

Invitae Corp
Form 424B5
March 01, 2019
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**Filed Pursuant to 424(b)(5)
Registration No. 333-226756**

PROSPECTUS SUPPLEMENT

(To Prospectus dated August 24, 2018)

Invitae Corporation

Up to \$100,000,000

Common Stock

We entered into an amendment to the sales agreement with Cowen and Company, LLC, or Cowen, dated as of August 9, 2018, relating to shares of our common stock offered by this prospectus supplement and the accompanying prospectus. In accordance with the terms of such amended sales agreement, or Sales Agreement, we may offer and sell shares of our common stock having an additional aggregate offering price of up to \$100,000,000 from time to time during the term of the Sales Agreement through Cowen acting as our agent.

Our common stock is listed on The New York Stock Exchange under the symbol NVTA. On February 27, 2019, the last reported sale price of our common stock on The New York Stock Exchange was \$20.40 per share.

Sales of our common stock, if any, under this prospectus supplement and the accompanying prospectus will be made in sales deemed to be an at the market offering as defined in Rule 415(a)(4) promulgated under the Securities Act of 1933, as amended, or the Securities Act. Cowen is not required to sell any specific amount of securities, but will act as our sales agent using commercially reasonable efforts consistent with its normal trading and sales practices, on mutually agreed terms between Cowen and us. There is no arrangement for funds to be received in any escrow, trust or similar arrangement.

The compensation to Cowen for sales of common stock sold pursuant to the Sales Agreement will be an amount up to 3.0% of the gross proceeds of any shares of common stock sold under the Sales Agreement. In connection with the sale of the common stock on our behalf, Cowen will be deemed to be an underwriter within the meaning of the Securities Act and the compensation of Cowen will be deemed to be underwriting commissions or discounts. We have also agreed to provide indemnification and contribution to Cowen with respect to certain liabilities, including liabilities under the Securities Act or the Securities Exchange Act of 1934, as amended.

Investing in our common stock involves risks. See the section entitled Risk Factors beginning on page S-5 of this prospectus supplement and in the documents we incorporate by reference into this prospectus supplement and the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement and the accompanying prospectus. Any representation to the contrary is a criminal offense.

Cowen

The date of this prospectus supplement is February 28, 2019

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ABOUT THIS PROSPECTUS SUPPLEMENT

This document contains two parts. The first part is this prospectus supplement, which describes the specific terms of this offering and also supplements and updates information contained in the accompanying prospectus and the documents incorporated by reference into this prospectus supplement and the accompanying prospectus. The second part is the accompanying prospectus, which provides more general information, some of which may not apply to this offering. If the information contained in this prospectus supplement differs or varies from the information contained in the accompanying prospectus, you should rely on the information set forth in this prospectus supplement.

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and Cowen has not, authorized anyone else to provide you with information that is in addition to or different from that contained or incorporated by reference in this prospectus supplement and the accompanying prospectus, along with the information contained in any permitted free writing prospectuses we have authorized for use in connection with this offering.

We are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus supplement and the accompanying prospectus is accurate only as of the date of this prospectus supplement or the date of the accompanying prospectus, and the information in the documents incorporated by reference in this prospectus supplement and the accompanying prospectus is accurate only as of the date of those respective documents, regardless of the time of delivery of this prospectus supplement and the accompanying prospectus or of any sale of our common stock. Our business, financial condition, results of operations and prospects may have changed since those dates. It is important for you to read and consider all information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus in making your investment decision. You should read both this prospectus supplement and the accompanying prospectus, as well as the documents incorporated by reference into this prospectus supplement and the accompanying prospectus and the additional information described under **Where You Can Find More Information** in this prospectus supplement and in the accompanying prospectus, before investing in our common stock.

Unless the context otherwise requires, references in this prospectus supplement to **Invitae**, **the company**, **we**, **us** and **our** refer to Invitae Corporation and its consolidated subsidiaries.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights certain information about us and this offering. Because it is a summary, it does not contain all of the information that you should consider before investing. Before investing in our common stock, you should read this entire prospectus supplement and the accompanying prospectus carefully, including the Risk Factors, and the financial statements and accompanying notes and other information incorporated by reference in this prospectus supplement and the accompanying prospectus.

Our Company

Our mission is to bring comprehensive genetic information into mainstream medical practice to improve the quality of healthcare for billions of people. Combining genetic testing services that support patient care throughout life's journey from family planning, to proactive health screening, to inherited disease diagnosis with a unique, rapidly expanding network of patients, healthcare providers, biopharma and advocacy partners, we seek to capture the broad potential of genetics and expand its use across the healthcare continuum.

We offer high quality, comprehensive, affordable genetic testing across multiple clinical areas, including hereditary cancer, cardiology, neurology, pediatrics, metabolic conditions and rare diseases. To augment our offering and realize our mission, we have acquired multiple assets. We acquired four businesses in 2017 and in doing so expanded our suite of genome management offerings and completed our entry into prenatal and perinatal genetic testing.

In 2017, we established a leading position in family health genetic information services through the strategic acquisition of reproductive health testing capabilities. In January 2017, we acquired AltaVoice, formerly PatientCrossroads, a patient-centered data company with a global platform for collecting, curating, coordinating and delivering safeguarded data from patients and clinicians. This acquisition was complemented by the acquisition in June 2017 of Ommdom, Inc. and its product, CancerGene Connect, an end-to-end platform for collecting and managing genetic family histories to deliver personalized genetic risk information. In August 2017, we acquired Good Start Genetics Inc., or Good Start, a molecular diagnostics company focused on preimplantation and carrier screening for inherited disorders. In November 2017, we completed our acquisition of CombiMatrix Corporation, or CombiMatrix, a company which specialized in prenatal diagnosis, miscarriage analysis and pediatric developmental disorders.

We have experienced rapid growth. For the years ended December 31, 2018, 2017 and 2016, our revenue was \$147.7 million, \$68.2 million and \$25.0 million, respectively, and we incurred net losses of \$129.4 million, \$123.4 million and \$100.3 million, respectively. At December 31, 2018, our accumulated deficit was \$516.7 million. To meet the demands of scaling our business, we increased our number of employees to 788 at December 31, 2018 from 594 on December 31, 2017. We grew our sales force to 128 at December 31, 2018 from 103 at December 31, 2017. We expect headcount will continue to increase in 2019 as we add to the team to support anticipated growth.

Sales of our tests have grown significantly. In 2018, 2017 and 2016, we generated approximately 292,000, 145,000 and 57,000 billable tests, respectively. Approximately 29% of the billable tests we performed in 2018 were billable to institutions and patients, and the remainder were billable to third-party payers. Many of the gene tests on our assays are tests for which private insurers reimburse. However, when we do not have reimbursement policies or contracts with private insurers, our claims for reimbursement may be denied upon submission, and we must appeal the claims. The appeals process is time consuming and expensive, and may not result in payment. Even if we are successful in achieving reimbursement, we may be paid at lower rates than if we were under contract with the third-party payer. When there is not a contracted rate for reimbursement, there is typically a greater co-insurance or co-payment requirement from the patient which may result in further delay or decreased likelihood of collection.

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We expect to incur operating losses for the near-term future and may need to raise additional capital in order to fund our operations. If we are unable to achieve our revenue growth objectives and successfully manage our costs, we may not be able to achieve profitability.

We believe that the keys to our future growth will be to increase billable test volume, achieve broad reimbursement coverage for our tests from third-party payers, consistently drive down the price for genetic analysis and interpretation, steadily increase the amount of genetic content we offer, consistently improve the client experience, drive physician and patient utilization of our website for ordering and delivery of results and increase the number of strategic partners working with us to add value for our clients.

Corporate Information

We were incorporated in the state of Delaware on January 13, 2010, as Locus Development, Inc. and changed our name to Invitae Corporation in 2012. Our principal executive offices are located at 1400 16th Street, San Francisco, California 94103 and our telephone number is (415) 374-7782. Our website address is www.invitae.com. We do not incorporate the information on, or accessible through, our website into this prospectus supplement, and you should not consider any information on, or accessible through, our website as part of this prospectus supplement.

Invitae, and the Invitae logo are our trademarks. This prospectus supplement and the documents incorporated by reference into this prospectus supplement may also contain trademarks and trade names that are the property of their respective owners. We do not intend our use or display of other companies' trade names, trademarks or service marks to imply relationships with, or endorsements or sponsorship of us by, these other companies.

We are an emerging growth company, as defined in the Jumpstart Our Business Startups Act of 2012. We will remain an emerging growth company until the earlier of (1) the last day of the fiscal year following the fifth anniversary of the completion of our initial public offering of common stock (December 31, 2020), (2) the last day of the fiscal year in which we have total annual gross revenue of at least \$1.07 billion, (3) the last day of the fiscal year in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30th, and (4) the date on which we have issued more than \$1.0 billion in non-convertible debt during the prior three-year period.

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THE OFFERING

| | |
|--|--|
| Common stock offered by us | 4,901,960 shares |
| Common stock to be outstanding immediately after the offering | 80,382,659 shares |
| Manner of offering | At the market offering that may be made from time to time through our sales agent, Cowen and Company, LLC. See Plan of Distribution. |
| Use of proceeds | We currently intend to use the net proceeds from this offering for working capital and general corporate purposes. We may also use a portion of the net proceeds from this offering to acquire or invest in complementary businesses, assets or technologies, although we have no present commitments or agreements to do so. See Use of Proceeds. |
| Risk factors | See Risk Factors for a discussion of factors you should consider carefully before deciding to invest in our common stock. |
| NYSE symbol | NVTA |
| The number of shares of common stock to be outstanding immediately after this offering is based on 75,480,699 shares outstanding as of December 31, 2018 and excludes: | |

3,855,156 shares of common stock issuable upon exercise of stock options outstanding as of December 31, 2018 under our equity incentive plans, with a weighted-average exercise price of \$8.54 per share;

4,030,890 shares of common stock issuable upon vesting of restricted stock units as of December 31, 2018 under our equity incentive plans;

118,882 shares of common stock available for future issuance under our 2015 Stock Incentive Plan;

277,577 shares of common stock available for future issuance under our Employee Stock Purchase Plan;

3,458,823 shares of common stock issuable upon the conversion of our Series A convertible preferred stock;

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132,146 shares of common stock issuable in 2019 in connection with acquisitions and up to 452,079 shares of common stock potentially issuable in connection with an earn-out in 2019, in each case as of December 31, 2018; and

610,875 shares of common stock issuable upon the exercise of warrants to purchase common stock outstanding as of December 31, 2018, with a weighted-average exercise price of \$6.93 per share. The above also excludes 3,019,227 and 754,806 additional shares of common stock available for future issuance under our 2015 Stock Incentive Plan and Employee Stock Purchase Plan, respectively, as of January 1, 2019.

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Investing in our common stock involves a high degree of risk. Before making an investment decision, you should carefully consider the risks described below and in our Annual Report on Form 10-K for the year ended December 31, 2018, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K incorporated by reference in this prospectus supplement and the accompanying prospectus, any amendment or update thereto reflected in our subsequent filings with the SEC, and all of the other information in this prospectus supplement and the accompanying prospectus, including our financial statements and related notes incorporated by reference in this prospectus supplement and the accompanying prospectus. If any of these risks is realized, our business, financial condition, results of operations and prospects could be materially and adversely affected. In that event, the trading price of our common stock could decline and you could lose part or all of your investment. Additional risks and uncertainties that are not yet identified or that we think are immaterial may also materially harm our business, operating results and financial condition and could result in a complete loss of your investment.

Risks related to this offering

Purchasers in this offering will experience immediate and substantial dilution in the book value of their investment.

The common stock sold in this offering from time to time will be sold at various prices; however, we expect the price per share of common stock will be substantially higher than the net tangible book value of our common stock. Therefore, purchasers of our common stock in this offering will experience immediate dilution in the net tangible book value of the common stock purchased in this offering. Assuming that an aggregate of 4,901,960 shares of common stock are sold at a public offering price of \$20.40 per share, the last reported sale price of our common stock on The New York Stock Exchange on February 27, 2019, for an aggregate gross proceeds of \$100,000,000 and after deducting estimated commissions and estimated offering expenses payable by us, our adjusted net tangible book value as of December 31, 2018, would have been approximately \$178.1 million, or approximately \$2.22 per share of our common stock. As a result, if you purchase shares of common stock in this offering at that assumed public offering price, you would suffer immediate and substantial dilution of \$18.18 per share with respect to the net tangible book value of the common stock. See **Dilution** in this prospectus supplement for a detailed illustration of the dilution you will incur if you purchase shares in this offering.

We will have broad discretion in how we use the net proceeds of this offering. We may not use these proceeds effectively, which could affect our results of operations and cause our stock price to decline.

Although we currently intend to use the net proceeds from this offering in the manner described in the section entitled **Use of Proceeds** in this prospectus supplement, we will have considerable discretion in the application of the net proceeds of this offering. We may use the net proceeds for purposes that do not yield a significant return or any return at all for our stockholders. In addition, pending their use, we may invest the net proceeds from this offering in a manner that does not produce income or that loses value. If we do not invest or apply the net proceeds from this offering in ways that enhance stockholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

If we raise additional capital in the future, your ownership in us could be diluted.

Any issuance of equity we may undertake in the future to raise additional capital could cause the price of our common stock to decline, or require us to issue shares at a price that is lower than that paid by holders of our common stock in the past, which would result in those newly issued shares being dilutive. If we obtain funds through a credit facility or

through the issuance of debt or preferred securities, these securities would likely have rights senior to your rights as a common shareholder, which could impair the value of our common stock.

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We have never paid dividends on our capital stock and we do not anticipate paying dividends in the foreseeable future.

We have never paid dividends on any of our capital stock and currently intend to retain any future earnings to fund the growth of our business. In addition, our loan and security agreement restricts our ability to pay cash dividends on our common stock. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant. As a result, capital appreciation, if any, of our common stock will be the sole source of gain for the foreseeable future.

Sales of a substantial number of shares of our common stock in the public market could cause our stock price to fall.

Sales of a substantial number of shares of our common stock in the public market or the perception that these sales might occur could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that sales may have on the prevailing market price of our common stock. In addition, the sale of substantial amounts of our common stock could adversely impact its price. As of December 31, 2018, we had outstanding 75,480,699 shares of our common stock, options to purchase 3,855,156 shares of our common stock (of which 2,736,658 were exercisable as of that date), outstanding restricted stock units representing 4,030,890 shares of our common stock, outstanding Series A convertible preferred stock convertible into 3,458,823 shares of our common stock, 132,146 shares of our common stock issuable in 2019 in connection with acquisitions, up to 452,079 shares of our common stock potentially issuable in connection with an earn-out in 2019 and warrants to purchase 610,875 shares of our common stock. In addition, 3,019,227 and 754,806 additional shares of common stock are available for future issuance under our 2015 Stock Incentive Plan and Employee Stock Purchase Plan, respectively, as of January 1, 2019. The sale or the availability for sale of a large number of shares of our common stock in the public market could cause the price of our common stock to decline.

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FORWARD-LOOKING STATEMENTS

This prospectus supplement, the accompanying base prospectus and the documents we have filed with the SEC that are incorporated by reference in this prospectus supplement and the accompanying prospectus contain forward-looking statements that involve risks and uncertainties. These statements relate to future periods, future events or our future operating or financial plans or performance. All statements other than statements of fact, including statements identified by words such as believe, may, will, estimate, continue, anticipate, plan, and similar expressions are forward-looking statements, and include but are not limited to, statements regarding our expected increases in employee headcount, our strategy; our business plan, including expectations regarding future partnerships, acquisitions and networks; future growth and the keys to such growth; continued investment in our business; future operations; the anticipated use of proceeds from this offering; future operating results and expense levels; and the prospects, plans and objectives of management are forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, strategy, short- and long-term business operations and objectives, and financial requirements. These statements are subject to known and unknown risks, uncertainties and assumptions that could cause actual results to differ materially from those projected or otherwise implied by the forward-looking statements, including the following: risks associated with our ability to develop and commercialize new tests and expand into new markets; our ability to use rapidly changing genetic data to interpret test results accurately, consistently and quickly; our history of losses; our need to scale our infrastructure in advance of demand for our tests and our ability to increase demand for our tests; our ability to drive revenue; our ability to successfully operationalize payer contracts; our ability to achieve and maintain positive cash flows and to execute our strategy to create a profitable long-term business; the risk that we may not obtain or maintain sufficient levels of reimbursement for our tests; laws and regulations applicable to our business, including potential regulation by the Food and Drug Administration; the risk that Medicare and other payers may change the pricing or other terms for reimbursement, or not reimburse for our tests in the future; and our ability to compete. You should not place undue reliance on these forward-looking statements. We discuss in greater detail, and incorporate by reference into this prospectus supplement and the accompanying prospectus, many of these risks, uncertainties and assumptions under the heading Risk Factors. Additional cautionary statements or discussions of risks, uncertainties and assumptions that could affect our results or the achievement of the expectations described in forward-looking statements are also contained in the documents we incorporate by reference into this prospectus supplement and the accompanying prospectus. Any forward-looking statement made by us in this prospectus supplement, the accompanying prospectus, or any of the documents incorporated by reference in this prospectus supplement and the accompanying prospectus speaks only as of the date on which it was made. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. You should, however, review additional disclosures we make in our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K filed with the SEC.

You should read this prospectus supplement, the accompanying prospectus, and the documents that we incorporate by reference in this prospectus supplement and the accompanying prospectus completely and with the understanding that our actual future results, levels of activity and performance as well as other events and circumstances may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

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USE OF PROCEEDS

We may issue and sell shares of common stock having aggregate sales proceeds of up to \$100,000,000 from time to time in this offering. Because there is no minimum offering amount required as a condition to close this offering, the actual total public offering amount, commissions and net proceeds to us, if any, are not determinable at this time. There can be no assurance that, in the future, we will sell any shares under or fully utilize the Sales Agreement with Cowen as a source of financing.

We currently intend to use the net proceeds from the sale of common stock offered by this prospectus supplement and the accompanying prospectus for working capital and general corporate purposes. We may also use a portion of the net proceeds from this offering to acquire or invest in complementary businesses, assets or technologies, although we have no present commitments or agreements to do so. Accordingly, we will retain broad discretion over the use of these proceeds. Pending application of the net proceeds as described above, we intend to invest the net proceeds in short- and intermediate-term, interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the U.S. government.

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If you purchase our common stock in this offering, your ownership interest will be immediately diluted to the extent of the difference between the public offering price per share and the net tangible book value per share of our common stock immediately after this offering. Net tangible book value per share is determined by dividing the number of shares of common stock outstanding as of December 31, 2018 into our total tangible assets less total liabilities.

Our net tangible book value as of December 31, 2018 was approximately \$81.3 million, or \$1.08 per share, based on 75,480,699 shares of our common stock outstanding as of that date. After giving effect to the sale of 4,901,960 shares of common stock by us at an assumed public offering price of \$20.40 per share, the last reported sale price of our common stock on The New York Stock Exchange on February 27, 2019, and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us, our as adjusted net tangible book value as of December 31, 2018 would have been \$178.1 million, or \$2.22 per share. This represents an immediate increase in net tangible book value of \$1.14 per share to existing stockholders and immediate dilution of \$18.18 per share to investors in this offering, as illustrated by the following table:

| | |
|--|----------|
| Assumed public offering price per share | \$ 20.40 |
| Net tangible book value per share as of December 31, 2018 | \$ 1.08 |
| Increase in net tangible book value per share attributable to investors participating in this offering | 1.14 |
| As adjusted net tangible book value per share after giving effect to this offering | 2.22 |
| Dilution per share to investors in this offering | \$ 18.18 |

The table above assumes for illustrative purposes that an aggregate of 4,901,960 shares of our common stock are sold at a price of \$20.40 per share, the last reported sale price of our common stock on The New York Stock Exchange on February 27, 2019, for aggregate gross proceeds of \$100,000,000. The shares sold in this offering, if any, will be sold from time to time at various prices. A \$1.00 increase or decrease in the price at which the shares are sold from the assumed public offering price of \$20.40 per share, would increase or decrease our as adjusted net tangible book value by approximately \$0.05 per share, and the dilution per share to investors in this offering by approximately \$0.95 per share, after deducting estimated commissions and estimated offering expenses payable by us. The as adjusted information provided above is illustrative only. The common stock sold in this offering, if any, will be sold from time to time at various prices.

The number of shares of common stock to be outstanding immediately after this offering is based on 75,480,699 shares outstanding as of December 31, 2018 and excludes:

3,855,156 shares of common stock issuable upon exercise of stock options outstanding as of December 31, 2018 under our equity incentive plans, with a weighted-average exercise price of \$8.54 per share;

4,030,890 shares of common stock issuable upon vesting of restricted stock units as of December 31, 2018 under our equity incentive plans;

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118,882 shares of common stock available for future issuance under our 2015 Stock Incentive Plan;

277,577 shares of common stock available for future issuance under our Employee Stock Purchase Plan;

3,458,823 shares of common stock issuable upon the conversion of our Series A convertible preferred stock;

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132,146 shares of common stock issuable in 2019 in connection with acquisitions and up to 452,079 shares of common stock potentially issuable in connection with an earn-out in 2019, in each case as of December 31, 2018; and

610,875 shares of common stock issuable upon the exercise of warrants to purchase common stock outstanding as of December 31, 2018, with a weighted-average exercise price of \$6.93 per share.

The above also excludes 3,019,227 and 754,806 additional shares of common stock available for future issuance under our 2015 Stock Incentive Plan and Employee Stock Purchase Plan, respectively, as of January 1, 2019.

To the extent that additional shares are issued pursuant to the foregoing, investors purchasing our common stock in this offering will experience further dilution. In addition, we may offer other securities in other offerings due to market conditions or strategic considerations. To the extent we issue such securities, investors may experience further dilution.

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PLAN OF DISTRIBUTION

We entered into a sales agreement with Cowen as of August 9, 2018, pursuant to which we may offer and sell up to \$75 million of shares of our common stock from time to time through Cowen as our sales agent. We entered into an amendment to the sales agreement, as of February 28, 2019, primarily to provide for a \$100 million increase in the aggregate offering price under the sales agreement. Sales of our common stock, if any, will be made at market prices by any method that is deemed to be an at the market offering as defined in Rule 415(a)(4) under the Securities Act, including sales made directly on The New York Stock Exchange or any other existing trading market for our common stock. If authorized by us in writing, Cowen may purchase shares of our common stock as principal.

Cowen will offer our common stock subject to the terms and conditions of the Sales Agreement on a daily basis or as otherwise agreed upon by us and Cowen. We will designate the maximum amount of common stock to be sold through Cowen on a daily basis or otherwise determine such maximum amount together with Cowen. Subject to the terms and conditions of the Sales Agreement, Cowen will use its commercially reasonable efforts to sell on our behalf all of the shares of common stock requested to be sold by us. We may instruct Cowen not to sell common stock if the sales cannot be effected at or above the price designated by us in any such instruction. Cowen or we may suspend the offering of our common stock being made through Cowen under the Sales Agreement upon proper notice to the other party. Cowen and we each have the right, by giving written notice as specified in the Sales Agreement, to terminate the Sales Agreement in each party's sole discretion at any time.

The aggregate compensation payable to Cowen as sales agent will be an amount equal to 3.0% of the gross sales price of the shares sold through it pursuant to the Sales Agreement. We have also reimbursed \$50,000 of Cowen's actual outside legal expenses incurred in connection with offerings pursuant to the Sales Agreement and have agreed to reimburse Cowen, if applicable, up to an aggregate of \$10,000 of Cowen's actual outside legal expenses for filings with the FINRA Corporate Financing Department. We estimate that the total expenses of this offering payable by us, excluding commissions payable to Cowen under the Sales Agreement, will be approximately \$200,000.

The remaining sales proceeds, after deducting any expenses payable by us and any transaction fees imposed by any governmental, regulatory, or self-regulatory organization in connection with the sales, will equal our net proceeds for the sale of such common stock.

Cowen will provide written confirmation to us following the close of trading on The New York Stock Exchange on each day in which common stock is sold through it as sales agent under the Sales Agreement. Each confirmation will include the number of shares of common stock sold through it as sales agent on that day, the volume weighted average price of the shares sold, the percentage of the daily trading volume and the net proceeds to us.

We will report at least quarterly the number of shares of common stock sold through Cowen under the Sales Agreement, the net proceeds to us and the compensation paid by us to Cowen in connection with the sales of common stock.

