUBLICATIONS

A copy of our Annual Report on Form 10-K
is available without charge upon written
request to:

WMS Industries Inc.
800 S. Northpoint Blvd.
Waukegan, IL 60085
Attn: Chief Financial Officer

WEBSITE

www.wmsgaming.com

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800 S. Northpoint Blvd.
Waukegan, IL 60085
Tel 847-785-3000
Fax 847-785-3790
www.wmsgaming.com