Settlement for sales of common stock will occur, unless the parties agree otherwise or as otherwise required by law, on the second business day that is also a trading day following the date on which any sales were made in return for payment of the net proceeds to us. There is no arrangement for funds to be received in an escrow, trust or similar arrangement.

In connection with the sales of our common stock on our behalf, Cowen will be deemed to be an underwriter within the meaning of the Securities Act, and the compensation paid to Cowen will be deemed to be underwriting commissions or discounts. We have agreed in the Sales Agreement to provide indemnification and contribution to

Cowen against certain liabilities, including liabilities under the Securities Act. As sales agent, Cowen will not engage in any transactions that stabilize our common stock.

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Our common stock is listed on The New York Stock Exchange and trades under the symbol NVTA. The transfer agent of our common stock is American Stock Transfer & Trust Company, LLC.

Cowen and/or its affiliates have provided, and may in the future provide, various investment banking and other financial services for us for which services they have received and, may in the future receive, customary fees.

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LEGAL MATTERS

The validity of the common stock offered by this prospectus supplement will be passed upon for us by Pillsbury Winthrop Shaw Pittman LLP, Palo Alto, California. Cowen and Company, LLC is being represented by Cooley LLP, New York, New York, in connection with this offering.

EXPERTS

Ernst & Young LLP, independent registered public accounting firm, has audited our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018, as set forth in their report, which is incorporated by reference in this prospectus supplement and elsewhere in this registration statement. Our consolidated financial statements are incorporated by reference in reliance on Ernst & Young LLP's report, given on their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement on Form S-3 with the SEC under the Securities Act of 1933. This prospectus supplement and the accompanying prospectus is part of the registration statement but the registration statement includes and incorporates by reference additional information and exhibits. We file annual, quarterly and current reports, proxy statements and other information with the SEC. The SEC maintains a web site that contains reports, proxy and information statements and other information regarding companies, such as ours, that file documents electronically with the SEC. The address of that site on the worldwide web is <http://www.sec.gov>. The information on the SEC's web site is not part of this prospectus supplement and the accompanying prospectus, and any references to this website or any other web site are inactive textual references only.

The SEC permits us to incorporate by reference the information contained in documents we file with the SEC, which means that we can disclose important information to you by referring you to those documents rather than by including them in this prospectus supplement and the accompanying prospectus. Information that is incorporated by reference is considered to be part of this prospectus supplement and the accompanying prospectus and you should read it with the same care that you read this prospectus supplement and the accompanying prospectus. Later information that we file with the SEC will automatically update and supersede the information that is either contained, or incorporated by reference, in this prospectus supplement and the accompanying prospectus, and will be considered to be a part of this prospectus supplement and the accompanying prospectus from the date those documents are filed. We have filed with the SEC, and incorporate by reference in this prospectus supplement and the accompanying prospectus:

our Annual Report on Form 10-K for the year ended December 31, 2018;

our Definitive Proxy Statement on Schedule 14A filed with the SEC on April 5, 2018 and incorporated by reference into Part III of our Annual Report on Form 10-K for the year ended December 31, 2017; and

the description of our common stock contained in our Registration Statement on Form 8-A filed on February 11, 2015, including any amendment or report filed for the purpose of updating such description. We also incorporate by reference all additional documents that we file with the SEC under the terms of Section 13(a), 13(c), 14 or 15(d) of the Exchange Act that are made after the initial filing date of the registration statement of which

this prospectus supplement and the accompanying prospectus is a part and the effectiveness of the registration statement, as well as between the date of this prospectus supplement and the termination of any offering of securities offered by this prospectus supplement and the accompanying prospectus. We are not,

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however, incorporating, in each case, any documents or information that we are deemed to furnish and not file in accordance with SEC rules.

You may request a copy of any or all of the documents incorporated by reference but not delivered with this prospectus supplement and the accompanying prospectus, at no cost, by writing or telephoning us at the following address and number: Investor Relations, Invitae Corporation, 1400 16th Street, San Francisco, California 94103 and (415) 374-7782. We will not, however, send exhibits to those documents, unless the exhibits are specifically incorporated by reference in those documents.

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PROSPECTUS

\$250,000,000

Invitae Corporation

Debt Securities

Common Stock

Preferred Stock

Depository Shares

Warrants

Rights

We may, from time to time, offer and sell the securities identified above in one or more offerings. The aggregate initial offering price of all securities sold under this prospectus will not exceed \$250,000,000.

This prospectus describes the general terms of these securities and the general manner in which these securities will be offered. We will provide the specific terms of these securities in supplements to this prospectus. The prospectus supplements will also describe the manner in which these securities will be offered and may also add to, update or change information contained in this prospectus. You should read carefully this prospectus and the accompanying prospectus supplement before you invest.

We may offer and sell the securities separately or together in any combination for sale directly to investors or through underwriters, dealers or agents. If any underwriters, dealers or agents are involved in the sale of these securities we will set forth their names and describe their compensation in the applicable prospectus supplement.

Our common stock is listed on The New York Stock Exchange under the symbol NVTA. On August 8, 2018, the last reported sale price of our common stock on The New York Stock Exchange was \$9.44 per share.

Investing in our securities involves risks. See the section entitled Risk Factors included in or incorporated by reference into the accompanying prospectus supplement and in the documents we incorporate by reference in this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is August 24, 2018

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You should rely only on the information incorporated by reference or provided in this prospectus, any prospectus supplement, any applicable free writing prospectus and the registration statement. We have not authorized anyone else to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information in this prospectus, any prospectus supplement, any applicable free writing prospectus or the documents incorporated by reference, is accurate only as of the dates of those documents. Our business, financial condition, results of operations and prospects may have changed since those dates.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, using a shelf registration, or continuous offering, process. Under this shelf registration process, we may, from time to time, offer and sell separately or together in any combination the securities described in this prospectus in one or more offerings up to a maximum aggregate offering price of \$250,000,000.

This prospectus provides you with a general description of the securities we may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering and the offered securities. Any prospectus supplement, or information incorporated by reference in this prospectus or any prospectus supplement that is of a more recent date, may also add, update or change information contained in this prospectus. Any statement that we make in this prospectus will be modified or superseded by any inconsistent statement made by us in a prospectus supplement. The registration statement we filed with the SEC includes exhibits that provide more detail of the matters discussed in this prospectus. You should read this prospectus and the related exhibits filed with the SEC, any prospectus supplement, and any applicable free writing prospectus, together with additional information described under the headings *Where You Can Find More Information*, and *Incorporation by Reference*, before making your investment decision.

Unless the context otherwise requires, references in this prospectus to *Invitae*, the company, *we*, *us* and *our* refer to *Invitae Corporation* and its consolidated subsidiaries.

RISK FACTORS

Investing in our securities involves risk. The prospectus supplement relating to a particular offering will contain or incorporate by reference a discussion of risks applicable to an investment in the securities offered. Prior to making a decision about investing in our securities, you should carefully consider the specific factors discussed under the heading *Risk Factors* included in or incorporated by reference into the applicable prospectus supplement together with all of the other information contained in the prospectus supplement or appearing in or incorporated by reference into this prospectus, including the risk factors incorporated by reference to our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q or Current Reports on Form 8-K. The occurrence of any of these risks might cause you to lose all or part of your investment in the offered securities.

INVITAE CORPORATION

Our mission is to bring comprehensive genetic information into mainstream medical practice to improve the quality of healthcare for billions of people. Our goal is to aggregate most of the world's genetic tests into a single service with higher quality, faster turnaround time and lower pricing than many single gene tests today. By aggregating large numbers of currently available genetic tests into a single service, we believe we can achieve great economies of scale that allow us to not only provide primary single gene or multi-gene tests but also to generate and store additional genetic information on behalf of the patient for future use. We refer to the service of managing genetic information over the course of disease or the lifetime of a patient as *genome management*. In addition, as more individuals gain access to their genetic information, we believe that sharing genetic information will provide an economic opportunity for patients and us to participate in advancing the understanding and treatment of disease.

We were incorporated in the state of Delaware on January 13, 2010, as *Locus Development, Inc.* and changed our name to *Invitae Corporation* in 2012. Our principal executive offices are located at 1400 16th Street, San Francisco, California 94103 and our telephone number is (415) 374-7782. Our website address is www.invitae.com. We do not incorporate the information on, or accessible through, our website into this prospectus, and you should not consider

any information on, or accessible through, our website as part of this prospectus.

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Invitae, and the Invitae logo are our trademarks. This prospectus and the documents incorporated by reference into this prospectus may also contain trademarks and trade names that are the property of their respective owners. We do not intend our use or display of other companies' trade names, trademarks or service marks to imply relationships with, or endorsements or sponsorship of us by, these other companies.

We are an emerging growth company, as defined in the Jumpstart Our Business Startups Act of 2012. We will remain an emerging growth company until the earlier of (1) the last day of the fiscal year following the fifth anniversary of the completion of our initial public offering of common stock (December 31, 2020), (2) the last day of the fiscal year in which we have total annual gross revenue of at least \$1.07 billion, (3) the last day of the fiscal year in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30th, and (4) the date on which we have issued more than \$1.0 billion in non-convertible debt during the prior three-year period.

FORWARD-LOOKING STATEMENTS

When used in this prospectus, words such as believe, may, will, estimate, continue, anticipate, intend, expect, or similar expressions, are intended to identify forward-looking statements. These statements are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those projected or otherwise implied by the forward-looking statements. These forward-looking statements speak only as of the date of this prospectus. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. We will discuss many of these risks and uncertainties in greater detail in any prospectus supplement under the heading Risk Factors. Additional cautionary statements or discussions of risks and uncertainties that could affect our results or the achievement of the expectations described in forward-looking statements may also be contained in the documents we incorporate by reference into this prospectus.

These forward-looking statements speak only as of the date of this prospectus. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. You should, however, review additional disclosures we make in our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K filed with the SEC.

USE OF PROCEEDS

Unless we state otherwise in the applicable prospectus supplement, we intend to use the net proceeds from the sale of the securities offered by this prospectus for general corporate purposes. General corporate purposes may include additions to working capital, financing of capital expenditures, repayment or redemption of existing indebtedness, repurchases of stock and future acquisitions and strategic investment opportunities. Unless we state otherwise in the applicable prospectus supplement, pending the application of net proceeds, we expect to invest the net proceeds in short- and intermediate-term, interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the U.S. government.

Table of Contents**RATIO OF EARNINGS TO FIXED CHARGES**

The ratio of earnings to fixed charges for each of the periods indicated are set forth in the following table. Our earnings were insufficient to cover fixed charges for each of those periods. For the periods indicated, we had no outstanding shares of preferred stock with required dividend payments. Accordingly, we have not included ratios of earnings to combined fixed charges and preferred stock dividends because those ratios would be identical to the ratio of earnings to fixed charges.

| | Year Ended December 31, | | | | | Six Months Ended |
|------------------------------------|--------------------------------|-------------|-------------|-------------|-------------|-------------------------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | June 30, 2018 |
| Ratio of earnings to fixed charges | (1) | (1) | (1) | (1) | (1) | (1) |

- (1) The ratio of earnings to fixed charges is computed by dividing loss before taxes plus fixed charges by fixed charges. Fixed charges consist of interest expense (including interest expense from capital leases), debt financing expense and the estimated portion of rental expense deemed by us to be representative of the interest factor of rental payments under operating leases. Earnings were insufficient to cover fixed charges by \$24.8 million, \$47.5 million, \$89.8 million, \$100.3 million, \$123.4 million and \$67.8 million for the years ended December 31, 2013, 2014, 2015, 2016 and 2017 and the six months ended June 30, 2018, respectively.

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DESCRIPTION OF DEBT SECURITIES

The following is a summary of the general terms of the debt securities. We will file a prospectus supplement that may contain additional terms when we issue debt securities. The terms presented here, together with the terms in a related prospectus supplement, together with any pricing supplement or term sheet, will be a description of the material terms of the debt securities.

We may issue, from time to time, debt securities, in one or more series. These debt securities that we may issue include senior debt securities, senior subordinated debt securities, subordinated debt securities, convertible debt securities and exchangeable debt securities. The debt securities we offer will be issued under an indenture between us and the trustee named in the indenture. The following is a summary of the material provisions of the form of indenture filed as an exhibit to the registration statement of which this prospectus is a part. All capitalized terms have the meanings specified in the indentures. For each series of debt securities, the applicable prospectus supplement for the series may change and supplement the summary below.

As used in this section only, we, us and our refer to Invitae Corporation excluding our subsidiaries, unless expressly stated or the context otherwise requires.

General Terms of the Indenture

The indenture does not limit the amount of debt securities that we may issue. It provides that we may issue debt securities for any series of debt securities up to the principal amount that we may authorize. Except for the limitations on consolidation, merger and sale of all or substantially all of our assets contained in the indenture, the terms of the indenture do not contain any covenants or other provisions designed to give holders of any debt securities protection against changes in our operations, financial condition or transactions involving us. For each series of debt securities, any restrictive covenants for those debt securities will be described in the applicable prospectus supplement for those debt securities.

We may issue the debt securities issued under the indenture as discount securities, which means they may be sold at a discount below their stated principal amount. These debt securities, as well as other debt securities that are not issued at a discount, may, for United States federal income tax purposes, be treated as if they were issued with original issue discount, or OID, because of interest payment and other characteristics. Special United States federal income tax considerations applicable to debt securities issued with original issue discount will be described in more detail in any applicable prospectus supplement.

You should refer to the prospectus supplement relating to a particular series of debt securities for a description of the following terms of the debt securities offered by that prospectus supplement and by this prospectus:

the title of those debt securities;

We are authorized to sell or lease our gaming machines to casinos in 187 tribal jurisdictions, 32 state jurisdictions, and 125 other gaming jurisdictions worldwide. See Government Regulation General below. In most gaming jurisdictions, we sell our gaming machines directly, rather than through the use of distributors, which we believe allows us to provide superior customer service and enhances profitability.

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From our introduction of the *Bluebird* cabinet and *CPU-NXT* in September 2003 through June 30, 2008, we have issued sales orders or executed agreements to sell over 137,000 *Bluebird* video gaming machines or *CPU-NXT* upgrade kits. Of the over 137,000 units for which we have issued sales orders or executed agreements, almost 128,000 of them were installed by June 30, 2008. Of the remaining units, approximately 9,000 are *Bluebird* units and over 600 are *CPU-NXT* upgrade kits. We expect to deliver the balance of these units over the next four quarters.

We sell and lease our gaming machines through 31 salespeople in offices in several United States locations, and 15 salespeople in our international locations. Our salespeople earn a salary and commissions.

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The sale of gaming machines takes place throughout our fiscal year and the order sizes typically range from a small quantity of units to over 1,000 units. We conduct one-on-one meetings with our customers to demonstrate our products at their locations, host customers at private demonstrations in our offices and at other locations, and participate in various trade shows domestically and internationally each year. In certain cases, we participate in responding to competitive requests for proposals from private and public entities who are seeking to purchase gaming machines. We advertise in trade and consumer publications that appeal to casino operators, their employees and casino patrons. Usually, with the launch of a featured product or product category, we will design web-based learning experiences for both internal groups and external customers. We use thematic and interactive web-based micro sites as a means to educate our customers and players about our products, and allow them to learn and explore different aspects of our products at their convenience, while also providing instant win and sweepstakes prizes.

Our field service team is a customer-focused organization, responsible for attending to the needs of our customers. Our field service technicians install, remove and convert gaming machines at the customer's request, work with our customers in performing routine maintenance on participation gaming machines owned by us that are located at our customers' casinos, initiate sales of replacement parts and conversion kits, and assist with general maintenance of gaming machines owned by our customers. In fiscal 2006, we also opened a centralized call center that allows us to be even more responsive to our customers' needs.

In response to rapidly changing slot technology and the need for casinos to have vendor-neutral, consistent, and easily accessible training specifically targeted to slot floor personnel, we launched *Slot Machine University*[®] (SMU) in fiscal 2007. SMU is an interactive, online training and certification program (www.slotmachineuniversity.com) applicable for professionals working in all facets of slot technology, and is the first of its kind to meet the strict requirements for the International Association for Continuing Education and Training accreditation. SMU offers a universal learning solution that helps individuals working in slot technology to support and maintain the wide variety of gaming machines and networked systems used in the gaming industry. Course topics encompass basic slot functionality appropriate for beginning technicians to advanced networking skills required for the future SBG environment. As we continue to grow our business internationally, we intend to translate SMU into various languages to support our customers. Courses are offered on a subscription basis and we believe this service demonstrates our commitment to listen and respond to our customers' evolving needs.

For international markets, we have translated our most popular games into Spanish, Portuguese, French, Italian and Mandarin Chinese. No single country outside of the United States accounted for 10% or more of our revenues in fiscal 2008, 2007 or 2006. Revenues derived from customers outside of the United States accounted for approximately \$156 million, \$135 million and \$95 million for fiscal 2008, 2007 and 2006, respectively. Geographic revenue information is determined by country of destination. Substantially all international sales are made in United States dollars. Revenue from participation games has been primarily limited to North America, and we expect this trend to continue. See Note 15, Information on Geographic Areas, to our Consolidated Financial Statements for further information on international sales.

We generally offer customers payment terms of 30 to 90 days from the date of invoice. In certain circumstances, we may offer extended payment terms typically for one year but in limited cases up to three years, in which case we usually charge interest to the customer. No single customer accounted for 10% or more of our revenues in fiscal 2008, 2007 or 2006.

Competition

The gaming machine market is highly competitive and is characterized by the continuous introduction of new games and new technologies. Our ability to compete successfully in this market is based, in large part, upon our ability to:

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develop and offer games and gaming machines with higher earnings performance than the games and gaming machines from our competitors;

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- Ø create an expanding and constantly refreshed portfolio of games;

- Ø identify and develop or obtain rights to commercially marketable intellectual properties; and

- Ø adapt our products for use with new technologies.

In addition, successful competition in this market is based upon:

- Ø engineering innovation and reliability;

- Ø mechanical and electronic reliability;

- Ø brand recognition;

- Ø effective marketing and customer support; and

- Ø competitive prices and lease terms.

We estimate that about 25 companies in the world manufacture gaming machines and VLTs for legalized gaming markets. Of these companies, we believe that Aristocrat Leisure Limited, Bally Technologies, Inc., IGT, Konami Co. Ltd., Lottomatica's G-Tech Holdings, Atronic Casino Technology and Speilo Manufacturing Inc. subsidiaries, Multimedia Games, Inc., Novomatic Group of Companies and WMS have a majority of this worldwide market. In the categories of video and mechanical reel gaming machines, we compete with market leader IGT, as well as Aristocrat Leisure Limited, Lottomatica's Atronic Casino Technology subsidiary, Bally Technologies, Inc., Franco Gaming Ltd., Konami Co. Ltd., Multimedia Games, Inc., the Novomatic Group of Companies, and Unidesa Gaming and Systems. In the VLT category, we compete primarily with Bally Technologies, Inc., IGT, Lottomatica's G-Tech Holdings and Speilo subsidiaries and Scientific Games Corp.

Our competitors vary in size from small companies with limited resources to a few large multi-national corporations with greater financial, marketing and product development resources than ours. The larger competitors, particularly IGT, have an advantage in being able to spend greater amounts than us to develop new technologies, games and features that are attractive to players and customers. In addition, some of our competitors have developed, sell or otherwise provide to customers security, centralized player tracking and accounting systems which allow casino operators to accumulate accounting and performance data about the operation of gaming machines. We have not offered these systems in the past and, with the acquisition of SiP, we expect to only offer these systems to smaller international customers.

Manufacturing

Other than our Orion Gaming products, we manufacture all of our gaming machines at our facility in Waukegan, Illinois. We are continuously reconfiguring our assembly lines in order to lower our manufacturing lead times, eliminate wasteful activities, improve productivity, and effectively increase our practical capacity. We completed an expansion of our Waukegan facility in July 2007 to a total of 350,000 square feet in

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order to relocate warehousing and distribution activities that were maintained at outside-leased facilities under one roof, which we believe will improve production efficiencies. With our July 2006 acquisition of Orion Gaming, we added a manufacturing facility in the Netherlands. In fiscal 2006, we began refurbishing used gaming machines at our Las Vegas facility.

Manufacturing commitments are generally based on sales orders from customers. However, due to uneven order flow from customers, component parts common to all gaming machines are purchased and assembled into a partial product that are inventoried in order to be able to quickly fill final customer orders. Our manufacturing processes generally consist of assembling component parts into a complete gaming machine. We generally warranty our gaming machines sold in the U.S. for a period of 90 days, while we generally warranty our gaming machines sold internationally for a period of 180 days to one year. Warranty costs have not been significant.

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The raw materials used in manufacturing our gaming machines include various metals, plastics, wood, glass and numerous component parts, including electronic subassemblies and LCD screens. We believe that our sources of supply of component parts and raw materials are generally adequate and we have few sole sourced parts.

We continue to implement cost savings and efficiency initiatives and focus on best practices, in order to improve the efficiency of our manufacturing processes and reduce time to fulfill orders. We continue to make improvements in sourcing and supply management, in inventory and warehouse management, and other manufacturing processes. We are implementing a new sales operations strategy in an effort to produce gaming machines more ratably throughout the quarter, with the goal of significantly reducing or eliminating quarter-end compression in manufacturing. We also have ongoing manufacturing initiatives, such as enhanced strategic sourcing and supplier management, value engineering the products and designing products for both ease of manufacturability and installation, that we expect will help improve gross margins in future quarters.

The European Union (EU) adopted the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive to facilitate the recycling of electrical and electronic equipment sold in the EU. The RoHS directive restricts the use of lead, mercury, and certain other substances in electrical and electronic products placed on the market in the EU after July 1, 2006. We worked with our suppliers to develop RoHS-compliant products and, since the effective date of the directive, we have been providing RoHS-compliant gaming machines to the EU. We expect that other countries and certain U.S. states, including California, may adopt similar standards in the near future.

Patent, Trademark, Licenses, Copyright and Product Protection

Each game, gaming machine and associated equipment embodies a number of separately protected intellectual property rights, including trademarks, copyrights and patents. We believe these intellectual property rights are significant assets to our business in the aggregate. During fiscal 2008, 2007 and 2006, we utilized technology licensed from two separate third parties in more than 90% of the products we sold or leased. In addition, intellectual property from another licensor was utilized in leased units which generated over 10% of our total revenues. We seek to protect our investment in research and development and the unique and distinctive features of our products and services by maintaining and enforcing our intellectual property rights.

We have obtained patent protection covering many of our products. We applied for approximately 125 original patents during fiscal 2008 and currently have more than 1,000 patents pending. We generally seek to obtain trademark protection in the U.S. for the names or symbols under which we market and license our products. We also rely on our copyrights, trade secrets and proprietary know-how. In addition, some of our most popular gaming machines are based on trademarks and other intellectual property licensed from third parties. We file for patent rights and trademark protection internationally in approximately 15 key countries, based upon the nature of the patent or trademark, the laws of the given country and our anticipated product placements in that country.

Brand Licenses

We believe that our use of brand name intellectual property contributes to the appeal and success of our products, and that our future ability to obtain and develop new brand names is important to our continued success. Therefore, we continue to invest in the market positioning of WMS and the awareness and recognition of WMS and our other brand names, in developing new proprietary brand names and in obtaining licenses to additional brand name intellectual property rights.

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We have a long-term agreement with Hasbro, Inc. for the use of their *MONOPOLY* brand through calendar year 2011. We continue to devote significant development efforts to *MONOPOLY*-branded products and intend to keep doing so in the coming years. We currently have approvals for 58 *MONOPOLY*-branded games,

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including 14 *MONOPOLY* WAP themes. In fiscal 2008, 2007 and 2006, we added three, eight and four *MONOPOLY* games to our participation game portfolio, respectively.

We also license *A FISTFUL OF DOLLARS*®, *BRONCO BILLY*® and *DIRTY HARRY*®, featuring Clint Eastwood. Other licensed brands we use in our products include: an exclusive agreement to develop, market and distribute games using the lottery brand *POWERBALL* that we developed principally as a WAP game; *MEN IN BLACK*; *JOHN WAYNE*; *HAPPY DAYS*; *STAR TREK*; *THE WIZARD OF OZ*; *GREEN ACRES*; *TOP GUN*; and *THE DUKES OF HAZZARD*.

Government Regulation

General

We sell our games and gaming machines in legal gaming jurisdictions worldwide. The manufacture and distribution of gaming equipment and related software is subject to regulation and approval by various city, county, state, provincial, federal, tribal and foreign agencies.

We believe we hold all of the licenses and permits necessary to conduct our business. In all, we are authorized to sell or lease our gaming machines to casinos in 344 jurisdictions worldwide, including 125 international gaming jurisdictions.

WMS and our key personnel have obtained or applied for all approvals necessary to maintain compliance with these regulatory agency requirements. The regulatory requirements vary among jurisdictions, but the majority of jurisdictions require licenses, permits, or findings of suitability for the company, individual officers, directors, major stockholders and key employees, and documentation of qualification. We must satisfy all conditions for each gaming license or permit. Our gaming equipment also must be approved either by a gaming agency lab or a private lab authorized by the gaming authority.

In some jurisdictions, regulators govern not only the activities within their own jurisdiction but also activities that occur in other jurisdictions to ensure that the entities it licenses are in compliance with local standards on a worldwide basis. Nevada is such a jurisdiction. The Nevada gaming authorities require us and our gaming subsidiary, WMS Gaming, to maintain Nevada standards of conduct for all of our gaming activities and operations worldwide. To make our compliance efforts more efficient, we have centralized all licensing, compliance and non-product approval gaming regulatory matters, including the shipment of gaming equipment and related software worldwide.

The gaming industry by its very nature is complex and constantly evolving, particularly in new jurisdictions. We continue to devote significant resources to ensure regulatory compliance throughout our company. Additionally, we have an active gaming compliance committee consisting of one outside consultant and two members of our board of directors that works in concert with our compliance department in order to avoid any appearances of impropriety as a result of a business relationship or new market opportunity. We have never been denied a gaming-related license, nor have our licenses ever been suspended or revoked.

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Since the gaming law requirements of many jurisdictions are similar, we are not including descriptions of all jurisdictions due to the number of jurisdictions to which we are subject. Following are the specifics of the gaming law requirements as a representative example of the gaming regulation to which we are subject.

Nevada Regulations

Overview of Regulatory Framework:

The manufacture, sale and distribution of gaming machines for use or play in Nevada or for use outside of Nevada are subject to extensive state and local laws, regulations and ordinances of the Nevada Gaming

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Commission, the Nevada State Gaming Control Board, and various county and municipal regulatory authorities (collectively, the Nevada gaming authorities). The laws, regulations and ordinances primarily cover the responsibility, financial stability and character of gaming equipment manufacturers, distributors and operators, as well as persons financially interested in or involved in gaming operations. We currently hold all necessary gaming licenses to manufacture, distribute and operate a slot route or a wide-area progressive system.

The laws, regulations and supervisory procedures of the Nevada gaming authorities are based on public policy and seek to:

- Ø prevent unsavory or unsuitable persons from having a direct or indirect involvement with gaming at any time or in any capacity;
- Ø establish and maintain responsible accounting practices and procedures;
- Ø maintain effective control over the financial practices of licensees, including establishing minimum procedures for internal fiscal affairs and safeguarding the assets and revenues, providing reliable record keeping and requiring the filing of periodic reports to the Nevada gaming authorities;
- Ø prevent cheating and fraudulent practices;
- Ø provide a source of state and local revenues through taxation and licensing fees; and
- Ø provide strict regulation of all persons, locations, practices, associations and activities relating to casino operations and the manufacture and distribution of gaming machines and related software and equipment.

Licensing Requirements:

Of Our Security Holders

A holder of our stock or of our issued debt may be required to file an application, be investigated and be subject to a suitability hearing as a beneficial holder if the Nevada Gaming Commission has reason to believe that the holder's ownership in our securities would be inconsistent with its public policies and those of the State of Nevada. As with any other gaming applicant, the holder will be required to pay all costs associated with any investigation conducted by the Nevada gaming authorities.

A security holder will have to abide by the following requirements:

- Ø If the holder acquires 5% or more of our securities, report acquisition of beneficial interest in our securities to the Nevada gaming authorities.

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- Ø If the holder acquires 10% or more of our securities, file a gaming application within 30 days after receiving written notice from the Chairman of the Nevada Gaming Control Board.

If the person holding our voting securities is a corporation, partnership or a trust, and is required to be found suitable, the entity will be required to submit to the Nevada gaming authorities detailed business and financial information, including a list of its beneficial owners.

Any person who fails or refuses to apply for a finding of suitability or a license within 30 days after being ordered to do so by the Nevada gaming authorities may be found unsuitable and may be subject to criminal penalties. The same restrictions apply to a record owner if the record owner, after request, fails to identify the beneficial owner. We are required to render maximum assistance to the Nevada gaming authorities in determining the identity of our beneficial owners.

If an institutional investor holds more than 10%, but not more than 15%, of our voting securities, that investor may apply to the Nevada gaming authorities for a waiver of the finding of suitability if it holds the voting securities for investment purposes only. Under certain circumstances, an institutional investor may be able

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to hold up to 19% for a limited period of time. To qualify for this waiver, the institutional investor must have acquired the voting securities in the ordinary course of business. In addition, the institutional investor may not hold the securities for the purpose of causing (1) the election of a majority of the members of our board of directors, (2) a change in our corporate charter, bylaws, management, policies or operations, or those of any of our gaming affiliates, or (3) any other action which the Nevada gaming authorities would find inconsistent with holding our voting securities for investment purposes only.

Of Our Company:

We are registered with the Nevada Gaming Commission as a publicly traded corporation. We are required to periodically file detailed financial and operating reports to the agency and furnish any other information which the Nevada gaming authorities may require.

As a registered company, we also adhere to the following restrictions imposed by the Nevada gaming authorities:

- Ø Any individual having a material relationship or material involvement with us may be required to be found suitable and individually licensed.
- Ø Our officers, directors and key employees must file license applications with the Nevada gaming authorities and may be required to be licensed or found suitable by them. The Company pays all costs of any such investigation.
- Ø Each stockholder applicant is required to pay all costs of any investigation.
- Ø Changes of an applicant's position with us must be reported to the Nevada gaming authorities.
- Ø We must sever all relationships with an officer, director or key employee that the Nevada gaming authorities have found unsuitable and may be required to terminate the employment of any person that refuses to file a gaming application when requested.
- Ø We are required to maintain a current stock ledger in the State of Nevada, which may be examined by the Nevada gaming authorities at any time.
- Ø The Nevada gaming authorities have the power to require that our stock certificates bear a legend indicating that the securities are subject to the Nevada Gaming Control Act (although compliance with this requirement has not been requested to date).
- Ø We may not make a public offering of our securities without the prior approval of the Nevada Gaming Commission if the securities or the proceeds are intended to be used to construct, acquire or finance gaming facilities in Nevada, or to retire or extend obligations incurred for these purposes or for similar transactions. We currently hold an approval to make certain public offerings through March 2009, subject to certain conditions. This shelf approval can be rescinded for good cause and does not mean that for any offering we may make, the Nevada gaming authorities have found, recommended or approved the issued securities or passed on the accuracy or adequacy of the prospectus or the investment merits of the securities offered. Any representation to the contrary is unlawful.
- Ø

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We are subject to disciplinary action if, after we receive notice that a person is unsuitable to be a security holder or to have any other relationship with us, we:

- Ø pay that unsuitable person any dividend, interest or other distribution on any of our securities;
- Ø allow that person to exercise, directly or indirectly, any voting rights conferred through securities held by that person;
- Ø pay remuneration in any form to that person;
- Ø fail to pursue all lawful efforts to require the unsuitable person to relinquish voting securities including, if necessary, the immediate repurchase of the voting securities for cash at fair market value;

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- Ø fail to pursue all lawful efforts to terminate our relationship with that person; or

- Ø make any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation or similar transaction.

- Ø If we violate the Nevada gaming authorities' rules and regulations, our gaming licenses could be limited, conditioned, suspended or revoked and we, and those involved with us, could be fined for each separate violation.

- Ø Changes in control whether through merger, consolidation, stock or asset acquisitions, management or consulting agreements, or any act or conduct by a person where control of WMS is obtained, may not occur without the prior approval of the Nevada gaming authorities. Persons seeking to acquire control of us must satisfy the Nevada gaming authorities' standards prior to assuming control.

Any decision made by the Nevada gaming authorities regarding a person's suitability or licensing is not subject to judicial review. We believe we have obtained all required licenses and/or approvals necessary to carry on our business in Nevada, including receiving the necessary findings of suitability of our officers, directors and key personnel.

Of Our WMS Gaming Subsidiary

WMS Gaming manufactures, sells and distributes gaming machines in Nevada and for use outside Nevada and in 2004, began to operate a wide-area progressive system in Nevada casinos. WMS Gaming holds the necessary license to conduct this activity in addition to sharing in gaming revenue under our slot route operator's license which covers our participation games.

WMS Gaming's gaming licenses are subject to the following restrictions:

- Ø The Nevada gaming authorities have broad discretion in reviewing the conduct of a licensee on a continuing basis.

- Ø The officers, directors and key employees of our gaming subsidiary must file license applications with the Nevada Gaming Authorities and may be required to be licensed or found suitable by them.

- Ø A person may not become a stockholder of or receive any percentage of profits from our licensed gaming subsidiary without first obtaining licenses and approvals from the Nevada gaming authorities.

- Ø We are required to report substantially all loans, leases, sales of securities and similar financing transactions of a material nature to the Nevada Gaming Control Board and/or have them approved by the Nevada Gaming Commission.

- Ø Our gaming activity licenses are not transferable.

Changes in Control:

The Nevada legislature has declared that some corporate acquisitions opposed by management, repurchases of voting securities and corporate defense tactics affecting Nevada gaming licensees, and publicly traded corporations that are affiliated with those operations, may be injurious to stable and productive corporate gaming. The Nevada Gaming Commission has established a regulatory framework to guard against the potentially adverse effects of these business practices upon Nevada's gaming industry.

Approvals are, in certain circumstances, required from the Nevada Gaming Commission before we can make exceptional repurchases of voting securities above their current market price and before a corporate acquisition opposed by management can be consummated. Nevada's gaming laws and regulations also require prior approval by the Nevada Gaming Commission if we were to adopt a plan of recapitalization proposed by our board of directors in opposition to a tender offer made directly to our stockholders for the purpose of acquiring control of us.

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Gaming Equipment Approvals:

Nevada has its own laboratory within its agency. Before we can sell a new gaming machine in Nevada, it must first be approved by the Nevada agency. The agency conducts rigorous testing of the gaming machine and related equipment, and may require a field trial of the gaming machine and platform before determining that the gaming machines and platform meet the agency's strict technical standards. Throughout the course of offering our gaming machines and related software in Nevada, the Nevada gaming authorities may require subsequent modifications and subsequent approvals.

We do not have any control over the length of time that the agency takes to review our products. However, we work closely with the agency's staff to timely respond to their inquiries and assist them, where we can, in their evaluation, inspection and review of our products. We also do this for all other state labs (Michigan, Mississippi, New Jersey, Ontario, Pennsylvania) and Gaming Laboratories International, Inc., an independent lab used by many jurisdictions worldwide.

Taxes and License Fees:

License fees and taxes are imposed by the Nevada gaming authorities and are either payable quarterly, semiannually or annually. The fees and taxes are computed in various ways depending on the type of gaming or activity conducted by our subsidiary and on the cities and counties in which our subsidiary conducts operations. Annual fees are payable to the Nevada State Gaming Control Board for renewal of licenses as a manufacturer, distributor, operator of a slot machine route and operator of an inter-casino linked system. Nevada law also requires that we pay our proportionate share of the gaming taxes from the revenue generated from our participation games placed in Nevada casinos.

Any person who is licensed, required to be licensed, registered, required to be registered, or is under common control with any such person, and who proposes to participate in the conduct of gaming operations outside of Nevada, is required to deposit with the Nevada State Gaming Control Board, and thereafter maintain, a revolving fund to pay the expenses of investigation of the licensee's participation in foreign gaming. The revolving fund is subject to increase or decrease at the discretion of the Nevada Gaming Commission. As a licensee, we are required to comply with reporting requirements imposed by Nevada law. We are also subject to disciplinary action by the Nevada gaming authorities if we:

- Ø knowingly violate any laws of the foreign jurisdiction pertaining to our foreign gaming operations;
- Ø fail to conduct the foreign gaming operation in accordance with the standards of honesty and integrity required of Nevada gaming operations;
- Ø engage in activities that are harmful to the State of Nevada or its ability to collect gaming taxes and fees; or
- Ø employ, contract with or associate with a person in the foreign operation who has been denied a license or finding of suitability in Nevada on the grounds of personal unsuitability.

Federal Registration

WMS Gaming is required to register annually with the Criminal Division of the United States Department of Justice in connection with the sale, distribution or operation of gaming equipment. The Federal Gambling Devices Act of 1962 (commonly known as the Johnson Act) makes it unlawful, in general, for a person to manufacture, transport or receive gaming machines or components across interstate lines unless that person has first registered with the U.S. Attorney General of the Department of Justice. We also have various record-keeping and equipment-identification requirements imposed by this act. Violation of the Johnson Act may result in seizure and forfeiture of the equipment, as well as other penalties. Our WMS Gaming subsidiary is required to register and renew our registration annually.

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Native American Gaming Regulation

Numerous Native American tribes have become engaged in or have licensed gaming activities on Native American tribal lands as a means of generating revenue for tribal governments. Gaming on Native American lands, including the terms and conditions under which gaming equipment can be sold or leased to Native American tribes, is or may be subject to regulation under the laws of the tribes, the laws of the host state, and the Indian Gaming Regulatory Act of 1988, which is administered by the National Indian Gaming Commission and the Secretary of the United States Department of the Interior. Furthermore, gaming on Native American lands may also be subject to the provisions of statutes relating to contracts with Native American tribes, which are also administered by the Secretary of the United States Department of the Interior.

The Indian Gaming Regulatory Act of 1988 requires that the tribe and the host state enter into a written agreement called a tribal-state compact, that specifically authorizes Class III gaming. The compact must be approved by the Secretary of the United States Department of the Interior, with the notice of approval published in the Federal Register. Tribal-state compacts vary from state to state. Many require that equipment suppliers meet ongoing registration and licensing requirements of the state and/or the tribe and some impose background check requirements on the officers, directors, principals and shareholders of gaming equipment suppliers. Under the Indian Gaming Regulatory Act of 1988, tribes are required to regulate gaming on their tribal lands under ordinances approved by the National Indian Gaming Commission. These ordinances may impose standards and technical requirements on hardware and software and may impose registration, licensing and background check requirements on gaming equipment suppliers and their officers, directors, principals and shareholders.

We have the required licenses to manufacture and distribute our products in the Native American jurisdictions in which we do business and to operate our wide-area progressive systems.

International Regulation

Many foreign jurisdictions permit the importation, sale and/or operation of gaming equipment in casino and non-casino environments. Where importation is permitted, some countries prohibit or restrict the payout feature of the traditional gaming machine or limit the operation of gaming machines to a controlled number of casinos or casino-like locations. Each gaming machine must comply with the individual jurisdiction's regulations. Some jurisdictions require the licensing of gaming machine operators and manufacturers. We manufacture and supply gaming equipment, as well as license our games and intellectual property to customers in various international markets worldwide. We have the required licenses to manufacture and distribute our products in the foreign jurisdictions in which we do business.

Seasonality

Sales of our gaming machines to casinos are generally strongest in the spring and slowest in the summer months, while gaming operations revenues are generally strongest in the spring and summer. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for new games from regulators than in other quarters, when a game or platform that achieves significant player appeal is introduced, if a significant number of new casinos open or existing casinos expand, or if gaming is permitted in a significant new jurisdiction.

Employees

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As of June 30, 2008, we employed 1,531 persons, including 132 that are internationally based. Approximately 280 of our domestic employees are represented by the International Brotherhood of Electrical Workers (the IBEW). Our collective bargaining agreement with the IBEW relates to our Waukegan, Illinois manufacturing facility and expires on June 30, 2011. We believe that our relations with our employees are satisfactory.

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ITEM 1A. RISK FACTORS

We urge you to carefully review the following discussion of the specific risks and uncertainties that affect our business. These include, but are not limited to, the following:

Gaming licenses, regulatory approvals and gaming legislation impact the ability to operate our business and sell and lease our products:

- Ø The manufacture and distribution of gaming machines is subject to extensive federal, state, local and foreign regulations and taxes. Most of the jurisdictions in which we operate require licenses, permits, documentation of qualification, including evidence of financial stability, and other forms of approval of our company and our officers, directors, major security holders and key personnel, along with our products. Licenses, approvals or findings of suitability may be revoked, suspended or conditioned. We cannot assure you that we will be able to obtain or maintain all necessary registrations, licenses, permits or approvals, that the licensing process will not result in delays or adversely affect our operations and our ability to maintain key personnel, or that complying with these regulations will not increase our costs.
- Ø The gaming authorities in some jurisdictions may investigate companies or individuals who have a material relationship with us or our security holders to determine whether the selected individual or security holder is acceptable to those gaming authorities. While any such investigated company, individual or security holder must pay the costs of the investigation, such an investigation may be time consuming and distracting to our operations. Failure of companies, individuals or security holders to cooperate with any such investigation could negatively impact our ability to obtain or maintain our licenses.
- Ø Each of our games and gaming machine hardware and software must be approved in each jurisdiction in which it is placed, and we cannot assure you that a particular game and gaming machines, hardware or software will be approved in any jurisdiction. Our SBG technology will require regulatory approval in gaming jurisdictions prior to any shipment or implementation and we cannot assure you that we will receive the approvals.
- Ø To expand into new jurisdictions, we may need to be licensed, obtain approvals of our products and/or seek licensure of our officers, directors, major security holders, key personnel or business partners. If we fail to seek, do not receive or receive a revocation of a license in a particular jurisdiction for our games and gaming machines, hardware or software, we cannot sell or place on a participation or leased basis our products in that jurisdiction.
- Ø Delays in, amendments to or repeals of legislation approving gaming or the expansion of gaming in jurisdictions in which we operate or plan to commence operations, may adversely affect our operations. Delays in approvals of our customers' operations or expansions of their operations may adversely affect our operations.
- Ø Some jurisdictions require gaming manufacturers to obtain government approval before engaging in certain transactions, such as business combinations, reorganizations, borrowings, stock offerings and share repurchases. Obtaining such pre-approvals can be time consuming and costly. We cannot assure you that we will be able to obtain or maintain all necessary approvals or that the approval process will not result in delays or changes to our business plans.

Our profitability depends on our ability to timely develop new technologies and high earning products that appeal to the player:

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- Ø The gaming machine business is characterized by the rapid development of new technologies and the introduction of new products using such technologies. We must continually adapt our products to incorporate new technologies and if we cannot adapt, or do not timely adapt new technologies, our operations may be adversely impacted.

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- Ø The success of a newly introduced technology, such as SBG, is dependent on our casino customers' acceptance of a dynamic change in the way they manage their casino floors. While we have designed *WAGE-NET* to support our customers' existing investment in our *Bluebird* products, such acceptance may nevertheless only build gradually over time. Delays in acceptance by our customers of new technologies may adversely affect our operations.

- Ø Our success depends upon our ability to adapt our manufacturing capabilities and processes to meet the demands of producing new and innovative products. Because our newer products are generally more technologically sophisticated than those we have produced in the past, we must continually refine our production capabilities to meet the needs of our product innovation. If we cannot efficiently adapt our manufacturing infrastructure to meet the needs of our product innovations, or if we are unable to make upgrades to our production capacity in a timely manner, our business could be negatively impacted.

- Ø Our success also depends on continually developing and successfully marketing new games and gaming machines with strong and sustained player appeal. A new game or gaming machine will be accepted by casino operators only if we can show that it is likely to produce more revenue and net win to the casino operator than our competitors' products. Gaming machines can be installed in casinos on a trial basis, and only after a successful trial period are the gaming machines purchased by the casinos. Additionally, we are at risk that customers may cancel orders for products that are not performing to expectations at other casinos. If a new product does not achieve significant market acceptance, we may not recover our development, regulatory approval and promotion costs.

- Ø Participation gaming machines are replaced on short notice by casino operators if the gaming machines do not meet and sustain revenue and profitability expectations. Therefore, these gaming machines are particularly susceptible to pressure from competitors, declining popularity, changes in economic conditions and increased taxation and are at risk of replacement by the casinos, which would end our recurring revenues from these gaming machines until they can be placed with another customer or repurposed.

- Ø Our success depends on our ability to avoid, detect, replicate and correct software and hardware anomalies and fraudulent manipulation of our gaming machines. Our gaming machines have experienced anomalies and fraudulent manipulation in the past. Games and gaming machines may be replaced by casinos and other gaming machine operators if they do not perform according to expectations, or may be shut down by regulators. The occurrence of anomalies in, or fraudulent manipulation of, our gaming machines may give rise to claims for lost revenues and related litigation by our customers and may subject us to investigation or other action by gaming regulatory authorities including suspension or revocation of our gaming licenses, or disciplinary action. Additionally, in the event of such issues with our gaming machines, substantial engineering and marketing resources may be diverted from other projects to correct these issues, which may delay our other projects.

We are dependent on our intellectual property and trade secrets:

- Ø Our competitors have been granted patents covering, among other items, numerous gaming machine features, bonusing techniques and related technologies. If our products use processes or other subject matter that is claimed under our competitors' patents, or if other companies obtain patents claiming subject matter that we use, those companies may bring infringement actions against us. We might then be forced to discontinue the affected products or be required to obtain licenses from the company holding the patent, if it is willing to give us a license, in order to continue to develop, manufacture or market our products. We might also be found liable for treble damage claims relating to past use of the patented subject matter if the infringement is found to be willful.

- Ø Substantially all of our gaming machines utilize trademarks and other intellectual properties licensed from third parties. Our future success may depend upon our ability to obtain, retain and/or expand licenses for popular intellectual properties in a competitive market. In the event that we cannot renew

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and/or expand existing licenses, we may be required to discontinue or limit our use of the games or gaming machines that use the licensed technology or bear the licensed marks.

- Ø Our success may depend in part on our ability to obtain trademark protection for the names or symbols under which we market our products and to obtain copyright protection and patent protection of our proprietary technologies, intellectual property and other game innovations. We cannot assure you that we will be able to build and maintain goodwill in our trademarks or obtain trademark or patent protection, that any trademark, copyright or issued patent will provide competitive advantages for us or that our intellectual properties will not be successfully challenged or circumvented by competitors.
- Ø We also rely on trade secrets and proprietary know-how. We enter into confidentiality agreements with our employees and independent contractors regarding our trade secrets and proprietary information, but we cannot assure you that the obligation to maintain the confidentiality of our trade secrets or proprietary information will be honored. Despite various confidentiality agreements and other trade secret protections, our trade secrets and proprietary know-how could become known to, or independently developed by, competitors.
- Ø We have entered into multiple agreements to license intellectual property and technologies that, as of June 30, 2008, had a net book value of \$67.1 million and total potential future commitment of \$21.0 million, including contingent payments. In the June 2008 quarter we recorded a \$3.7 million write down to net realizable value for a licensed technology. If we determine that we may not realize the value of any of the intellectual property or technology net assets or commitments, we would record an immediate charge against earnings up to the full amount of these net assets or commitments that are recorded on our Consolidated Balance Sheet in the period in which such determination is made. See Note 7, *Intangible Assets* to our Consolidated Financial Statements for further information on the amount of intellectual property and technologies recorded on our Consolidated Balance Sheets and Note 13, *Commitments, Contingencies and Indemnifications* to our Consolidated Financial Statements for further information on total potential future commitments.

Our industry is competitive:

- Ø The gaming machine business is intensely competitive. Some of our competitors are large companies with greater financial, marketing and product development resources than ours. In addition, new competitors may enter our key markets. Obtaining space and favorable placement on casino gaming floors is a competitive factor in our industry. Competitors with a larger installed base of gaming machines than ours have an advantage in obtaining and retaining the most space and best positions in casinos.
- Ø In addition, some of our competitors have developed and sell or otherwise provide to customers centralized player tracking and accounting systems which allow casino operators to accumulate accounting and performance data about the operation of gaming machines. While, with the acquisition of SiP, we can now offer a centralized player tracking and accounting system, we anticipate it will only be used in small international casinos. By not having such a system for large casinos, we are at a competitive disadvantage.

Our business is subject to other economic, political, market, and financial risks:

- Ø We face risks associated with an economic downturn and the impact that the rising price of oil and gasoline has on people's disposable income. Casino operators may reduce capital spending on new gaming machines and may reduce the number of participation gaming machines on their floors which would reduce our revenues and earnings. In addition, lower play levels on our participation gaming machines would reduce our revenues and profits as our lease payments are typically based on a percentage of coin-in or net win of the gaming machines. We cannot predict the impact that the economy will have on our revenues and profits.

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- Ø The gaming industry can be affected by public opinion of gaming. In the event that there is a decline in public acceptance of gaming, either through unfavorable legislation affecting the introduction of gaming into emerging markets, or through legislative and regulatory changes, including tax increases, in existing gaming markets, our ability to continue to sell and lease our gaming machines in those markets and jurisdictions would be adversely affected. We cannot assure you that public opinion will continue to support legalized gaming.
- Ø In an economic downturn, casinos and other gaming machine operators may experience lower revenues and profitability and may delay payments to us to conserve cash which would impact our cash flow. In addition, more of our customers may request financing from us increasing our credit risk. Furthermore, casinos and other gaming machine operators may seek protection from creditors by filing for bankruptcy protection and if the economy does not improve in fiscal 2009 such filings could increase.
- Ø Our gross margins are impacted by increases to our costs of products sold including higher material costs due to the fluctuating commodities markets, higher labor costs and increased freight charges reflecting escalating gas prices.
- Ø We face risks associated with doing business in international markets related to political and economic instability and related foreign currency fluctuations. Unstable governments and changes in treaties and legislation may affect the international gaming market with respect to gaming regulation, taxation, tariffs and import duties, and the legality of gaming in some markets, as we experienced with the Russian market in fiscal 2006. Additionally, we may have increased costs in connection with complying with international laws.
- Ø Compliance with applicable environmental, health and safety laws and regulations, including new regulations requiring higher standards, may increase our costs, limit our ability to utilize our current supply chain and force design changes to our products. These changes could reduce the net realizable value of our inventory, which would result in an immediate charge to our Consolidated Income Statements. Non-compliance could negatively impact our operations and financial position as a result of fines, penalties, and the cost of mandated remediation or delays to our manufacturing.
- Ø Customer financing is becoming an increasingly prevalent component of the sales process and therefore increases business risk of non-payment, especially in emerging markets. These customer financing arrangements also delay our receipt of cash and can negatively impact our ability to enforce our rights upon default if the customer is from a foreign country.
- Ø In certain sales of new gaming machines and placement of participation gaming machines we have offered free gaming machines and/or free conversions, while at the same time we continue to charge our customers for gaming machines and conversions, including *CPU-NXT* upgrade kits. We cannot be sure that competitive pressure will not cause us to increase the number of free gaming machines and conversions we offer to our customers, which would decrease the revenue we expect to receive and reduce our gross profit.
- Ø If we cannot maintain and execute adequate internal control over financial reporting or implement required new or improved controls that provide reasonable assurance of the reliability of the financial reporting and preparation of our financial statements for external use, we may suffer harm to our reputation, fail to meet our public reporting requirements on a timely basis, or be unable to properly report on our business and the results of our operations. Additionally, the inherent limitations of internal control over financial reporting may not prevent or detect all misstatements or fraud, regardless of the adequacy of those controls.
- Ø Our credit facility contains financial covenants which may restrict our ability to, among other things, make certain levels of capital expenditures; incur additional debt; incur liens; change the nature of our business; merge with or acquire other companies, liquidate or dissolve; limit share repurchases; and sell, transfer, lease or dispose of all or substantially all of our assets.

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We are dependent on the success and growth of our customers.

- Ø Our success depends on our customers buying our gaming machines to expand their existing operations, replace existing gaming machines, or equip a new casino. Customers building new facilities generally finance construction costs by raising money publicly or by borrowings. If credit markets tighten, new casino projects may be delayed, as occurred at fiscal 2008. Additionally, to the extent the our customers allocate capital to expenditures other than gaming machines, such as hotel furnishings, restaurants and other non-gaming improvements, or generally reduce capital expenditures, our business could be negatively impacted. Any further slow down in the replacement cycle or delays in expansions or new openings may negatively impact our operations.

- Ø Casino operators in the gaming industry are undergoing a period of consolidation. The result of this trend is that a smaller number of companies control a larger percentage of our current and potential customer base. Because a significant portion of our sales come from repeat customers, to the extent one of our customers is sold to or merges with an entity that utilizes more of one of our competitors products and services, or that reduces spending on our products, our business could be negatively impacted.

We are dependent on our employees.

- Ø The loss or unavailability of one or more of our executive officers or the inability to attract or retain key employees in the future could have an adverse effect on our operations.

- Ø Our ability to continue to develop new technologies and create innovative products depends on our ability to retain and recruit talented employees. A lack of skilled, technical workers could delay or negatively impact our business plans.

The existence of our preferred stock could adversely affect the market price of our common stock.

- Ø Our certificate of incorporation authorizes the issuance of five million shares of preferred stock with designations, rights and preferences that may be determined from time to time by the board of directors. Accordingly, our board has broad power, without stockholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of our common stock. Our board of directors could use preferred stock to discourage, delay or prevent a change in control. Our board has no current plans, agreements or commitments to issue any shares of preferred stock. The existence of the preferred stock, however, could adversely affect the market price of our common stock.

Sumner Redstone owns or controls approximately 8% of our outstanding common stock, and may dispose of all or a portion of his remaining stock ownership at any time, which could cause our stock price to decrease.

- Ø Sumner Redstone beneficially owns 3,997,555 shares, or approximately 8%, of our outstanding common stock, as reported in amendment No. 55 to a Form 13D filed with the SEC in July 2008. Mr. Redstone could sell any or all of his shares at any time on the open market or to a person who wishes to acquire control of us. Such a sale may require prior regulatory approval. We cannot assure you that any such person would agree with our strategy and business goals described in this Report. Sales by Mr. Redstone of a large number of shares would likely have an adverse effect on the market price of our common stock. In August 2005, we executed a five-year extension through August 2010 of a voting trust agreement, which governs the voting rights of all shares of our common stock beneficially owned by Mr. Redstone. Mr. Brian R. Gamache, our Chairman and Chief Executive Officer, acts as the proxy holder under the voting trust agreement with Mr. Redstone.

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Risks that impact our customers may impact us if fewer players visit our customers facilities, if such players have less disposable income to spend at our customers facilities or if our customers are unable to devote resources to purchasing and leasing our products including:

- Ø Global geopolitical events such as terrorist attacks and other acts of war or hostility.

- Ø Natural disasters such as major fires, floods, hurricanes and earthquakes.

- Ø Adverse economic and market conditions in gaming markets, including recession, economic slowdown, adverse credit markets, higher interest rates, higher airfares and higher energy and gasoline prices.

- Ø Concerns about contagious illnesses or other influenza.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Manufacturing Facility & Corporate Headquarters

Our manufacturing facility and corporate headquarters is located in Waukegan, Illinois, a suburb of Chicago, where we own a facility of more than 350,000 square feet to house our manufacturing and corporate administrative personnel and it also includes warehouse space. This facility was built in 1995 and expanded and improved in both 1998 and 2007. The expansion enabled us to bring under one roof raw materials and finished goods that had previously been stored at separate third-party warehouses. The fiscal 2007 expansion of our Waukegan facility ensures that it will be adequate in capacity and condition to satisfy our expected future growth requirements.

Chicago Technology Campus

Our engineering and game development headquarters is located in Chicago, Illinois, where we own a facility of more than 129,000 square feet that houses our Chicago engineering and game development personnel. Our Chicago facility has been renovated into a research and development center to accommodate the growth of our engineering and game development staff. This facility supports engineering and game development for all North American markets and certain international markets. We own a parcel of land and a building in Chicago down the street from our technology campus which we are renovating for use in early fiscal 2009. In fiscal 2008 we purchased an additional parcel of land and building down the street from our Chicago technology campus for further expansion and have assumed a lease and given notice to purchase the related land and building for another parcel in the same area for future expansion.

Bergen op Zoom, the Netherlands

With our July 2006 acquisition of Orion Gaming, we own a 91,500 square-foot manufacturing, development and distribution facility in Bergen op Zoom, the Netherlands.

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In addition to the facilities described above, we maintain leased space in major gaming jurisdictions worldwide including:

| North America | Europe and South Africa | Asia Pacific / Latin America |
|----------------------------|--------------------------------|-------------------------------------|
| Egg Harbor, New Jersey | Aosta, Italy | Buenos Aires, Argentina |
| Chicago, Illinois | Barcelona, Spain | Macau, China |
| Dover, Delaware | Graz, Austria | Sydney, Australia |
| Golden, Colorado | Guateng, South Africa | |
| Gulfport, Mississippi | Uxbridge, England | |
| Kansas City, Missouri | | |
| Las Vegas, Nevada | | |
| Plantation, Florida | | |
| Reno, Nevada | | |
| Toronto, Ontario, Canada | | |
| Robinsonville, Mississippi | | |

ITEM 3. LEGAL PROCEEDINGS

On October 2, 2003, La Societe de Loteries du Quebec (Loto-Quebec) filed claims against us and Video Lottery Consultants Inc., a subsidiary of IGT (VLC) in the Superior Court of the Province of Quebec, Quebec City District (200-06-000017-015). The pleadings allege that Loto-Quebec would be entitled to be indemnified by the manufacturers of Loto-Quebec s VLTs, specifically WMS and VLC, if the class action plaintiffs, described below, are successful in the pending class action lawsuit against Loto-Quebec. In July 2008 we entered into a settlement agreement with Loto-Quebec under which Loto-Quebec agreed to suspend the action in warranty against us in exchange for our agreement to continue cooperating with the defense of the class action lawsuit against Loto-Quebec and, in the event of an adverse outcome in such lawsuit against Loto-Quebec, to arbitration of any warranty claim by Loto-Quebec. The settlement agreement reserves all of WMS defenses against Loto-Quebec.

The class action lawsuit discussed in Loto-Quebec s claim was brought on May 18, 2001 against Loto-Quebec in the Superior Court of the Province of Quebec. It alleges that the members of the class developed a pathological gambling addiction by using Loto-Quebec s VLTs and that Loto-Quebec, as owner, operator and distributor of VLTs, failed to warn players of the alleged dangers associated with VLTs. Spielo Manufacturing Inc., another manufacturer of VLTs, voluntarily intervened to support Loto-Quebec s position. Class status was granted by the Court on May 6, 2002, authorizing Jean Brochu to act as the representative plaintiff. The class, which is currently undetermined, but potentially comprising more than 119,000 members, is requesting damages totaling almost \$700 million Canadian dollars, plus interest. The trial is set to begin in September 2008. It is too early to assess the outcome of these actions and to determine whether any further claim will be pursued by Loto-Quebec under the terms of our settlement agreement.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Product names mentioned in this Report are trademarks of WMS Gaming Inc., except for the following marks: 3 WAY ACTION is a trademark of Yehia Awada; 3SPACE, BOSE and FREE FIELD are trademarks of Bose Corporation; A FISTFUL OF DOLLARS is a trademark of Metro-Goldwyn-Mayer Studios Inc.; BRONCO BILLY and DIRTY HARRY are trademarks of Warner Bros. Consumer Products Inc.; CLINT EASTWOOD is a registered trademark of Clint Eastwood; G2E is a trademark of Reed Elsevier Inc. and the American Gaming Association; GS2 and S2S are trademarks of the Gaming Standards Association; GREEN ACRES is a trademark of

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PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock, par value \$0.50, trades publicly on the New York Stock Exchange under the symbol WMS. On August 26, 2008, there were approximately 642 holders of record of our common stock. On May 7, 2007, our Board of Directors authorized a three-for-two stock split of our common stock, effected in the form of a stock dividend. All stockholders received one additional share for every two shares of our common stock owned as of the close of business on the record date of May 29, 2007. The additional 16,624,363 shares of \$0.50 par value common stock were issued on June 14, 2007 and recorded as a reduction to retained earnings in the amount of \$8.3 million. Our common stock began trading on the split-adjusted basis on June 15, 2007. Earnings per share, stock prices and all other common share data presented have been retroactively adjusted, as appropriate, to reflect the effect of this stock split.

The following table shows the high and low sale prices of our common stock for the two most recent fiscal years, as reported on the NYSE:

| | High | Low |
|--|-------------|------------|
| Fiscal Year Ended June 30, 2008 | | |
| First Quarter | \$ 33.10 | \$ 24.61 |
| Second Quarter | 37.14 | 30.89 |
| Third Quarter | 40.78 | 31.66 |
| Fourth Quarter | 38.74 | 29.45 |
| Fiscal Year Ended June 30, 2007 | | |
| First Quarter | \$ 20.21 | \$ 16.40 |
| Second Quarter | 24.92 | 19.35 |
| Third Quarter | 27.51 | 23.41 |
| Fourth Quarter | 31.20 | 25.73 |

Dividend Policy

Except for cash paid in lieu of fractional shares in connection with our fiscal 2007 stock split, no cash dividends were declared or paid on our common stock during fiscal 2008 or 2007. Our ability to pay future cash dividends will depend upon, among other things, our earnings, anticipated expansion, capital requirements and financial condition. We do not expect to pay cash dividends in the foreseeable future.

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We have agreed to make additional payments of interest on our convertible subordinated notes if we declare a cash dividend on our common stock. The amount of the additional payments will be equal to the cash dividends that would be payable to the holders of the notes if the holders had converted their notes into shares of our common stock on the record date for the dividend. However, no such payment need be made if the dividend that would otherwise trigger the payment causes an adjustment to the note conversion rate. As a result of the three-for-two stock split discussed above, the note conversion rate was adjusted proportionately.

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We have a multi-year revolving credit agreement, as amended, that provides for \$100 million of unsecured borrowing through December 31, 2009, including the potential to expand the line up to \$125 million. Up to \$10 million of the credit facility is available for the issuance of letters of credit. The credit agreement requires that we maintain certain financial ratios, which could limit our ability to acquire companies, declare dividends or make any distribution to holders of any shares of capital stock, or repurchase or otherwise acquire shares of our common stock. At June 30, 2008, approximately \$103.4 million was available for such purposes under the most restrictive of these covenants.

Issuance of Unregistered Securities

In July 2007, we issued 4,157 shares of our common stock (the "Shares") in connection with our acquisition of privately held SiP. The Shares were issued as partial consideration to two of SiP's stockholders for their equity interest in SiP in connection with our acquisition of 100% of the outstanding equity interests in SiP. The Shares were valued at \$0.1 million, based on the average closing price of our common stock on the New York Stock Exchange for the 30 business days that ended two days prior to the date of the acquisition. The Shares issued to the SiP stockholders under the purchase agreement were issued pursuant to the exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), afforded by Regulation S promulgated under the Securities Act as an offer and sale of securities occurring outside the United States, and by Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder, as a transaction with an accredited investor not involving a public offering. Each of the two SiP stockholders represented that, on the date of issuance, he was located outside the United States and that he was acquiring our common stock for his own account. Each of the SiP stockholders further represented to us that his intention was to acquire the securities for investment only and not with a view to resell or distribute the securities. The SiP stockholders have agreed to transfer restrictions with respect to the Shares issued under the purchase agreement.

Repurchases of Common Shares

The following table provides information relating to repurchases of our common shares for the fourth quarter of fiscal 2008:

| Period | | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) | Maximum Number (Or Approximate Dollar Value) of Shares that May Yet Be Purchased under the Plans or Programs(1) |
|---------------|----------------|----------------------------------|------------------------------|---|---|
| April 1, 2008 | April 30, 2008 | | \$ | | \$ 35,029,088 |
| May 1, 2008 | May 31, 2008 | 154,010 | 34.88 | 154,010 | \$ 29,657,219 |
| June 1, 2008 | June 30, 2008 | 609,180 | 32.16 | 609,180 | \$ 10,065,990 |
| Total | | 763,190 | \$ 32.75 | 763,190 | \$ 10,065,990 |

- (1) On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. This authorization increases the existing program, previously authorized on August 6, 2007, from \$50 million to \$150 million. As of August 26, 2008, we have a total open authorization of approximately \$107 million. Pursuant to the authorization, purchases may be made from time to time in the open market, through block purchases or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on market conditions. During the fiscal year ended June 30, 2008, we purchased 1,208,971 shares for approximately \$40 million at an average cost of \$33.08 per share.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The data as of June 30, 2008 and 2007 and for the years ended June 30, 2008, 2007 and 2006 are derived from our audited Consolidated Financial Statements and related Notes that are included elsewhere in this Report. The data as of June 30, 2006, 2005 and 2004 and for the years ended June 30, 2005 and 2004 are derived from our audited Consolidated Financial Statements and related Notes that are included in other reports filed with the Securities and Exchange Commission. See Note 1, Business Overview Common Stock Split to our Consolidated Financial Statements. Earnings per share, stock prices and all other common share data presented have been retroactively adjusted, as appropriate, to reflect the effect of our May 2007 stock split.

The selected financial data should be read in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements.

| | 2008 | Fiscal Year Ended June 30, | | | 2004 |
|---|---|----------------------------|----------------|-----------|-----------|
| | | 2007 | 2006 | 2005 | |
| | (in millions, except per share amounts) | | | | |
| Statement of Operations Data: | | | | | |
| Revenues | \$ 650.1 | \$ 539.8 | \$ 451.2 | \$ 388.4 | \$ 230.2 |
| Operating income (loss) | 104.4 | 74.2 | 49.0 | 30.7 | (1.8) |
| Income (loss) before income taxes | 105.6 | 71.7 | 49.2 | 30.3 | (3.0) |
| Provision (benefit) for income taxes | 38.1 | 22.8 | 15.9 | 9.1 | (2.1) |
| Net income (loss)(1)(2)(3)(4) | \$ 67.5 | \$ 48.9 | \$ 33.3 | \$ 21.2 | \$ (0.9) |
| Earnings (loss) per share: | | | | | |
| Basic | \$ 1.34 | \$ 1.01 | \$ 0.71 | \$ 0.46 | \$ (0.02) |
| Diluted | \$ 1.15 | \$ 0.86 | \$ 0.63 | \$ 0.41 | \$ (0.02) |
| Weighted-average common shares: | | | | | |
| Basic common stock outstanding | 50.2 | 48.4 | 47.1 | 46.1 | 44.6 |
| Diluted common stock and common stock equivalents | 60.6 | 59.6 | 56.9 | 56.6 | 44.6 |
| Dividends per common share | \$ | \$ | \$ | \$ | \$ |
| Cash Flow Data: | | | | | |
| Net cash provided by (used in): | | | | | |
| Operating activities | \$ 186.2 | \$ 118.9 | \$ 103.1 | \$ 6.1 | \$ (18.0) |
| Investing activities | (117.8) | (158.8) | (94.1) | (45.8) | (43.6) |
| Financing activities | (5.2) | 35.6 | (4.6) | 15.4 | 22.0 |
| Effect of exchange rates on cash and cash equivalents | 0.4 | 2.4 | (0.5) | (0.4) | (0.1) |
| Increase (decrease) in cash and cash equivalents | \$ 63.6 | \$ (1.9) | \$ 3.9 | \$ (24.7) | \$ (39.7) |
| | 2008 | 2007 | As of June 30, | | 2004 |
| | | | 2006 | 2005 | |
| | (in millions) | | | | |
| Balance Sheet Data: | | | | | |
| Cash and cash equivalents | \$ 100.8 | \$ 37.2 | \$ 39.1 | \$ 35.2 | \$ 59.9 |
| Short-term investments | | | | 6.1 | 55.8 |
| Working capital | 296.7 | 255.5 | 234.2 | 241.8 | 237.5 |
| Total assets | 772.7 | 655.7 | 526.4 | 478.4 | 395.0 |
| Long-term debt | 115.0 | 115.0 | 115.0 | 115.0 | 115.0 |
| Stockholders' equity | 510.8 | 433.6 | 325.6 | 285.2 | 239.5 |

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- (1) Net income in fiscal 2008 includes \$9.4 million of after-tax share-based payment expense, compared to \$7.7 million, \$7.6 million, \$2.4 million and \$0.5 million in fiscal 2007, 2006, 2005 and 2004, respectively. The increase in share-based payment expense in fiscal 2008, 2007, and 2006 is due to the Company's adoption of Statement of Financial Accounting Standards (SFAS) No. 123R, effective July 1, 2005. See Note 2, Principal Accounting Policies to our Consolidated Financial Statements.

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- (2) Net income in fiscal 2008 includes a \$2.3 million after-tax write down to net realizable value of a technology license.
- (3) Net income in fiscal 2007 includes a \$1.0 million after-tax charge for expenses associated with management separation costs during the period and a \$0.7 million tax benefit related to the period January 1, 2006 through June 30, 2006, due to the retroactive reinstatement of the research and development tax credit legislation in December 2006.
- (4) Net income in fiscal 2005 includes: an after-tax charge of \$0.7 million for employee separation costs; an after-tax gain of \$0.4 million in other income from the license of certain intellectual property of a discontinued business; pre- and after-tax income of \$1.5 million related to final settlement of tax advances with our former subsidiary, Midway Games Inc., which we previously fully reserved; and a non-cash after-tax charge of \$2.9 million relating to net inventory charges to reduce legacy inventory to net realizable value.

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

The following discussion and analysis should be read in conjunction with our Consolidated Financial Statements and Notes thereto included elsewhere in this Report. This discussion and analysis also contains forward-looking statements and should also be read in conjunction with the disclosures and information contained in Cautionary Note and Item 1A. Risk Factors in this Report.

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

OVERVIEW

Our mission is to create the most entertaining products in the world and service our customers with uncompromising passion for quality. We design, manufacture and distribute gaming machines and video lottery terminals (VLTs) for customers in legalized gaming jurisdictions worldwide. Our products consist primarily of video gaming machines, mechanical reel gaming machines and VLTs. Our gaming machines are installed in all of the major regulated gaming jurisdictions in the United States, as well as in over 100 international gaming jurisdictions. We generate revenue in two principal ways: from product sales and from gaming operations.

Product Sales

Product sales revenue includes the sale of new and used gaming machines and VLTs, parts, conversion kits (including theme and/or operating system conversions), amusement-with-prize (AWP) gaming machines, gaming-related systems for smaller international casino operators and equipment manufactured under original equipment manufacturing (OEM) agreements to casinos and other licensed gaming machine operators. We derive product sales revenue from the sale of the following:

- Ø Multi-line, multi-coin video gaming machines, in our *Bluebird* and Orion Gaming's *Twinstar*-branded cabinets;
- Ø Mechanical reel-spinning gaming machines in our *Bluebird*-branded cabinets;

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- Ø Video poker machines in our *Bluebird*-branded cabinets, which are primarily offered as a casino-owned daily fee game, where the casino purchases the base gaming machine and then leases the top box and game for a lower lease price point;
- Ø Replacement parts and conversion kits for our legacy, *Bluebird*, *Twinstar* and AWP gaming machines, and *CPU-NXT* upgrade kits;
- Ø Used gaming machines that are acquired on a trade-in basis or that were previously placed on a participation basis;

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- Ø AWP gaming machines in certain international markets;

- Ø Gaming-related systems, including linked progressive systems and slot accounting systems applicable to smaller international casinos; and

- Ø Gaming stations in legacy, *Bluebird* and *Twinstar* cabinets in limited cases under OEM agreements to certain third parties.

Gaming Operations

We earn gaming operations revenues from leasing participation games, gaming machines, and VLTs, and earn royalties that we receive from third parties under license agreements to use our game content and intellectual property. Our gaming operations include the following product lines:

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

 - Ø Local-area progressive participation games (LAP);

 - Ø Stand-alone participation games;

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

 - Ø Leased gaming machines;

 - Ø Video lottery terminals; and

 - Ø Licensing revenues related to our game content and intellectual properties.

For further information regarding our products, see [Company and Product Overview](#) in Item 1 [Business](#) in this Report.

OUR FOCUS

With the marketplace dynamics of lower replacement demand in fiscal 2008 and 2007, coupled with a slowing economy especially in North America in fiscal 2008, we remained focused on the five key strategic priorities: (1) continue to grow our gaming operations business with its recurring revenue stream and higher gross profit margins; (2) extend our North American market share gains through innovative new product offerings; (3) expand globally to further diversify our revenue mix and reduce our dependence on North American revenues; (4) increase margins through operating process improvements; and (5) continue to generate and grow sustainable, recurring cash flows.

1. *Priority:* Continue to pursue the managed expansion of our high-margin gaming operations business, while working to achieve a higher return on invested capital in this business.

Fiscal 2008 Result: During the year ended June 30, 2008, our average installed base of participation gaming machines increased 20% over the prior year and, at June 30, 2008, our total installed participation footprint stood at 9,321 units compared to 8,276 units at June 30, 2007. Growth in the installed base was primarily led by our stand-alone units due to the success of our *Big Event Community Gaming* series and our WAP products, which at June 30, 2008 comprised 20% of the

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footprint compared to 18% at June 30, 2007. A shift in strategy to focus on return on investment of our gaming operations assets in late fiscal 2007 resulted in improved revenue per day in fiscal 2008. This strategy included limiting the number of gaming machines for specific new games at each casino and re-deploying gaming machines from casinos generating a lower revenue per day to casinos generating a higher revenue per day. By limiting the initial placement of participation products, we reduced the capital invested in gaming operations in fiscal 2008 by \$25.5 million or 34% from fiscal 2007. A 10% improvement to \$63.34 in the average daily revenue, coupled with the 20% improvement in the average installed base, produced a 32% year-over-year increase in revenue from our gaming operations business.

2. *Priority:* Gain North American product sales market share.

Fiscal 2008 Result: The North American replacement cycle has lengthened and the economy has slowed, thus overall industry demand has been reduced. In spite of this, our new unit shipments in North America were essentially flat in fiscal 2008 due to our continued ability to gain market share with high earning products in a competitive marketplace. In fiscal 2008, amended compacts were approved in California that provide five Native American casinos with expanding gaming capability, and we believe we achieved approximately 25% market share for the first gaming machines purchased by these casinos. In addition, our expanded product bandwidth coupled with our strength in available content contributed directly to the stronger demand for our game conversions. We are dependent, in part, on innovative new products, casinos expansions and new market opportunities to generate growth. We have continued to increase our spending on research and development activities to be able to offer creative and high earning products to our customers and for fiscal 2008, such expenses are up \$21.8 million or 38% over fiscal 2007. Expansion and new market opportunities may come from political action as governments look to gaming to provide tax revenues in support of public programs and view gaming as a key driver for tourism.

3. *Priority:* Continue to expand our international revenue base.

Fiscal 2008 Result: During fiscal 2008, international shipments increased 30%, driven by strong demand across the range of international markets, from Asia to Latin America to Europe. Shipments to international markets represented 35% of our total new unit shipments in fiscal 2008, compared with 30% in fiscal 2007. We are accomplishing this international success through the simultaneous introduction of new products in both the domestic and international markets, and thereby capitalizing globally on the popularity and success of our newest introductions. The addition of Orion Financement Company (Orion Gaming) and Systems in Progress (SiP) also contributed to our expanding worldwide presence through complementary technology and game development capabilities. In the June 2008 quarter, Orion Gaming launched its new *Twinstar2* gaming machine and its new *N-Able* operating system which we expect will drive greater demand for Orion Gaming products in the future. Also we continue to achieve benefits from the opening of new international offices and the addition of new geographically dispersed sales account executives. We believe we will continue to increase our global market share in fiscal 2009.

4. *Priority:* Focus on improving our margins.

Fiscal 2008 Result: Our operating margin improved 240 basis points to 16.1% in fiscal 2008 from 13.7% a year ago even as research and development expenses increased year-over year by \$21.8 million, or 38%. In fiscal 2008 our overall gross profit margin improved by 290 basis points to 59.4% led by a 260 basis point increase to 48.4% in our product sales margin. We are still only in the early stages of implementing our lean sigma and strategic sourcing initiatives, but we are realizing positive results, and we believe these initiatives will continue to drive margin improvement in future years. We expect to benefit from an expanded volume of business which should result in greater volume discounts from our suppliers and enable us to spread our overhead costs over a larger number of units thereby reducing cost per unit. In addition, through disciplined cost management, we continue to expect to realize operating leverage from higher revenues as our total operating costs are not expected to grow at

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the same percentage as revenues. Our research and development spending includes the ongoing investment we are making to create intellectual property and advanced technologies that will power our innovative products in the future and support our existing product lines.

5. *Priority:* To drive higher cash flow.

Fiscal 2008 Result: For fiscal 2008 net cash provided by operations increased by \$67.3 million to \$186.2 million, or 57% higher than in fiscal 2007. A cross functional focus on improving utilization of working capital resulted in improving our inventory turns to 3.1x and reducing our days sales outstanding to 105 days. As a result, our changes in assets and liabilities in our Consolidated Statements of Cash Flows have improved to an inflow of \$0.1 million in fiscal 2008 compared to a use of \$29.8 million in fiscal 2007, despite a 20% increase in revenues. In addition, significant improvement is being made in our ability to more effectively manage the capital deployed in our gaming operations business. During fiscal 2008, the installed footprint of participation gaming machines increased 1,045 units or 13%, while our investment in gaming operations equipment totaled \$50.4 million, compared to the \$75.9 million invested in fiscal 2007 when our installed base increased 1,191 units or 17%. Our investment in gaming operations equipment reflects the continued strong positive response to our three new participation platforms: *Community Gaming*, *Sensory Immersion* and *Transmissive Reels*. As a result of our improving cash flow, our total cash, cash equivalents and restricted cash as of June 30, 2008, rose 125% to \$119.6 million from \$53.2 million as of June 30, 2007.

The priorities for the utilization of our improving cash flow are to continue to enhance stockholder value by emphasizing internal and external investments to create and license advanced technologies and intellectual property, continuing to seek acquisitions that can extend our international presence, increase our intellectual property portfolio, and expand our earnings potential and, when appropriate, repurchase shares in the open market or in privately negotiated transactions. In fiscal 2008, our research and development spending increased \$21.8 million over fiscal 2007. We spent \$19.5 million in investments and advances in royalties, licensed technologies, patents and trademarks, and we funded approximately \$35.0 million of common share repurchases.

Server-Based Gaming

We believe that server-based gaming (SBG) will be the next significant technology development in the gaming machine industry. SBG refers to a networked gaming system that links groups of server-enabled gaming machines to a remote server in the casino data center. Once the gaming machines are on the server-based network, new applications, game functionality, and system-wide features can be enabled. SBG networks will require regulatory approval in gaming jurisdictions prior to any implementation and will represent a significant addition to our existing portfolio of product offerings. We have been introducing the foundational technologies and hardware for SBG to the market for the past two years and we will continue to implement this strategy in fiscal 2009 leading up to the launch of our *WAGE-NET* SBG system in late fiscal 2010.

Our vision for SBG expands on the basic functionality of downloadable games, remote configuration of betting denominations and central determination of game outcomes and emphasizes enhanced game play and excitement for the player. In a networked environment, we believe game play will no longer be limited to an individual gaming machine; rather, we believe SBG will permit game play to be communal among many players. We also expect that with networked gaming machines that we will be able to offer system wide features and game functionality along with applications that add value to casino operators' operations. We will continue SBG development, working with our competitors and customers to ensure the future is powered by an open, networked environment that uses industry standard communication protocols which will enable products from multiple suppliers to efficiently work together with limited investment in additional programming or interfaces.

Our path to the server-enabled marketplace takes elements of our technology road map and converts them into commercializable products in advance of the launch of the full functionality of SBG systems. Fiscal 2007

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was highlighted by the successful launch of *Community Gaming*, made possible by using a server outside the gaming machine to drive the bonusing activity for an entire bank of games, thereby creating a true communal gaming experience. In fiscal 2007, we also commercialized the next step forward in computing power and capability with our *CPU-NXT2* operating system and platform that will be the basis for our server-enabled *Bluebird2* gaming machines. *CPU-NXT2* drives our *Transmissive Reels* platform and real-time, 3D graphics and surround sound capabilities for our *Sensory Immersion* platform. Further, we combined an interactive see-through LCD with the traditional appeal of authentic mechanical spinning reels to make *Transmissive Reels* a potential fixture for mechanical reel gaming machines on the server-based slot floor. We launched *Adaptive Gaming*, another key component to our server-based technology in July 2008. The commercial launch of the *Bluebird2* cabinet, which is server ready, is expected to begin in the December 2008 quarter. At the *G2E* trade show in November 2007 and the ICE trade show in January 2008, we also demonstrated the inter-operability of our *WAGE-NET* system, *Bluebird2* cabinets and *CPU-NXT2* operating system with other manufacturers' products and systems using the open access of the industry standard communication protocols developed by the Gaming Standards Association: *G2S* and *S2S*.

In February 2008, we entered into a ten-year non-exclusive, royalty-bearing patent cross-license agreement with IGT. This agreement provides for a cross license of intellectual property evidenced by certain patents owned by each of us relating to computing and SBG infrastructures. Also in February 2008 we received GLI approval on the first-point release of our *WAGE-NET* server-based system, incorporating GSA communication standards and basic server-based functionality, which was placed for field trial at a popular tribal casino. In July 2008 we received similar approval from the Nevada gaming regulators and began a field trial at a popular Las Vegas strip casino. While basic in functionality, this system represents the first step in the process to receive regulatory approval of the first commercial version of *WAGE-NET*. We are pleased with the feedback and field test results thus far; and we continue to expect final approval of the first commercial version of the *WAGE-NET* system in fiscal 2010.

OTHER KEY FISCAL 2008 ACTIVITIES

Acquisition of Systems in Progress

On July 19, 2007, we completed the acquisition of 100% of the outstanding stock of privately held SiP, an Austrian-based company focused on developing and selling gaming related systems, including linked progressive systems and slot accounting systems applicable for smaller international casino operators. The total consideration for SiP, including acquisition costs, was \$4.9 million. SiP's former majority shareholder is a customer of ours and \$4.5 million of the total consideration resulted from extinguishing trade accounts receivable owed by that customer to us for the customer's entire equity ownership in SiP. Two minority shareholders were paid equal value in cash and shares of our common stock that in total aggregated approximately \$0.2 million. The final purchase price allocation resulted in \$3.1 million of identifiable intangible assets and \$1.8 million of goodwill. The transaction was immaterial to our fiscal 2008 Consolidated Financial Statements and, therefore, pro forma financial information is not provided.

See Note 4, "Business Acquisitions" to our Consolidated Financial Statements.

Common Stock Repurchase Program

On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. This authorization increases the existing program, previously authorized on August 6, 2007, from \$50 million to \$150 million. As of August 26, 2008, we have a total open authorization of approximately \$107 million. Pursuant to the authorization, purchases may be made from time to time in the open market, through block purchases or in privately negotiated transactions. The timing and actual number of

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shares repurchased will depend on market conditions. During the fiscal year ended June 30, 2008, we purchased 1,208,971 shares for approximately \$40 million at an average cost of \$33.08 per share. As of

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June 30, 2008, prior to the recent authorization increase, we had approximately \$10 million available under the then existing program.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our accounting policies are more fully described in Note 2, "Principal Accounting Policies" to our Consolidated Financial Statements. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in our Consolidated Financial Statements and accompanying Notes. Actual results could differ significantly from those estimates. We believe that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective and complex judgments. We have discussed the development, selection and disclosure of our critical accounting policies and estimates with the Audit Committee of our Board of Directors.

Revenue Recognition

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

- Ø Persuasive evidence of an agreement exists;
- Ø The price to the customer is fixed or determinable;
- Ø The product is delivered; and
- Ø Collectibility is reasonably assured.

The application of revenue recognition policies is critical due to the nature of the product sales contracts we execute. When multiple product deliverables are included under a sales contract, we allocate revenue to each product based upon its respective fair value against the total contract value and defer revenue recognition on those deliverables where we have not met all requirements of revenue recognition. Fair value is determined based on the prices charged when each element is sold separately. Revenues are recognized in accordance with our accounting policies for the separate elements when the products have value on a stand-alone basis and fair value of the separate elements exists. While determining fair value and identifying separate elements requires judgment, generally fair value and the separate elements are readily identifiable as we also sell those elements unaccompanied by other elements. In accordance with Emerging Issues Task Force Issue 00-21,

Accounting for Revenue Arrangements with Multiple Deliverables, we allocate 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 individually.

For LAP and stand-alone participation gaming machines, revenues are calculated based on gaming machine performance data provided to us by our customers (such as a percentage of the amount of a gaming machine's win per day or fixed fee based on the actual number of days the gaming machine was on the casino floor). Due to the timing of the receipt of such performance data, we are required to make estimates of our LAP and stand-alone participation revenue based on an analysis of the historical data reported to us and taking into account anticipated or known

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events that may affect the historical trend, such as contract cancellations or additional gaming machine placements at a particular customer's facility. We compare our estimates to the actual data, once received, and adjust our revenue estimates accordingly.

We currently do not apply the provisions of Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2), to sales of our products. The sales of our gaming machines includes games and an operating

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system, which are an integral part of a gaming machine, but are incidental under the guidance of SOP 97-2 and, as such, we apply the revenue recognition principles discussed in Note 2, *Principal Accounting Policies* to our Consolidated Financial Statements. We do apply SOP 97-2 to gaming-related systems revenues generated by SiP. We will continually monitor the application of SOP 97-2 to our business as we receive final regulatory approval of our SBG system.

The application of this policy affects the level of our product sales and gaming operations revenue, cost of product sold, cost of gaming operations, accounts receivable, deferred revenue and accrued expenses. In fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

Income Tax Accounting

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 amount 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.

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. We calculate and provide for income taxes in each of the tax jurisdictions in which we operate. This involves estimating current tax exposures in each jurisdiction as well as making judgments regarding the recoverability of deferred tax assets. Tax exposures can involve complex issues and may require an extended period to resolve. Changes in the geographic mix or estimated level of annual income before taxes can affect the overall effective tax rate.

We apply an estimated annual effective tax rate to our quarterly operating results to calculate the provision for income tax expense. In the event there is a significant, unusual or infrequent item recognized in our quarterly operating results, the tax attributable to that item is recorded in the interim period in which it occurs. We modify our annual effective tax rate if facts and circumstances change between quarters. Our effective tax rates for fiscal 2008, 2007 and 2006 were 36%, 32% and 32%, respectively.

No taxes have been provided on certain undistributed foreign earnings that are planned to be indefinitely reinvested. If future events, including material changes in estimates of cash, working capital and long-term investment requirements, necessitate that these earnings be distributed, an additional provision for withholding taxes may apply, which could materially affect our future effective tax rate.

As a matter of course, we are regularly audited by various taxing authorities, and sometimes these audits result in proposed assessments where the ultimate resolution may result in our owing additional taxes. We establish reserves when, despite our belief that our tax return positions are appropriate and supportable under local tax law, we believe certain positions are likely to be challenged and we may not succeed in realizing the tax benefit. We evaluate these reserves each quarter and adjust the reserves and the related interest in light of changing facts and circumstances regarding the probability of realizing tax benefits, such as the progress of a tax audit or the expiration of a statute of limitations. We believe the estimates and assumptions used to support our evaluation of tax benefit realization are reasonable. However, final determinations of prior-year tax liabilities, either by settlement with tax authorities or expiration of statutes of limitations, could be materially different than estimates reflected in our Consolidated Balance Sheets and historical income tax provisions in our Consolidated Statements of Income. The outcome of these final determinations could have a material effect on our income tax provision, net income, or cash flows in the period in which that determination is made. We believe our tax positions comply with applicable tax law and that we have adequately provided for any known tax contingencies.

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Prior to fiscal 2008, we recognized income tax accruals with respect to uncertain tax positions based upon Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies. In fiscal 2008,

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we adopted Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 Accounting for Uncertainty in Income Taxes and we recorded a \$1.8 million increase in our liability for unrecognized tax benefits that are accounted for as a reduction in our retained earnings as of July 1, 2007. Under FIN 48, the benefits of tax positions that are more likely than not of being sustained upon audit based on the technical merits of the tax position are recognized in our Consolidated Financial Statements; positions that do not meet this threshold are not recognized. For tax positions that are at least more likely than not of being sustained upon audit, the largest amount of the benefit that is more likely than not of being sustained is recognized in our Consolidated Financial Statements.

The application of this policy affects the level of our tax expense, current income tax receivables and liabilities, and current and non-current deferred tax assets and liabilities. Other than the \$1.8 million impact from the adoption of FIN 48 effective July 1, 2007, in fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

Share-Based Compensation Expense

We account for share-based compensation in accordance with the provisions of SFAS No. 123R. Pre-tax share-based compensation expense was \$15.2 million, \$12.4 million, and \$12.2 million for fiscal 2008, 2007 and 2006, respectively. In fiscal 2008, we recorded a provision for equity-based performance units outstanding of \$2.7 million that relate to the thirty-six month periods ended June 30, 2009 and 2010, based on the current assessment of achievement of the performance goals. Additional charges will be recorded in future periods depending on the assessment of achievement of the performance goals. Prior to fiscal 2008, we concluded that the achievement of the performance goals was not probable and therefore a provision related to the awards was not required. As of June 30, 2008, we had \$8.6 million of total stock option compensation expense related to nonvested stock options not yet recognized, which is expected to be recognized over a weighted average period of 2.6 years. Also, as of June 30, 2008, we had \$6.8 million of total restricted share compensation expense related to nonvested awards not yet recognized, which is expected to be recognized over a weighted average period of 2.6 years.

Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of share-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life. If actual results differ significantly from these estimates, share-based compensation expense and our results of operations could be materially impacted. See Note 2, *Principal Accounting Policies* to our Consolidated Financial Statements.

The application of this policy affects the level of our cost of product sales, cost of gaming operations, research and development expenses, selling and administrative expenses, additional paid-in capital and income tax expense. During fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

Allowances for Slow-Moving and Obsolete Inventories

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 Consolidated Financial Statements. Demand for parts inventory is subject to technical obsolescence. Inventory on hand in excess of forecasted demand is written down to net realizable value.

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An active market exists mostly outside of North America for used gaming machines. When we receive a gaming machine on trade-in, we estimate a carrying value for the gaming machine. The value is based upon an

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estimate of the condition of the gaming machine, as well as our experience in selling used gaming machines and could change due to changes in demand in general for used gaming machines. We either sell these trade-ins as-is or renovate the gaming machines before resale. We also sell participation gaming machines as used gaming machines when we no longer need them in our gaming operations business. Therefore, we review our used gaming machine inventory for impairment on a routine basis. Actual demand for new and used gaming machines may differ from anticipated demand, and such differences may have a material effect on our Consolidated Financial Statements.

We sold over 4,500 and over 6,600 used gaming machines in fiscal 2008 and 2007, respectively. At June 30, 2008 and 2007, our inventories included 748 and 951 legacy gaming machines, respectively, and \$1.4 million and \$8.5 million of total legacy inventory, respectively.

The application of this policy affects the amount of our inventory and cost of product sales. In fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

Participation Gaming Machine Depreciation

We depreciate the *Bluebird* participation gaming machines over a three-year useful life to residual value, while we depreciate the top boxes over a one-year useful life. A material adverse impact could occur if the actual useful life of the participation gaming machines or top boxes is less than what was used in estimating depreciation expense, or if actual residual value is less than the anticipated residual value.

The application of this policy affects the level of our gaming operations equipment, accumulated depreciation on gaming operations equipment, depreciation expense, income tax expense and deferred tax assets and liabilities. In fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

Intellectual Property and Licensed Technology Valuations

We license intellectual property and technologies from third parties that we use in our games and gaming machines. At June 30, 2008 and 2007, we had \$67.1 million and \$66.7 million capitalized on our Consolidated Balance Sheets for such costs, along with commitments not on our Consolidated Balance Sheets for an additional \$21.0 million and \$27.3 million, respectively, including contingent payments. As part of our contracts with the licensors, we typically provide a minimum guaranteed commitment and prepay royalties and license fees, usually at the time the contract is signed, even though the product may not be introduced until months or years later. We capitalize the royalty and license fee advances as intangible assets.

When 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 are included in cost of product sales if related to a product sale or cost of gaming operations if related to placement or lease of gaming operations equipment. We regularly evaluate the estimated future benefit of royalty and license fee advances, as well as minimum commitments not yet paid, to determine amounts unlikely to be realized from forecasted sales or placements of our gaming machines. If actual or revised forecasts fall below the initial estimate, then we may need to revise the remaining useful life and/or record an impairment charge or write down to net realizable value as we did in the June 2008 quarter when we recorded a \$3.7 million pre-tax writedown to net realizable value for a licensed technology.

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See Note 7, Intangible Assets and Note 13, Commitments, Contingencies, and Indemnifications, to our Consolidated Financial Statements for further information.

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The application of this policy affects the level of our current assets, non-current assets, current liabilities, cost of product sales, cost of gaming operations, research and development expense and selling and general expense. Other than the fiscal year 2008 pre-tax write down of \$3.7 million to net realizable value for a licensed technology, in fiscal 2008, 2007 and 2006, we had no material changes in the critical accounting estimates arising from the application of this policy and we do not anticipate material changes in the near term.

RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. Subsequent to the issuance of SFAS 157, the FASB issued FASB Staff Positions (FSP) 157-2 *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. For the instruments subject to the effective date delay under FSP 157-2, the effective date to adopt the fair value provisions for us will be July 1, 2009. We will continue to evaluate the impact of the provisions of SFAS 157 on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* including an amendment of SFAS 115, (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities using different measurement techniques. The fair value measurement provisions are elective and can be applied to individual financial instruments. SFAS 159 requires additional disclosures related to the fair value measurements included in the entity's financial statements. We are required to adopt this statement beginning July 1, 2008 and we currently expect no material impact from the provisions of SFAS 159 on our Consolidated Financial Statements.

RESULTS OF OPERATIONS

Gulf Coast Hurricanes

During the September 2005 quarter, two hurricanes devastated the Gulf Coast of Louisiana and Mississippi, which affected the Company's facilities and its customers' facilities. We reopened our Gulfport facility in November 2005, but incurred, and continue to incur hurricane-related revenue loss. Historically, our participation revenue per day in the Mississippi and Louisiana markets is over 40% higher than the Company's overall average.

We carry both property and business interruption insurance. We expect damage to our leased facility in Gulfport to be covered by our property insurance, after the deductible. In fiscal 2005, we received the first property insurance payment from the insurance company. We have assessed the usability of the inventory and participation gaming machines damaged in our Gulfport facility and added damaged items to our property claim.

The property insurance carries a deductible that was expensed in fiscal 2005. There is no deductible for the business interruption insurance and this coverage began 48 hours after elected officials ordered the evacuation of the areas. During fiscal 2006, we received business interruption

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insurance proceeds of \$1.0 million, representing an initial reimbursement for losses arising from Hurricane Katrina, which we recorded in interest and other income, net in our Consolidated Statements of Income. We began litigation against the insurance company in the Mississippi courts in the September 2006 quarter. We continue to pursue our insurance claims, but cannot presently estimate the amount or timing of any additional payment, or the results of any litigation. We have not recorded and will not record any amount for unreimbursed business interruption claims until an agreement is reached with our insurer as to the amount of the recovery.

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Sales of our gaming machines to casinos are generally strongest in the spring and slowest in the summer months, while gaming operations revenues are generally strongest in the spring and summer. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for 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.

Fiscal Year Ended June 30, 2008 Compared to Fiscal Year Ended June 30, 2007

Revenues, Gross Margins and Key Performance Indicators are as follows (in millions, except unit data):

| | Year Ended June 30, 2008 | Year Ended June 30, 2007 | Increase (Decrease) | Percent Increase (Decrease) |
|--|-----------------------------|-----------------------------|------------------------|-----------------------------------|
| Product Sales Revenues | | | | |
| New unit sales revenues | \$ 358.0 | \$ 317.0 | \$ 41.0 | 12.9% |
| Other product sales revenues | 63.2 | 49.3 | 13.9 | 28.2 |
| Total product sales revenues | \$ 421.2 | \$ 366.3 | \$ 54.9 | 15.0 |
| New units sold | 27,931 | 25,613 | 2,318 | 9.1 |
| Average sales price per new unit | \$ 12,817 | \$ 12,378 | \$ 439 | 3.5 |
| Gross profit on product sales revenues(1) | \$ 203.9 | \$ 167.7 | \$ 36.2 | 21.6 |
| Gross margin on product sales revenues(1) | 48.4% | 45.8% | 260 bp | 5.7 |
| Gaming Operations Revenues | | | | |
| Participation revenues | \$ 203.4 | \$ 153.6 | \$ 49.8 | 32.4 |
| Other gaming operations revenues | 25.5 | 19.9 | 5.6 | 28.1 |
| Total gaming operations revenues | \$ 228.9 | \$ 173.5 | \$ 55.4 | 31.9 |
| WAP games at period end | 1,820 | 1,507 | 313 | 20.8 |
| LAP games at period end | 2,134 | 2,333 | (199) | (8.5) |
| Stand-alone games at period end | 5,367 | 4,436 | 931 | 21.0 |
| Total installed participation base at period end | 9,321 | 8,276 | 1,045 | 12.6 |
| Average participation installed base | 8,771 | 7,299 | 1,472 | 20.2 |
| Average revenue per day per participation machine | \$ 63.34 | \$ 57.66 | \$ 5.68 | 9.9 |
| Installed casino-owned daily fee games at period end | 819 | 760 | 59 | 7.8 |
| Average casino-owned daily fee games installed base | 776 | 728 | 48 | 6.6 |
| Gross profit on gaming operations revenues(1) | \$ 182.3 | \$ 137.3 | \$ 45.0 | 32.8 |
| Gross margin on gaming operations revenues(1) | 79.6% | 79.1% | 50 bp | 0.6 |
| Total revenues | \$ 650.1 | \$ 539.8 | \$ 110.3 | 20.4 |
| Total gross profit(1) | \$ 386.2 | \$ 305.0 | \$ 81.2 | 26.6 |
| Total gross margin(1) | 59.4% | 56.5% | 290 bp | 5.1 |

bp basis point

(1) As used herein, gross profit and gross margin exclude depreciation and distribution expense.

Revenues and Gross Profit

Total revenues for fiscal 2008 increased 20.4%, or \$110.3 million, over fiscal 2007, reflecting:

Ø A \$41.0 million, or 12.9%, increase in new unit sales revenue as a result of:

Ø A 2,318 unit, or 9.1%, increase in new units sold.

International new units sold increased 30.2% over the prior year, reflecting growth in China with our Mandarin-based games and continued growth throughout Europe, South Africa and South America.

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North American new units sold in fiscal 2008 were essentially flat to fiscal 2007 due to the continued sluggish North American replacement market and the slowing of the economy offsetting a higher number of new casino openings and expansions in fiscal 2008.

The North American new unit sales in fiscal 2008 benefitted from shipments of new units to five California casinos as a result of amended compacts while fiscal 2007 benefitted from initial and ongoing shipments of new units to properties located in the newly opened Pennsylvania and Broward County, Florida jurisdictions, as well as a strong contribution from Oklahoma which was a new market for us at the time.

Sales of mechanical reel products totaled 8,344 units, or approximately 29.9% of total new units sold compared to 25.4% of units sold in the prior fiscal year.

- Ø A 3.5% increase in the average selling price of new gaming units, principally reflecting the benefit of higher list prices.

- Ø A \$13.9 million, or 28.2%, increase in other product sales revenues, reflecting strong sales of conversion kits and used gaming machines.
 - Ø We earned revenue on more than 9,000 conversion kits in fiscal 2008, compared to over 7,200 conversion kits in the fiscal 2007 period, due to the positive response to our new video and mechanical reel games.
 - Ø We sold approximately 4,500 used gaming machines at higher prices in fiscal 2008, compared to nearly 6,600 used gaming machines in fiscal 2007.

- Ø A \$49.8 million, or 32.4%, growth in participation revenues due primarily to:
 - Ø A 20.2% increase in the average installed base of participation gaming machines, driven by the growth in our WAP and stand-alone installed bases. The WAP units in the installed base as of June 30, 2008 was 313 units higher than at June 30, 2007, reflecting continued strong performance of our *Sensory Immersion* and *Transmissive Reels* platforms in fiscal 2008. Our controlled roll-out strategy has led to the desired result of a higher level of incremental footprint for the WAP units. The WAP installed base accounted for 20% and 18% of the installed base at June 30, 2008 and 2007, respectively.
 - Ø Overall average revenues per day increased by \$5.68, or 9.9%, principally reflecting favorable player response to the new games for our three innovative participation platforms.

- Ø A \$5.6 million, or 28.1%, increase in other gaming operations revenues as we experienced a net increase in royalty revenue from third party licensees.

Total gross profit, as used herein excluding distribution and depreciation expense, increased 26.6%, or \$81.2 million, to \$386.2 million for the fiscal 2008 period from \$305.0 million for the fiscal 2007 period. Our gross margins may not be comparable to those of other entities as we include the costs of distribution in selling and administrative expenses. This improvement reflects:

- Ø Gross margin on product sales revenues of 48.4% for the fiscal 2008 period, compared to 45.8% for the fiscal 2007 period. Gross margin for the fiscal 2008 period reflects continued success with the ongoing implementation of our lean sigma process improvement

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and strategic sourcing initiatives, the benefits from a higher volume of business, greater sales of higher-margin conversion kits, and a higher average selling price for new gaming machines, partially offset by a lower mix of premium-priced products than a year ago.

- Ø Gross margin on gaming operations revenues of 79.6% in the fiscal 2008 period was up slightly from fiscal 2007, reflecting the positive influence of the high performing *Community Gaming*, *Sensory Immersion* and *Transmissive Reels* games and favorable overall WAP jackpot experience offset by the greater number of WAP gaming machines in the installed base.

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We expect to generate solid revenue growth in fiscal 2009 and fiscal 2010 as we continue to increase our market share globally, increase our average selling price with the introduction of our *Bluebird2* platform in the December 2008 quarter and continue to grow our participation installed base through the introduction of new participation games and platforms. Royalty revenues may decline in fiscal 2009 as our licensing arrangement with Stargames Corporation Pty. Ltd. ended January 31, 2008 commencing an agreed upon sell-off period. We expect continued improvements in our product sales gross margin, resulting from the ongoing implementation of process improvements throughout the entire organization with the utilization of lean sigma tools, results from our strategic sourcing initiatives and the benefits from higher unit volumes and ongoing leveling of the production schedule throughout each quarter.

Operating Expenses

Operating expenses were as follows (in millions of dollars):

| | Year Ended June 30, | | | | Increase | |
|----------------------------|---------------------|-----------------|----------|-----------------|----------|---------|
| | 2008 | | 2007 | | Dollar | Percent |
| | Dollar | As % of Revenue | Dollar | As % of Revenue | | |
| Research and development | \$ 79.9 | 12.3% | \$ 58.1 | 10.8% | \$ 21.8 | 37.5% |
| Selling and administrative | 130.0 | 20.0 | 109.8 | 20.3 | 20.2 | 18.4 |
| Depreciation | 71.9 | 11.1 | 62.9 | 11.7 | 9.0 | 14.3 |
| Total operating expenses | \$ 281.8 | 43.4% | \$ 230.8 | 42.8% | \$ 51.0 | 22.1% |

Research and development expenses increased \$21.8 million to \$79.9 million in fiscal 2008, compared to \$58.1 million in the prior year. The year-over-year increase reflects:

- Ø our expanded product development initiatives for the continued creation of intellectual property and the ongoing expansion of our product portfolio;
- Ø higher payroll-related costs resulting from headcount increases and performance based incentives associated with improved operating performance;
- Ø higher costs to accelerate new systems and enterprise-wide system applications for our suite of innovative, high-value products in preparation for the advent of SBG;
- Ø a \$3.7 million pre-tax write down to net realizable value related to a licensed technology; and
- Ø the inclusion of research and development expenses for SiP since the mid-July 2007 acquisition.

During fiscal 2008, we introduced 55 new WMS-branded games for sale and 25 new participation and casino-owned daily fee games, compared to the introduction in fiscal 2007 of 49 new games for sale and 28 new participation and casino-owned daily fee games.

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Selling and administrative expenses increased \$20.2 million to \$130.0 million in fiscal 2008 compared to \$109.8 million in fiscal 2007. The increase includes:

- Ø higher marketing, promotion and distribution costs related to the roll-out of new products and branding initiatives;
- Ø increased payroll-related costs associated with headcount increases to support international expansion and overall growth in our business and performance based incentives associated with improved operating performance during the past twelve months;
- Ø higher spending on customer service activities to support our larger participation installed base and increased customer touch points; and
- Ø higher legal expenses and non-cash charges for bad debt expense, as well as the impact of consolidating SiP results since the mid July 2007 acquisition.

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Depreciation expense increased \$9.0 million to \$71.9 million in fiscal 2008 compared to \$62.9 million in fiscal 2007. This reflects the steady increase in the installed base of participation games throughout fiscal 2007 and 2008, as evidenced in the 20.2% year-over-year increase in the average installed base of participation machines. The increase also reflects depreciation related to SiP. We invested \$50.4 million in gaming operations gaming machines, top boxes and related equipment during fiscal 2008, \$75.9 million during fiscal 2007, and \$68.7 million during fiscal 2006.

For fiscal 2009 and 2010, we expect to increase research and development spending to support our expanding portfolio of innovative and differentiated product offerings, further our progress with our SBG initiatives, and for new game development tools, technological advancements and innovations in game play. The increased spending is also anticipated to support further growth of our game library and enhance the productivity of our development efforts. Selling and administrative expenses are anticipated to increase more modestly in fiscal 2009 and 2010 and are expected to decline slightly as a percent of revenues in fiscal 2009 and 2010. In line with the more moderate rate of growth expected for our installed participation footprint, we anticipate our capital investment in gaming operations equipment to flatten in fiscal 2009 and 2010, and estimate capital expenditures for property, plant and equipment to increase modestly in fiscal 2009 and 2010. In aggregate, we expect continued improvement in our operating margin, even with the additional spending on research and development initiatives.

Interest Expense

We incurred interest expense of \$4.0 million and \$5.1 million for fiscal 2008 and 2007, respectively, primarily related to our 2.75% convertible subordinated notes, amortization of debt issuance costs and, in fiscal 2007, interest and fees on borrowings under our revolving credit facility.

Interest and Other Income, Net

Interest and other income, net increased by \$2.6 million to \$5.2 million primarily due to higher interest income earned on cash in fiscal 2008 as a result of higher average cash balances and better short-term cash management in fiscal 2008.

Income Taxes

The effective income tax rates were approximately 36% and 32% for fiscal 2008 and 2007, respectively.

The fiscal 2008 effective tax rate reflects:

Ø increased income;

Ø the domestic manufacturing deduction;

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- Ø the research and development tax credit expiration on December 31, 2007; and

- Ø the impact of unrecognized tax benefits resulting from the implementation of FIN 48 effective July 1, 2007.

The fiscal 2007 effective tax rate reflects:

- Ø utilization of the export sales deduction, which expired in December 2006;

- Ø the domestic manufacturing deduction; and

- Ø the effect of the retroactive reinstatement of the research and development tax credit legislation which was reinstated in December 2006, retroactive to January 1, 2006. The effective tax rate includes the credit earned from January 1, 2006 thru June 30, 2006, which aggregated \$0.01 per diluted share, in addition to the tax credit earned during fiscal 2007.

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At the end of each interim period, we make our best estimate of the effective tax rate expected to be applicable for the full fiscal year and the impact of discrete items, if any, and adjust the quarterly tax rate, as necessary. As the research and development tax credit legislation expired on December 31, 2007, we expect our effective tax rate for fiscal 2009 to range between 36% and 37%.

Earnings Per Share

Diluted earnings per share increased to \$1.15 for fiscal 2008 from \$0.86 for fiscal 2007. The increase in earnings per share is attributable to increased net income in fiscal 2008 partially offset by a higher diluted share count, primarily resulting from the issuance of common shares upon exercise of stock options.

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 depend on the prevailing competitive environment and the acceptance of our products in the marketplace.

Fiscal Year Ended June 30, 2007 Compared to Fiscal Year Ended June 30, 2006

Revenues, Gross Margins and Key Performance Indicators are as follows (in millions, except unit data):

| | Year Ended June 30, | | Increase | Percent |
|---|---------------------|-----------|------------|------------|
| | 2007 | 2006 | (Decrease) | Increase |
| | | | | (Decrease) |
| Product Sales Revenues | | | | |
| New unit sales revenues | \$ 317.0 | \$ 254.7 | \$ 62.3 | 24.5% |
| Other product sales revenues | 49.3 | 47.8 | 1.5 | 3.1 |
| Total product sales revenues | \$ 366.3 | \$ 302.5 | \$ 63.8 | 21.1 |
| New units sold | 25,613 | 21,512 | 4,101 | 19.1 |
| Average sales price per new unit | \$ 12,378 | \$ 11,840 | \$ 538 | 4.5 |
| Gross profit on product sales revenues(1) | \$ 167.7 | \$ 128.4 | \$ 39.3 | 30.6 |
| Gross margin on product sales revenues(1) | 45.8% | 42.4% | 340bp | 8.0 |
| Gaming Operations Revenues | | | | |
| Participation revenues | \$ 153.6 | \$ 130.8 | \$ 22.8 | 17.4 |
| Other gaming operations revenues | 19.9 | 17.9 | 2.0 | 11.2 |
| Total gaming operations revenues | \$ 173.5 | \$ 148.7 | \$ 24.8 | 16.7 |
| WAP games at period end | 1,507 | 1,864 | (357) | (19.2) |
| LAP games at period end | 2,333 | 1,495 | 838 | 56.1 |
| Stand-alone games at period end | 4,436 | 3,726 | 710 | 19.1 |

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| | | | | |
|--|----------|----------|---------|-------|
| Total installed participation base at period end | 8,276 | 7,085 | 1,191 | 16.8 |
| Average participation installed base | 7,299 | 6,285 | 1,014 | 16.1 |
| Average revenue per day per participation machine | \$ 57.66 | \$ 57.04 | \$ 0.62 | 1.1 |
| Installed casino-owned daily fee games at period end | 760 | 794 | (34) | (4.3) |
| Average casino-owned daily fee games installed base | 728 | 773 | (45) | (5.8) |
| Gross profit on gaming operations revenues(1) | \$ 137.3 | \$ 112.3 | \$ 25.0 | 22.3 |
| Gross margin on gaming operations revenues(1) | 79.1% | 75.5% | 360bp | 4.8 |
| Total revenues | \$ 539.8 | \$ 451.2 | \$ 88.6 | 19.6 |
| Total gross profit(1) | \$ 305.0 | \$ 240.7 | \$ 64.3 | 26.7 |
| Total gross margin(1) | 56.5% | 53.3% | 320bp | 6.0 |

bp basis point

(1) As used herein, gross profit and gross margin exclude depreciation and distribution expense.

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Revenues and Gross Profit

Total revenues for fiscal 2007 increased 19.6%, or \$88.6 million, over fiscal 2006, reflecting:

Ø A \$62.3 million increase in new unit sales revenue as a result of:

Ø A 19.1% increase in new units sold worldwide. North American new units sold increased 13.2%, reflecting:

the introduction of new products and game segmentation strategies, such as our *G+* video games;

the initial and ongoing shipments into the new Pennsylvania and Broward County, Florida markets;

openings of new casinos in the Midwest;

steady demand from Native American tribal operators, particularly in Oklahoma;

the fulfillment of a previously announced state lottery commission contract;

the launch of several new products; and

all of which were partially offset by the sluggish North American replacement market.

Ø International new units sold increased 36.1% over the prior year, reflecting the positive contribution of Orion Gaming, growth in China and the broader pan-Asian market, and continued growth throughout Europe, South Africa and Latin America.

Ø Demand for our mechanical reel products continues to increase and accounted for 25% of new unit sales in fiscal 2007 compared to 14% in fiscal 2006.

Ø A 4.5% year-over-year increase in average selling price, due to an increase in list prices and higher sales of premium priced products.

Ø A \$1.5 million increase in other product sales, as an increase in conversion revenues, top box revenues, parts revenues, Orion Gaming AWP revenues and Orion Gaming OEM revenues were partially offset by a reduction in OEM revenues from Multimedia Games, used gaming machines revenues and the fact that fiscal 2006 benefited from \$1.8 million of revenue from an earn-out provision under a lottery contract.

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We sold over 6,600 used gaming machines in fiscal 2007 with a greater percentage being higher-priced refurbished units, compared to over 8,200 used gaming machines in fiscal 2006.

Ø We earned revenue on the sale of over 7,200 conversion kits in fiscal 2007, compared to over 6,200 conversion kits in fiscal 2006.

Ø A 16.7% growth in total gaming operations revenues due to:

Ø A 16.1% increase in the average installed base of participation gaming machines, driven by our newer products, such as *MONOPOLY Big Event* stand-alone gaming machines, *GREEN ACRES* and *Life of Luxury* LAP gaming machines, as well as the initial success of our *TOP GUN* and *MONOPOLY Super Money Grab* WAP gaming machines, partially offset by declines in our other stand-alone and *POWERBALL* WAP participation games.

Ø Overall average revenues per day increased slightly, reflecting a higher average installed base of higher-earning WAP gaming machines during fiscal 2007 than in fiscal 2006.

Total gross profit, as used herein excluding distribution and depreciation expense, increased 26.7%, or \$64.3 million, to \$305.0 million for fiscal 2007 from \$240.7 million for fiscal 2006. Our gross margins may not be comparable to those of other entities as we include the costs of distribution in selling and administrative expenses. This improvement reflects:

Ø Gross margin on product sales revenues was 45.8% for fiscal 2007 compared to 42.4% for fiscal 2006. Gross margin for fiscal 2007 reflects operating leverage from higher volume, the favorable impact from

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continued process improvements, and a favorable mix of premium-priced products, partially offset by the impact from selling lower-margin Orion Gaming machines. Furthermore, in fiscal 2007, refurbished used gaming machines that sell at higher prices and generate higher gross profit were a greater percent of total used gaming machine sales than in fiscal 2006.

- Ø Gross margin on gaming operations was 79.1% in fiscal 2007, compared to 75.5% for fiscal 2006, primarily due to favorable WAP jackpot experience and a larger number of higher-margin WMS branded themes in the average installed base, partially offset by a higher average installed based of lower-margin WAP units in fiscal 2007 than in fiscal 2006.

Operating Expenses

Operating expenses were as follows (in millions of dollars):

| | Year Ended June 30, | | | | Increase | |
|----------------------------|---------------------|-----------------|----------|-----------------|----------|---------|
| | 2007 | | 2006 | | Dollar | Percent |
| | Dollar | As % of Revenue | Dollar | As % of Revenue | | |
| Research and development | \$ 58.1 | 10.8% | \$ 49.0 | 10.9% | \$ 9.1 | 18.6% |
| Selling and administrative | 109.8 | 20.3 | 88.0 | 19.5 | 21.8 | 24.8 |
| Depreciation | 62.9 | 11.7 | 54.7 | 12.1 | 8.2 | 15.0 |
| Total operating expenses | \$ 230.8 | 42.8% | \$ 191.7 | 42.5% | \$ 39.1 | 20.4% |

Research and development expenses increased \$9.1 million to \$58.1 million in fiscal 2007, compared to \$49.0 million in the prior year. The increase reflects:

- Ø planned higher spending for our expanded product development initiatives, including SBG development, and for technology-based tools that are accelerating our product development cycle;
- Ø higher payroll-related costs resulting from headcount increases and performance based incentives associated with improved operating performance; and
- Ø the research and development expenses of Orion Gaming (acquired in July 2006), including the additional spending we have implemented since the July 2006 acquisition as part of our efforts to expand our international development capabilities.

During fiscal 2007, we introduced 49 new WMS-branded games for sale and 28 new participation and casino-owned daily fee games, compared to the introduction in fiscal 2006 of 57 new games for sale and 26 new participation and casino-owned daily fee games.

Selling and administrative expenses, inclusive of \$1.4 million of management separation costs incurred during the September 2006 quarter, increased \$21.8 million to \$109.8 million in fiscal 2007 compared to \$88.0 million in fiscal 2006. Fiscal 2007 includes the selling and administrative expenses of Orion Gaming incurred since the mid-July 2006 acquisition, higher payroll-related costs resulting from performance based incentives associated with our improved operating performance and headcount increases during the past twelve months, greater trade

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convention costs and increased marketing, promotion and distribution costs related to the roll-out of new products and branding initiatives.

Depreciation expense increased \$8.2 million to \$62.9 million in fiscal 2007 compared to \$54.7 million in fiscal 2006. This reflects the steady increase in the installed base of participation games throughout fiscal 2006 and 2007, as evidenced in the 16.1% year-over-year increase in the average installed base of participation gaming machines. The increase also reflects depreciation related to Orion Gaming. We invested \$75.9 million in gaming operations gaming machines, top boxes and related equipment during fiscal 2007, \$68.7 million during fiscal 2006, and \$63.9 million during fiscal 2005.

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Interest Expense

We incurred interest expense of \$5.1 million and \$4.3 million for fiscal 2007 and 2006, respectively, primarily related to our 2.75% convertible subordinated notes, amortization of debt issuance costs and, in fiscal 2007, interest and fees on borrowings under our revolving credit facility.

Interest and Other Income, Net

Interest and other income, net decreased by \$1.9 million primarily due to lower interest income earned on cash in fiscal 2007 as a result of lower average cash balances, and the fact that, in fiscal 2006, we received business interruption insurance proceeds of \$1.0 million, representing an initial reimbursement for business interruption losses arising from Hurricane Katrina.

Income Taxes

The effective tax rate for fiscal 2007 was 32%, consistent with the rate for fiscal 2006. The fiscal 2007 effective tax rate reflects:

The fiscal 2007 effective rate reflects:

- Ø increased income

- Ø utilization of the export sales deduction, which expired in December 2006;

- Ø the domestic manufacturing deduction; and

- Ø the effect of the retroactive reinstatement of the research and development tax credit legislation back to January 1, 2006. Since the research and development tax credit legislation was reinstated in December 2006, retroactive to January 1, 2006, the effective tax rate includes the credit earned for the period January 1, 2006 through June 30, 2006, which aggregated \$0.01 per diluted share, in addition to the tax credit earned during fiscal 2007.

The fiscal 2006 effective rate reflects:

- Ø increased income;

- Ø lower export sales deductions; and

Ø lower utilization of tax credits as a result of the December 31, 2005 expiration of the research tax credit.

Earnings Per Share

Diluted earnings per share increased to \$0.86 for fiscal 2007 from \$0.63 for fiscal 2006. The increase in earnings per share attributable to increased net income in fiscal 2007 was partially offset by a higher diluted share count resulting from the issuance of common shares upon the exercise of employee stock options and an increase in the dilutive effect of employee stock options due to the increase in the market price of our WMS common stock during fiscal 2007.

LIQUIDITY AND CAPITAL RESOURCES

Our use of cash flow from operations is largely for working capital to support our revenue base. Therefore, in any given reporting period, the amount of cash consumed or generated by operations will primarily relate to the rate of revenue increase or decrease, causing a corresponding change in working capital. In periods when revenues are increasing, the expanded working capital needs will be funded from available cash, cash equivalents, short-term investments, cash from operations, and, if necessary, proceeds from additional borrowings or additional equity offerings. Capital commitments are made for property, plant and equipment and gaming operations equipment; other commitments made relate primarily to licensing or technology agreements to obtain access to third-party brands, intellectual properties or technologies that we have not developed internally. Also, we will from time to time issue or retire borrowings or repurchase equity in an effort to maintain a cost-effective capital structure consistent with our anticipated capital requirements.

Our primary sources of liquidity are:

- Ø Existing cash and cash equivalents;
- Ø Cash flows from operations; and
- Ø Debt capacity available under our revolving credit facility.

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Selected balance sheet accounts at June 30 are summarized as follows (in millions):

| | 2008 | 2007 | Increase | |
|--|----------|---------|----------|---------|
| | | | Dollar | Percent |
| Total cash, cash equivalents, and restricted cash(1) | \$ 119.6 | \$ 53.2 | \$ 66.4 | 124.8% |
| Total current assets(A) | 413.3 | 342.2 | 71.1 | 20.8 |
| Total assets | 772.7 | 655.7 | 117.0 | 17.8 |
| Total current liabilities(B) | 116.6 | 86.7 | 29.9 | 34.5 |
| Long-term debt | 115.0 | 115.0 | | |
| Stockholders equity | 510.8 | 433.6 | 77.2 | 17.8 |
| Net working capital (A) (B) | 296.7 | 255.5 | 41.2 | 16.1 |

(1) Includes restricted cash of \$18.8 million and \$16.0 million as of June 30, 2008 and June 30, 2007, respectively. Cash required for funding WAP systems jackpot payments is considered restricted cash and is not available for general corporate purposes.

Our net working capital increased \$41.2 million from June 30, 2007, and was primarily affected by the following components:

- Ø An increase in cash, cash equivalents and restricted cash of \$66.4 million due primarily to our increased profitability and better management of working capital;
- Ø An increase in total current accounts and notes receivable, net, of \$24.6 million or 14.1%, to \$198.5 million compared to \$173.9 million at June 30, 2007, even though our revenues increased 20.4% during fiscal 2008 as we achieved a reduction in our days sales outstanding to 105 days;
- Ø A decrease in inventories of \$19.4 million to \$59.9 million due to focused efforts on increasing inventory turns which was 3.1 at June 30, 2008; and
- Ø An increase in accounts payable of \$8.2 million due to additional working capital management and international expansion, coupled with a \$5.1 million increase in accrued compensation and related benefits due to performance based incentives associated with improved operating performance, and a \$16.6 million increase in other accrued liabilities due to increased current income taxes payable.

We have not experienced significant bad debt expense in any of the periods presented. In fiscal 2008, we placed increased emphasis on more effectively utilizing working capital elements, in particular greater cross-functional team focus on better managing inventory, current accounts and notes receivable and accounts payable. We believe there continues to be opportunities to free up additional cash through greater focus and better management of these working capital categories. We also increased our emphasis on the effective use of capital deployed in general, and in specific, the amount of capital used in our gaming operations. We believe there continues to be opportunities to utilize lean sigma tools to further improve operating performance and achieve greater efficiencies in the deployment of capital associated with working capital and gaming operations equipment.

As described in Note 13, Commitments, Contingencies and Indemnifications to our Consolidated Financial Statements, we have royalty and license fee commitments for brand, intellectual property and technology licenses of \$21.0 million including contingent payments that are not recorded in our Consolidated Balance Sheets.

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We believe that total cash and cash equivalents of \$119.6 million at June 30, 2008, inclusive of \$18.8 million of restricted cash, and cash flow from operations will be adequate to fund our anticipated level of expenses, capital expenditures, cash to be invested in gaming operations equipment, the levels of inventories and receivables required in the operation of our business, and any repurchases of common stock for the next year. In fiscal 2009 and 2010, we expect cash flow from operations to continue to be strong. We do not believe we will need to raise a significant amount of additional capital in the short-term or long-term, and we have access to our \$100 million revolving credit facility. We will, however, assess market opportunities as they arise.

Table of Contents***Convertible Subordinated Notes***

At June 30, 2008, we had \$115 million of convertible subordinated notes outstanding, bearing interest at 2.75%, maturing on July 15, 2010. The notes are convertible at any time into an aggregate of 8.7 million shares of our common stock at a conversion price of \$13.19 per share, subject to adjustment. The notes are not callable. We pay interest on the notes semi-annually on January 15 and July 15 of each year, aggregating \$3.2 million annually. The conversion of the 2.75% convertible subordinated notes to common stock is dependent on individual holders' choices to convert, which is dependent on the spread of the market price of our stock above the conversion strike price of \$13.19 per share, and would reduce our annual interest expense. None of the holders have converted any of their convertible subordinated notes into our common stock. Our convertible notes are conventional convertible debt instruments in which the holder may only realize the value of the conversion option by exercising the option and receiving a fixed number of shares of our common stock.

Revolving Credit Facility

We have a multi-year revolving credit agreement, as amended, that provides for \$100 million of unsecured borrowing through December 31, 2009, including the potential to expand the line up to \$125 million. Up to \$10 million of the credit facility is available for the issuance of letters of credit. The credit agreement requires that we maintain certain financial ratios, which could limit our ability to acquire companies, declare dividends or make distributions to holders of any shares of capital stock, or purchase or otherwise acquire shares of our common stock. At June 30, 2008, approximately \$103.4 million was available for such purposes under the most restrictive of these covenants. During fiscal year 2008, we did not borrow any funds against this facility.

Common Stock Repurchase Program

On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. This authorization increases the existing program, previously authorized on August 6, 2007, from \$50 million to \$150 million. As of August 26, 2008, we had total open authorization of approximately \$107 million. Pursuant to the authorization, purchases may be made from time to time in the open market, through block purchases or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on market conditions. During the fiscal year ended June 30, 2008, we purchased 1,208,971 shares for approximately \$40 million at an average cost of \$33.08 per share.

Cash Flows Summary

Cash flows from operating, investing and financing activities, as reflected in our Consolidated Statements of Cash Flows, are summarized in the following table (in millions):

| | Year Ended June 30, | | | 2008 to 2007 Change | 2007 to 2006 Change |
|---------------------------------|---------------------|----------|----------|---------------------------|---------------------------|
| | 2008 | 2007 | 2006 | | |
| Net cash provided by (used in): | | | | | |
| Operating activities | \$ 186.2 | \$ 118.9 | \$ 103.1 | \$ 67.3 | \$ 15.8 |
| Investing activities | (117.8) | (158.8) | (94.1) | 41.0 | (64.7) |

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| | | | | | |
|---|---------|----------|--------|---------|----------|
| Financing activities | (5.2) | 35.6 | (4.6) | (40.8) | 40.2 |
| Effect of exchange rates on cash and cash equivalents | 0.4 | 2.4 | (0.5) | (2.0) | 2.9 |
| Net increase (decrease) in cash and cash equivalents | \$ 63.6 | \$ (1.9) | \$ 3.9 | \$ 65.5 | \$ (5.8) |

Operating activities: The \$67.3 million increase in cash provided by operating activities in the fiscal 2008 year compared to the fiscal 2007 year resulted from:

- Ø A positive impact from the \$18.6 million increase in net income and a \$9.0 million increase in depreciation;

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- Ø A positive impact from a \$16.2 million increase in non-cash items, including share-based compensation, amortization of intangibles and other assets and other non-cash items; and
- Ø A positive impact from improved utilization of working capital indicated by a \$29.9 million net decrease in changes in operating assets and liabilities, as the fiscal 2008 period decrease in inventories and increase in current liabilities was only partially offset by an increase in accounts and notes receivable and other current assets.

The \$15.8 million increase in cash provided by operating activities in fiscal 2007 compared to fiscal 2006 resulted from several factors, including:

- Ø A positive impact from the \$15.6 million increase in net income and a \$8.2 million increase in depreciation;
- Ø A positive impact from a \$13.1 million increase in non-cash items, including share-based compensation, amortization of intangibles and other assets and other non-cash items, partially offset by;
- Ø A negative impact from the \$24.3 million net increase in changes in operating assets and liabilities, due to the impact of inventory being flat from fiscal 2006 to fiscal 2007, as compared to the decrease from fiscal 2005 to fiscal 2006, partially offset by the smaller increase in our restricted cash from fiscal 2006 to fiscal 2007. While we continued to add new WAP links during fiscal 2007, we had established significantly more new WAP links during fiscal 2006, driving the growth in restricted cash during that period. The growth in our total receivables had a similar impact on cash flow from operations in fiscal 2007 and fiscal 2006.

Investing Activities: The \$41.0 million decrease in cash used by investing activities in fiscal 2008 compared to the fiscal 2007 year was primarily due to:

- Ø Lower cash used in purchasing businesses by \$20.7 million as only \$0.2 million of cash was used for the acquisition of SiP in the fiscal 2008 period compared to net cash of \$20.9 million used for the acquisition of Orion Gaming during fiscal 2007;
- Ø A \$25.5 million decrease in the amount invested in gaming operations machines, top boxes and related equipment during the fiscal 2008 period to \$50.4 million. We expect the rate of investment in gaming operations equipment to continue to moderate in fiscal 2009 and 2010;
- Ø An \$8.4 million reduction in investments and advances in royalties, licensed technologies, patents and trademarks to \$19.5 million in the fiscal 2008 period as we entered into fewer new agreements, partially offset by;
- Ø A \$14.2 million increase in the amount invested in property, plant and equipment during the fiscal 2008 period to \$48.3 million, due primarily to the acquisition of land and buildings near our Chicago technology campus to provide for future expansion, higher spending on information technology, renovation of our Waukegan, Illinois facility, as well as investments in manufacturing tools and internally developed and purchased software. We expect that capital expenditures for property, plant and equipment will increase modestly in fiscal 2009 and 2010.

The \$64.7 million increase in cash used by investing activities in fiscal 2007 compared to fiscal 2006 was primarily due to:

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- Ø The acquisition on July 13, 2006, of 100% of the outstanding stock of privately held Orion Gaming. The acquisition resulted in a net use of cash of \$20.9 million, including debt retirement, cash consideration paid and acquisition costs, net of cash acquired;

- Ø A \$7.2 million increase in the amount invested in gaming operations machines, top boxes and related equipment during fiscal 2007 to \$75.9 million;

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- Ø An \$18.5 million increase in the amount invested in property, plant and equipment during fiscal 2007 to \$34.1 million, due primarily to the expansion of our Waukegan, Illinois facility to consolidate outside warehousing and support our continued process improvement initiatives, as well as investments in internally developed and purchased software;
- Ø A \$12.0 million increase in investment and advances in royalties, licensed technologies, patents, and trademarks as we continued to license and acquire innovative and creative technologies and intellectual property;
- Ø Net cash of \$6.1 million was provided from the redemption of short-term investments during fiscal 2006, with no redemptions of such investments in fiscal 2007.

Financing Activities: The \$40.8 million decrease in cash provided by financing activities in fiscal 2008 compared to fiscal 2007 was primarily due to:

- Ø The use of \$35 million in fiscal 2008 to repurchase common stock compared to none in fiscal 2007;
- Ø A \$5.8 million reduction in the cash received and tax benefit from the exercised stock options. The amount we received from the exercise of stock options is dependent on individuals' choices to exercise options, which are dependent on the spread of the market price of our stock above the exercise price of vested options.

The \$40.2 million increase in cash provided by financing activities in fiscal 2007 compared to fiscal 2006 was primarily due to:

- Ø The receipt of \$26.7 million from the exercise of stock options in fiscal 2007, compared to \$4.2 million in fiscal 2006, along with the related tax benefit of \$8.9 million in fiscal 2007 and \$1.2 million in fiscal 2006. The amount we received from the exercise of stock options is dependent on individuals' choices to exercise options, which are dependent on the spread of the market price of our stock above the exercise price of vested options;
- Ø \$10.0 million in repurchases of our common stock during the fiscal 2006, with no similar repurchases during fiscal 2007.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

We are not dependent on off-balance sheet financing arrangements to fund our operations. We utilize financing arrangements for operating leases of equipment and facilities, none of which are in excess of our current needs. We also have minimum guaranteed royalty payments for intellectual property and technologies that are not recorded on our Consolidated Balance Sheets. Typically, we are obligated to make minimum commitment royalty payments over the term of our licenses and to advance payment against those commitments.

Our obligations under these arrangements, under our convertible subordinated notes and other contractual obligations at June 30, 2008, were as follows (in millions):

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| Contractual Obligations | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|--|-----------------|---------------------------------|----------------------|----------------------|----------------------------------|
| Operating leases | \$ 24.4 | \$ 3.9 | \$ 6.8 | \$ 6.3 | \$ 7.4 |
| Royalty and license fee payments | 21.0 | 9.6 | 10.9 | 0.5 | |
| Non-cancelable raw material purchase orders | 2.1 | 2.1 | | | |
| Accrued WAP jackpot liability | 11.3 | 11.3 | | | |
| Convertible subordinated notes | 115.0 | | 115.0 | | |
| Interest payments | 7.9 | 3.2 | 4.7 | | |
| Performance bonds | 1.0 | 1.0 | | | |
| Other, including guaranteed minimums in employment agreements and capital expenditures | 21.0 | 14.0 | 4.8 | 1.4 | 0.8 |
| Total | \$ 203.7 | \$ 45.1 | \$ 142.2 | \$ 8.2 | \$ 8.2 |

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The total potential royalty and license fee commitments decreased to \$21.0 million at June 30, 2008 from \$27.3 million at June 30, 2007, due to advances and payments made on existing commitments, partially offset by a slight increase in gross commitments. Potential royalty and license fee commitments could increase in the future as we enter into new intellectual property, technology or brand licensing agreements. See Note 13, Commitments, Contingencies and Indemnifications to our Consolidated Financial Statements.

Non-cancelable raw materials purchase orders decreased to \$2.1 million as of June 30, 2008 from \$6.3 million as of June 30, 2007, due to the reevaluation of our purchasing practices and procedures as part of our alignment with lean sigma principles.

We have performance bonds outstanding of \$1.0 million at June 30, 2008, to one customer, related to product sales, and we are liable to the issuer in the event of exercise due to our non-performance under the contract. Events of non-performance do not include the financial performance of our products.

Indemnifications

We have agreements in which we may be obligated to indemnify other parties with respect to certain matters. Generally, these indemnification provisions are included in sales orders and agreements arising in the normal course of business under which we customarily agree to hold the indemnified party harmless against claims arising from a breach of representations related to matters such as title to assets sold and licensed, defective equipment or certain intellectual property rights. Payments by us under such indemnification provisions are generally conditioned on the other party making a claim. Such claims are typically subject to challenge by us and to dispute resolution procedures specified in the particular sales order or contract. Further, our obligations under these agreements may be limited in terms of time and/or amount and, in some instances, we may have recourse against third parties. It is not possible to predict the maximum potential amount of future payments under these indemnification agreements due to the conditional nature of the obligations and the unique facts of each particular agreement. Historically, we have not made any payments under these agreements that have been material individually or in the aggregate. As of June 30, 2008, we were not aware of any obligations arising under indemnification agreements that would require material payments except for the matter disclosed in Note 14, Litigation, to our Consolidated Financial Statements.

We have agreements with our directors and certain officers that require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We have also agreed to indemnify certain former officers and directors of acquired companies. We maintain director and officer insurance, which may cover our liabilities arising from these indemnification obligations in certain circumstances. As of June 30, 2008, we were not aware of any obligations arising under these agreements that would require material payments.

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

Self-Insurance

We are self-insured for various levels of workers' compensation, electronic errors and omissions liability, automobile collision insurance, as well as employee medical, dental, prescription drug and disability coverage. We purchase stop-loss coverage to protect against unexpected claims.

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Accrued insurance claims and reserves include estimated settlements for known claims, and estimates of claims incurred but not reported.

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SUBSEQUENT DEVELOPMENTS

Share Repurchase Authorization

On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. This authorization increases the existing program from \$50 million to \$150 million. As of August 26, 2008, we had a total open authorization of approximately \$107 million. Pursuant to the authorization, purchases may be made from time to time in the open market, through block purchases or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on market conditions.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the ordinary course of our business, primarily associated with interest rate and foreign currency fluctuations. We do not currently hedge either of these risks, or utilize financial instruments for trading or other speculative purposes.

Interest Rate Risk

We have exposure to interest rate risk from our convertible subordinated notes and revolving credit facility. The notes are at a fixed rate and the revolving credit facility is at a variable rate.

As of June 30, 2008, we had \$115.0 million of convertible fixed-rate debt with an interest rate of 2.75% and a fair value of \$259.6 million. Using a discounted cash flow model, and assuming no change in the market price of our common stock into which the debt is convertible, we currently estimate that a 50 basis point change in the prevailing market interest rates would impact the fair value of our fixed rate debt by approximately \$1.0 million, but would not impact our cash flows or future results of operations. However, the fair value of our convertible fixed rate debt is more significantly dependent on the market price of our common stock into which it can be converted.

We have a multi-year revolving credit agreement that provides for \$100 million of unsecured borrowing through December 31, 2009, including the potential to expand the line up to \$125 million. Borrowings under this facility bear interest at a certain percentage above the agent's prime rate, or above the LIBOR rate. There were no outstanding borrowings under this facility as of June 30, 2008.

Foreign Currency Risk

We have subsidiaries in Australia, Austria, Canada, China, the Netherlands, Slovakia, Spain, South Africa, and the United Kingdom for distribution and development operations. These subsidiaries transact business in their respective foreign currencies and are exposed to risks resulting from fluctuations in foreign currency exchange rates. We estimate that a hypothetical 10% strengthening (or weakening) of the U.S.

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dollar for fiscal 2008 would have resulted in a pretax loss (or gain) of approximately \$0.7 million.

The net assets of these subsidiaries are exposed to foreign currency translation gains and losses, which are included as a component of accumulated other comprehensive income in stockholders' equity in our Consolidated Balance Sheets. Such translation resulted in unrealized gains of \$6.8 million and \$3.2 million for fiscal 2008 and 2007, respectively.

In addition, foreign governments could impose restrictions on currency movements that might make it costly or impossible to repatriate earnings to the U.S.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our Consolidated Financial Statements are included in this Report immediately following Part IV.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation as of June 30, 2008 of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2008.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is designed to provide reasonable assurance regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of June 30, 2008.

The effectiveness of our internal control over financial reporting as of June 30, 2008 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report included herein.

ITEM 9B. OTHER INFORMATION

Not Applicable.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about October 27, 2008 with the SEC.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about October 27, 2008 with the SEC.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about October 27, 2008 with the SEC.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about October 27, 2008 with the SEC.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference from our definitive proxy statement to be filed on or about October 27, 2008 with the SEC.

Table of Contents**PART IV****ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

- (a) (1) *Financial Statements*. See Index to Financial Information on page F-1.
- (2) *Financial Statement Schedule*. See Index to Financial Information on page F-1.
- (3) *Exhibits*.

| Exhibit | Description |
|----------------|---|
| 3.1 | Amended and Restated Certificate of Incorporation of WMS dated February 17, 1987; Certificate of Amendment dated January 28, 1993; and Certificate of Correction dated May 4, 1994, incorporated by reference to WMS Annual Report on Form 10-K for the year ended June 30, 1994 (the 1994 10-K). |
| 3.2 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of WMS, as filed with the Secretary of State of the State of Delaware on February 25, 1998, incorporated by reference to WMS Quarterly Report on Form 10-Q for the quarter ended March 31, 1998. |
| 3.3 | Amended and Restated By-Laws of WMS, as amended and restated through May 7, 2007, incorporated by reference to WMS Current Report on Form 8-K, filed on May 10, 2007. |
| 10.1 | Voting Proxy Agreement, dated September 21, 1995, among Louis J. Nicastro, Neil D. Nicastro, WMS, Sumner M. Redstone and National Amusements, Inc., incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 1995. |
| 10.2 | Amendment to Voting Proxy Agreement, dated July 20, 2005, among Neil D. Nicastro, WMS, Sumner M. Redstone and National Amusements, Inc., incorporated by reference to WMS' Current Report on Form 8-K, filed on July 29, 2005. |
| 10.3 | Third Amendment to Voting Proxy Agreement, effective as of November 20, 2006, by and between Mr. Sumner M. Redstone, National Amusements, Inc., Neil D. Nicastro, Brian R. Gamache and WMS Industries Inc., incorporated by reference to our Current Report on Form 8-K, filed on November 22, 2006. |
| 10.4 | Voting Proxy Agreement dated, November 8, 2003, among Louis J. Nicastro, Neil D. Nicastro, WMS and Phyllis G. Redstone, incorporated by reference to WMS Current Report on Form 8-K, filed on November 12, 2002. |
| 10.5 | Amendment to Voting Proxy Agreement, effective as of October 18, 2006, by and between Phyllis G. Redstone, Neil D. Nicastro, Brian R. Gamache and WMS Industries, Inc., incorporated by reference to our Current Report on Form 8-K, filed on October 20, 2006. |
| 10.6 | Worldwide Merchandising Agreement/License Agreement Summary and License Agreement (the License Agreement) between WMS Gaming Inc., Hasbro, Inc. and Hasbro International, Inc. dated September 1, 1997, incorporated by reference to WMS Registration Statement No. 333-83021 on Form S-3, filed on July 16, 1999 (the 1999 S-3). Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.7 | Amendment dated 1998 to License Agreement between WMS Gaming Inc., Hasbro, Inc. and Hasbro International, Inc., incorporated by reference to the 1999 S-3. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.8 | Amendment No. 3, dated December 16, 2002, to the License Agreement between WMS Gaming Inc., Hasbro, Inc. and Hasbro International Inc., incorporated by reference to WMS Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 (the 2003 1Q 10-Q). Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |

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| Exhibit | Description |
|----------------|--|
| 10.9 | Amendment No. 4, dated September 15, 2003, to the License Agreement between WMS Gaming Inc., Hasbro, Inc. and Hasbro International Inc., incorporated by reference to the 2003 1Q 10-Q. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.10 | Amendment No. 6, dated December 16, 2006, to the License Agreement, between WMS Gaming Inc., Hasbro, Inc. and Hasbro International, Inc., incorporated by reference to our Current Report on Form 8-K, filed on December 20, 2006. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the commission. |
| 10.11 | Warrant to purchase common stock of the Registrant, issued to Hasbro, Inc., incorporated by reference to the 2003 1Q 10-Q. |
| 10.12 | Game Manufacturer Cashless License Agreement, dated as of October 1, 2006, between IGT and WMS Gaming, Inc., incorporated by reference to WMS Current Report on Form 8-K, filed on October 3, 2006. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.13 | IGT/WMS Patent Cross License Agreement, between WMS Gaming Inc. and International Game Technology, dated as February 14, 2008, incorporated by reference to our Current Report on Form 8-K, filed on February 21, 2008. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.14 | License and Development Agreement between WMS Gaming Inc. and Sierra Design Group (SDG), dated as of April 24, 2002, incorporated by reference to WMS Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (the 2003 2Q 10-Q). Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.15 | First Amendment to License and Development Agreement between WMS Gaming Inc. and SDG, dated June 12, 2003, incorporated by reference to the 2003 2Q 10-Q. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.16 | Second Amendment to License and Development Agreement between WMS Gaming Inc. and SDG, dated July 15, 2003, incorporated by reference to the 2003 2Q 10-Q. |
| 10.17 | Third Amendment to License and Development Agreement between WMS Gaming Inc. and SDG, dated November 7, 2003, incorporated by reference to the 2003 2Q 10-Q. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.18 | Letter Amendment to License and Development Agreement between WMS Gaming Inc. and SDG, dated February 3, 2004, incorporated by reference to Form 10-K for the year ended June 30, 2004. Portions of this exhibit have been omitted under a request for confidential treatment filed separately with the Commission. |
| 10.19 | Indenture, dated June 25, 2003, between WMS and BNY Midwest Trust Company (the Indenture), incorporated by reference to WMS Current Report on Form 8-K, filed on June 25, 2003 (the 2003 8-K). |
| 10.20 | Form of Note contained in and incorporated by reference to Exhibit A to the Indenture. |
| 10.21 | Registration Rights Agreement, dated June 25, 2003, between WMS and BNY Midwest Trust Company, incorporated by reference to the 2003 8-K. |
| 10.22 | \$100 million Credit Agreement, dated May 1, 2006, by WMS with JPMorgan Chase Bank, N.A., as Administrator Agent, JP Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, LaSalle National Association, as Syndication Agent, and Bank of America, N.A. as Documentation Agent, incorporated by reference to WMS Current Report on Form 8-K, filed on May 5, 2006. |
| 10.23 | Amendment No. 1 to Credit Agreement, dated as of June 29, 2007, by WMS with JPMorgan Chase Bank, N.A., as Administrative Agent, JP Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, LaSalle Bank National Association, as Syndication Agent and Bank of America, N.A., as Documentation Agent, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2007. |

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| Exhibit | Description |
|--|--|
| 10.24 | Amendment No. 2 to Credit Agreement, dated as of June 30, 2008, by WMS with JPMorgan Chase Bank, N.A., as Administrative Agent, JP Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, LaSalle Bank National Association, as Syndication Agent and Bank of America, N.A., as Documentation Agent, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| <i>Management Contracts and Compensatory Plans or Arrangements</i> | |
| 10.25 | WMS Industries Inc. 1998 Non-Qualified Stock Option Plan, incorporated by reference to WMS Registration Statement No. 333-57585 on Form S-8, filed on June 24, 1998. |
| 10.26 | WMS Industries Inc. 2000 Non-Qualified Stock Option Plan, incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2000. |
| 10.27 | WMS Industries Inc. 2000 Stock Option Plan, incorporated by reference to Appendix B to WMS Proxy Statement for its 2001 Annual Meeting of Stockholders, filed on December 8, 2000. |
| 10.28 | WMS Industries Inc. 2002 Stock Option Plan, incorporated by reference to Appendix B to WMS' Proxy Statement for its 2002 Annual Meeting of Stockholders, filed on September 25, 2002. |
| 10.29 | Amended and Restated 2005 Incentive Plan, as adopted by our stockholders on December 15, 2006, incorporated by reference to Appendix A to our Proxy Statement, filed on October 26, 2006. |
| 10.30 | Form of Stock Option Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan, incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2005. |
| 10.31 | Form of Restricted Stock Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2005. |
| 10.32 | Form of Equity-Based Performance Award Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2005. |
| 10.33 | Form of Deferred Stock Unit Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2006. |
| 10.34 | Form of Restricted Stock Unit Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2007. |
| 10.35 | Form of Performance-based Restricted Unit Agreement under the WMS Industries Amended and Restated 2005 Incentive Plan. |
| 10.36 | WMS Industries Inc. Nonqualified Deferred Compensation Plan, amended and restated effective January 1, 2005, incorporated by reference to WMS Current Report on Form 8-K, filed on March 15, 2006. |
| 10.37 | Letter of Termination of Employment Agreement between Louis J. Nicastro and WMS, dated June 14, 2001, incorporated by reference to WMS Annual Report on Form 10-K for the fiscal year ended June 30, 2001 (the 2001 10-K). |
| 10.38 | Form of Officer and Director Indemnity Agreement, incorporated by reference to WMS Current Report on Form 8-K, filed on December 15, 2004. |

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| Exhibit | Description |
|----------------|--|
| 10.39 | Advisory Agreement between Louis J. Nicastro and WMS Industries Inc., dated May 5, 2008, incorporated by reference to WMS Quarterly Report on Form 10-Q for the quarter ended March 31, 2008. |
| 10.40 | Employment Agreement between Brian R. Gamache and WMS, dated December 27, 2004, incorporated by reference to WMS Current Report on Form 8-K, filed on December 30, 2004. |
| 10.41 | Letter Agreement, dated as of August 9, 2005, between WMS and Brian R. Gamache incorporated by reference to WMS Current Report on Form 8-K, filed on August 15, 2005. |
| 10.42 | Amendment to Executive Employment Agreement, dated July 1, 2008, between WMS and Brian R. Gamache, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.43 | Employment Agreement between Orrin J. Edidin and WMS, dated February 18, 2005, incorporated by reference to WMS Current Report on Form 8-K, filed on February 24, 2005. |
| 10.44 | Letter Agreement, dated as of August 9, 2005, between WMS and Orrin J. Edidin incorporated by reference to WMS Current Report on Form 8-K, filed on August 15, 2005. |
| 10.45 | Amendment to Executive Employment Agreement, dated July 1, 2008, between WMS and Orrin J. Edidin, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.46 | Employment Agreement between Scott D. Schweinfurth and WMS dated February 18, 2005, incorporated by reference to WMS Current Report on Form 8-K, filed on February 24, 2005. |
| 10.47 | Letter Agreement, dated as of August 9, 2005, between WMS and Scott D. Schweinfurth incorporated by reference to WMS Current Report on Form 8-K, filed on August 15, 2005. |
| 10.48 | Amendment to Executive Employment Agreement, dated July 1, 2008, between WMS and Scott D. Schweinfurth, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.49 | Employment offer letter, dated November 22, 2002, to Kathleen J. McJohn, Vice President, General Counsel and Secretary, incorporated by reference to WMS Quarterly Report on Form 10-Q for the quarter ended March 31, 2003. |
| 10.50 | Employment Agreement, dated September 7, 2005, between WMS and Larry J. Pacey, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.51 | Amendment to Executive Employment Agreement, dated July 1, 2008, between WMS and Larry J. Pacey, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.52 | Deferred Compensation Agreement, dated January 27, 2007, between WMS and Larry J. Pacey, incorporated by reference to WMS Current Report on Form 8-K, filed on July 3, 2008. |
| 10.53 | Description of Executive Compensation Salary increases, incorporated by reference to WMS Current Report on Form 8-K filed on July 3, 2008. |
| 10.54 | Description of Executive Compensation Cash Bonus Matrices and financial performance goals for Executive Officers, incorporated by reference to WMS Current Report on Form 8-K, filed on September 25, 2007. |
| <i>Other</i> | |
| 21 | Subsidiaries of the Registrant. |
| 23 | Consent of Ernst & Young LLP. |
| 31 | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 13(a)-14(a) of the Securities Exchange Act of 1934 (Section 302 of the Sarbanes-Oxley Act of 2002). |
| 32 | Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002). |

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WMS INDUSTRIES INC.

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| <u>Consolidated statements of income for the years ended June 30, 2008, 2007 and 2006</u> | F-5 |
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All other schedules are omitted since the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the Consolidated Financial Statements and Notes thereto.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of

WMS Industries Inc.

We have audited the accompanying consolidated balance sheets of WMS Industries Inc. (the Company) as of June 30, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended June 30, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. at June 30, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 30, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective July 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), WMS Industries Inc.'s internal control over financial reporting as of June 30, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 28, 2008 expressed an unqualified opinion thereon.

/S/ ERNST & YOUNG LLP

Chicago, Illinois

August 28, 2008

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders of

WMS Industries Inc.

We have audited WMS Industries Inc.'s internal control over financial reporting as of June 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). WMS Industries Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, WMS Industries Inc. maintained, in all material respects, effective internal control over financial reporting as of June 30, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of WMS Industries Inc. as of June 30, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended June 30, 2008 of WMS Industries Inc. and our report dated August 28, 2008 expressed an unqualified opinion thereon.

/S/ ERNST & YOUNG LLP

Chicago, Illinois

August 28, 2008

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

June 30, 2008 and 2007

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

| | 2008 | 2007 |
|---|-----------------|-----------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 100.8 | \$ 37.2 |
| Restricted cash | 18.8 | 16.0 |
| Total cash, cash equivalents, and restricted cash | 119.6 | 53.2 |
| Accounts receivable, net of allowances of \$3.0 and \$2.5, respectively | 131.8 | 114.5 |
| Notes receivable | 66.7 | 59.4 |
| Inventories | 59.9 | 79.3 |
| Deferred income tax assets | 7.3 | 9.4 |
| Other current assets | 28.0 | 26.4 |
| Total current assets | 413.3 | 342.2 |
| NON-CURRENT ASSETS: | | |
| Gaming operations equipment, net | 75.4 | 90.0 |
| Property, plant and equipment, net | 125.7 | 91.9 |
| Intangible assets | 106.3 | 97.0 |
| Deferred income tax assets | 34.9 | 19.9 |
| Other assets | 17.1 | 14.7 |
| Total non-current assets | 359.4 | 313.5 |
| TOTAL ASSETS | \$ 772.7 | \$ 655.7 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 47.0 | \$ 38.8 |
| Accrued compensation and related benefits | 22.6 | 17.5 |
| Other accrued liabilities | 47.0 | 30.4 |
| Total current liabilities | 116.6 | 86.7 |
| NON-CURRENT LIABILITIES: | | |
| Deferred income tax liabilities | 16.2 | 9.4 |
| Long-term debt | 115.0 | 115.0 |
| Other non-current liabilities | 14.1 | 11.0 |
| Total non-current liabilities | 145.3 | 135.4 |
| Commitments, contingencies and indemnifications (see Note 13) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock (5.0 shares authorized, none issued) | | |
| Common stock (100.0 shares authorized, 51.0 and 50.0 shares issued, respectively) | 25.5 | 25.0 |

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| | | |
|---|-----------------|-----------------|
| Additional paid-in capital | 298.1 | 269.1 |
| Retained earnings | 203.9 | 138.2 |
| Accumulated other comprehensive income | 8.1 | 1.3 |
| Treasury stock, at cost (0.8 and zero shares, respectively) | (24.8) | |
| Total stockholders equity | 510.8 | 433.6 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 772.7 | \$ 655.7 |

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

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Table of Contents**WMS INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF INCOME****For the Years Ended June 30, 2008, 2007 and 2006****(in millions of U.S. dollars and millions of shares, except per share amounts)**

| | 2008 | 2007 | 2006 |
|---|----------------|----------------|----------------|
| REVENUES: | | | |
| Product sales | \$ 421.2 | \$ 366.3 | \$ 302.5 |
| Gaming operations | 228.9 | 173.5 | 148.7 |
| Total revenues | 650.1 | 539.8 | 451.2 |
| COSTS AND EXPENSES: | | | |
| Cost of product sales(1) | 217.3 | 198.6 | 174.1 |
| Cost of gaming operations(1) | 46.6 | 36.2 | 36.4 |
| Research and development | 79.9 | 58.1 | 49.0 |
| Selling and administrative | 130.0 | 109.8 | 88.0 |
| Depreciation(1) | 71.9 | 62.9 | 54.7 |
| Total costs and expenses | 545.7 | 465.6 | 402.2 |
| OPERATING INCOME | 104.4 | 74.2 | 49.0 |
| Interest expense | (4.0) | (5.1) | (4.3) |
| Interest and other income, net | 5.2 | 2.6 | 4.5 |
| Income before income taxes | 105.6 | 71.7 | 49.2 |
| Provision for income taxes | 38.1 | 22.8 | 15.9 |
| NET INCOME | \$ 67.5 | \$ 48.9 | \$ 33.3 |
| Earnings per share: | | | |
| Basic | \$ 1.34 | \$ 1.01 | \$ 0.71 |
| Diluted | \$ 1.15 | \$ 0.86 | \$ 0.63 |
| Weighted-average common shares: | | | |
| Basic common stock outstanding | 50.2 | 48.4 | 47.1 |
| Diluted common stock and common stock equivalents | 60.6 | 59.6 | 56.9 |

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

| | | | |
|---------------------------|---------|---------|---------|
| Cost of product sales | \$ 3.7 | \$ 2.4 | \$ 2.3 |
| Cost of gaming operations | \$ 59.5 | \$ 53.3 | \$ 45.8 |

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

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WMS INDUSTRIES INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

For the Years Ended June 30, 2008, 2007 and 2006

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

| Common Shares Issued | Common Shares Held in Treasury | | Additional | | Accumulated | | Treasury stock, at cost | Total stockholders equity | |
|----------------------------|--------------------------------------|---|-----------------|--------------------|----------------------|----------------------------------|-------------------------------|---------------------------------|---------------------------------|
| | | | Common stock | paid-in capital | Retained Earnings | other comprehensive income | | | Unearned restricted stock |
| 48.6 | (1.1) | Balance, June 30, 2005 | \$ 16.2 | \$ 225.0 | \$ 64.3 | \$ 0.6 | \$ (11.5) | \$ (9.4) | \$ 285.2 |
| | | Comprehensive income: | | | | | | | |
| | | Net income | | | 33.3 | | | | 33.3 |
| | | Foreign currency translation adjustment | | | | (0.5) | | | (0.5) |
| | | Comprehensive income | | | | | | | 32.8 |
| | | Effect from adoption of SFAS No. 123R | | (11.5) | | | 11.5 | | |
| | 0.5 | Exercise of stock options and related tax benefits | | 1.5 | | | | 3.9 | 5.4 |
| | | Share-based payment expense | | 12.2 | | | | | 12.2 |
| | (0.6) | Purchase of treasury shares | | | | | | (10.0) | (10.0) |
| 48.6 | (1.2) | Balance, June 30, 2006 | 16.2 | 227.2 | 97.6 | 0.1 | | (15.5) | 325.6 |
| | | Comprehensive income: | | | | | | | |
| | | Net income | | | 48.9 | | | | 48.9 |
| | | Foreign currency translation adjustment | | | | 3.2 | | | 3.2 |
| | | Comprehensive income | | | | | | | 52.1 |
| 1.4 | 0.8 | Exercise of stock options and related tax benefits | 0.5 | 26.4 | | | | 8.7 | 35.6 |
| | | Forfeiture of restricted shares | | 0.3 | | | | | 0.3 |
| | 0.4 | Stock issued for business acquisition | | 2.8 | | | | 6.8 | 9.6 |
| | | Effect from adoption of SFAS No. 158, net of tax | | | | (2.0) | | | (2.0) |
| | | Share-based payment expense | | 12.4 | | | | | 12.4 |
| | | Impact of three-for-two stock split | 8.3 | | (8.3) | | | | |
| 50.0 | | Balance, June 30, 2007 | 25.0 | 269.1 | 138.2 | 1.3 | | | 433.6 |
| | | Comprehensive income: | | | | | | | |
| | | Net income | | | 67.5 | | | | 67.5 |
| | | Foreign currency translation adjustment | | | | 6.8 | | | 6.8 |
| | | Comprehensive income | | | | | | | 74.3 |
| 1.0 | 0.4 | Exercise of stock options and related tax benefits | 0.5 | 13.7 | | | | 15.2 | 29.4 |
| | (1.2) | Purchase of treasury shares | | | | | | (40.0) | (40.0) |
| | | Stock issued for business acquisition | | 0.1 | | | | | 0.1 |
| | | Effect from adoption of FIN 48 | | | (1.8) | | | | (1.8) |

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Share-based payment expense

15.2

15.2

| | | | | | | | | | |
|------|-------|-------------------------------|---------|----------|----------|--------|----|-----------|----------|
| 51.0 | (0.8) | Balance, June 30, 2008 | \$ 25.5 | \$ 298.1 | \$ 203.9 | \$ 8.1 | \$ | \$ (24.8) | \$ 510.8 |
|------|-------|-------------------------------|---------|----------|----------|--------|----|-----------|----------|

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

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Table of Contents**WMS INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Years Ended June 30, 2008, 2007 and 2006****(in millions of U.S. dollars)**

| | 2008 | 2007 | 2006 |
|---|-----------------|----------------|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | \$ 67.5 | \$ 48.9 | \$ 33.3 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation | 71.9 | 62.9 | 54.7 |
| Share-based compensation | 15.2 | 12.4 | 12.2 |
| Amortization of intangibles and other assets | 24.2 | 16.9 | 9.8 |
| Other non-cash items | 14.3 | 8.2 | 2.4 |
| Deferred income taxes | (7.0) | (0.6) | (3.8) |
| Change in operating assets and liabilities, net of business acquisitions: | | | |
| Restricted cash | (2.8) | (2.4) | (10.1) |
| Accounts and notes receivable | (32.6) | (26.5) | (23.7) |
| Inventories | 11.8 | | 32.7 |
| Other current assets | (6.1) | (0.7) | (8.3) |
| Other assets and liabilities | 14.8 | (8.4) | (4.9) |
| Current liabilities | 15.0 | 8.2 | 8.8 |
| Net cash provided by operating activities | 186.2 | 118.9 | 103.1 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Additions to gaming operations equipment | (50.4) | (75.9) | (68.7) |
| Purchase of property, plant and equipment | (48.3) | (34.1) | (15.6) |
| Investment and advances in royalties, licensed technologies, patents, and trademarks | (19.5) | (27.9) | (15.9) |
| Purchase of business, net of cash acquired | (0.2) | (20.9) | |
| Proceeds from short-term investments | | | 6.1 |
| Other | 0.6 | | |
| Net cash used in investing activities | (117.8) | (158.8) | (94.1) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Cash received from exercise of stock options | 21.0 | 26.7 | 4.2 |
| Tax benefit from exercise of stock options | 8.8 | 8.9 | 1.2 |
| Proceeds from borrowings under revolving credit facility | | 15.0 | |
| Repayments of borrowings under revolving credit facility | | (15.0) | |
| Purchase of treasury stock | (35.0) | | (10.0) |
| Net cash (used in) provided by financing activities | (5.2) | 35.6 | (4.6) |
| Effect of Exchange Rates on Cash and Cash Equivalents | 0.4 | 2.4 | (0.5) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 63.6 | (1.9) | 3.9 |
| CASH AND CASH EQUIVALENTS, beginning of year | 37.2 | 39.1 | 35.2 |
| CASH AND CASH EQUIVALENTS, end of year | \$ 100.8 | \$ 37.2 | \$ 39.1 |

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

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1. BUSINESS OVERVIEW

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

We market our gaming machines in two principal ways. First, product sales include the sales of new and used gaming machines and video lottery terminals (VLTs), conversion kits, parts, amusement-with-prize gaming machines, equipment manufactured under original equipment manufacturing agreements to casinos and other gaming machine operators and gaming related systems for smaller international casino operators. Second, we license our game content and intellectual property to third parties for distribution and we lease gaming machines and VLTs to casinos and other licensed gaming machine operators for payments based upon (1) a percentage of the net win, which is the earnings generated by casino patrons playing the gaming machine, (2) fixed daily fees or (3) in the case of gaming machines on a wide-area progressive (WAP) jackpot system, a percentage of the amount wagered or a combination of a fixed daily fee and a percentage of the amount wagered. We categorize our lease arrangements into five groups: WAP participation gaming machines; local-area progressive (LAP) participation gaming machines; stand-alone participation gaming machines; casino-owned daily fee games; and gaming machine and VLT leases. We refer to WAP, LAP and stand-alone participation gaming machines as participation games and when combined with casino-owned daily fee games, royalties we receive under license agreements with third parties to utilize our game content and intellectual property, and gaming machine, VLT and other lease revenues, we refer to this business as our gaming operations.

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

Common Stock Split

On May 7, 2007, our Board of Directors authorized a three-for-two stock split of our common stock, effected in the form of a stock dividend. All stockholders received one additional share for every two shares of our common stock owned as of the close of business on the record date of May 29, 2007. The additional 16,624,363 shares of \$0.50 par value common stock were issued on June 14, 2007 and recorded as a reduction to retained earnings in the amount of \$8.3 million. Our common stock began trading on the split-adjusted basis on June 15, 2007. Earnings per share, stock prices and all other common share data have been retroactively adjusted, as appropriate, to reflect the effect of this stock split.

2. PRINCIPAL ACCOUNTING POLICIES

Basis of Presentation and Consolidation Policy

Our Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles and, pursuant to the rules and regulations of the Securities and Exchange Commission, include all adjustments necessary to fairly present our consolidated financial position, results of operations, and cash flows for each period presented. Our Consolidated Financial Statements include the accounts of WMS

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Industries Inc. and its wholly owned subsidiaries (WMS or the Company). All significant intercompany accounts and transactions have been eliminated.

Reclassifications

Certain amounts within net cash provided by operating activities included in the prior years Consolidated Statements of Cash Flows have been reclassified to conform with the current year s presentation. These reclassifications did not affect the reported amounts of total net cash provided by operating activities included in our Consolidated Statements of Cash Flows.

Revenue Recognition

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

- Ø Persuasive evidence of an agreement exists;
- Ø The price to the customer is fixed or determinable;
- Ø The product is delivered; and
- Ø Collectibility is reasonably assured.

Product Sales

We sell gaming machines and VLTs typically with payment terms of 30 to 90 days. In certain circumstances we may offer extended payment terms typically for one year but in limited cases up to three years, which obligation may be secured by the related equipment and may accrue interest recognized at market rates. Revenues are reported net of incentive rebates or discounts.

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When multiple product deliverables are included under a sales contract, in accordance with Emerging Issues Task Force Issue 00-21 (EITF 00-21), *Revenue Arrangements with Multiple Deliverables*, we allocate revenue to each unit of accounting based upon its respective fair value against the total contract value and defer revenue recognition on those deliverables where we have not met all requirements of revenue recognition. We allocate 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 individually.

We recognize revenue when the product is delivered and defer revenue for any undelivered units of accounting. Deliverables are divided into separate units of accounting if:

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

If we 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.

Our services for initial installation, as well as standard warranty and technical support, are not separately priced components of our sales arrangements and are included in our revenues when the associated product sales

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

revenue is recognized. Labor costs for gaming machine installs and participation placements, as well as labor costs associated with performing routine maintenance on participation gaming machines are included in selling and administrative expenses. We accrue for the cost of installing gaming machines sold to our customers at the time of sale, based on the percent of such gaming machines that we expect to install for our customers. We capitalize the costs to install gaming operations equipment.

We currently do not apply the provisions of Statement of Position (SOP) 97-2, *Software Revenue Recognition* (SOP 97-2), to sales of our products. The sales of our gaming machines includes games and an operating system, which are an integral part of the gaming machine, but are incidental under the guidance of SOP 97-2 and, as such, we apply the revenue recognition principles outlined above. We do apply SOP 97-2 to gaming-related systems revenues generated by our subsidiary Systems in Progress GmbH (SiP). See Note 4 Business Acquisitions .

Gaming Operations

We earn gaming operations revenues from leasing participation gaming machines and VLTs, and earn royalties from third parties under license agreements to use our game content and intellectual property. 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 for each gaming machine based upon a percentage of coin-in, which is the amount of coins, currency and credits wagered on the gaming machine or a combination of a fixed daily fee and a percentage of coin-in. Participating casinos pay a percentage of the coin-in from WAP gaming machines directly to us for services related to the design, assembly, installation, operation, maintenance, and marketing of the WAP systems and to administer the progressive jackpot funding. Revenues are recognized as earned when collectibility is reasonably assured. WAP systems entail a configuration of numerous electronically linked gaming machines located in multiple casino properties, connected to our central computer system via a network of communications equipment. WAP system gaming machines differ from non-linked gaming machines in that they build a progressive jackpot with every wager until a player hits the top award winning combination.

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

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

Casino-owned daily fee game lease agreements are for a fixed daily fee per day. Casino-owned daily fee games are games for which we sell the base gaming machine 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 to the casino. We excluded casino-owned daily fee games from our installed based participation gaming machines.

VLTs may be operated as stand-alone units or may interface with central monitoring systems operated by government agencies. Our leased VLTs typically are located in places where casino-type gaming is not the only attraction, such as racetracks, bars and restaurants, and are usually operated by the lottery organization of the jurisdiction. Our revenues are based on a fixed percentage of the daily net win of the VLTs. We exclude our leased VLTs from our installed base of participation gaming machines.

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Under agreements with licensees who are generally located in geographic areas or operate in markets where we are not active, we license our games, artwork, and other intellectual property. License royalties are recorded as earned when the licensee purchases or places the game or other intellectual property, and collectibility is reasonably assured.

Sales of Used Gaming Machines

Cash generated from the remanufacture and sale of used gaming machines, including cash generated from the remanufacture and sale of used gaming operations machines, is included in our cash flow from operating activities for the periods in which such sales occur and have not been material.

Translation of Non-U.S. Currency Amounts

The local currency is the functional currency (primary currency in which business is conducted) for our non-U.S. subsidiaries and their assets and liabilities are translated into U.S. dollars at fiscal year-end exchange rates. Revenue and expense items are translated at average exchange rates prevailing during the fiscal year. Translation adjustments are included in Accumulated other comprehensive income. Gains and losses arising from intercompany foreign currency transactions that are of a long-term investment nature are reported in the same manner as translation adjustments. Foreign currency transaction gains (losses) are included in Interest and other income, net and totaled \$0.4 million, \$(0.3) million and \$0.3 million in fiscal years 2008, 2007 and 2006, respectively.

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 \$18.8 million and \$16.0 million at June 30, 2008 and 2007, respectively, is required to fund WAP systems' jackpot payments.

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. Imputed interest, if any, is determined based on current market rates at the time the note originated and is recorded in Interest and other income, net.

The fair value of notes receivable is estimated by discounting expected future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities. As of June 30, 2008 and 2007, the fair value of the notes receivable approximated the carrying value.

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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 parts inventory is subject to technical obsolescence. Inventory on hand in excess of forecasted demand is written down to net realizable value.

An active market exists mostly outside of North America for used gaming machines. When we receive a gaming machine on trade-in, we estimate a carrying value for the gaming machine. The value is based upon an estimate of the condition of the gaming machine, as well as our experience in selling used gaming machines and could change due to changes in demand in general for used gaming machines. We either sell these trade-ins as-is or renovate the gaming machines before resale. We also sell participation gaming machines as used gaming machines when we no longer need them in our gaming operations business. Therefore, we review our used gaming machine inventory for impairment on a routine basis. Actual demand for new and used gaming machines may differ from anticipated demand, and such differences may have a material effect on our financial statements.

Freight-out and Warehousing Costs

Freight-out and warehousing costs are included in cost of product sales in our Consolidated Statements of Income. Freight-out costs for gaming operations equipment are capitalized and depreciated over the useful life of the related asset.

Research and Development Costs, including Software Development Costs

We account for research and development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 2, *Accounting for Research and Development Costs*. Accordingly, costs associated with product development are included in Research and development and are generally expensed as incurred.

We account for amounts paid to third parties for purchased or licensed software under SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, (SFAS No. 86). Under these arrangements, we have alternative future uses for purchased software and we generally have the right to sub-license this software to third parties. See Note 13, *Commitments, Contingencies and Indemnifications* . In addition, according to SFAS No. 86, costs incurred in creating a computer software product are charged to expense when

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incurred as research and development until technological feasibility has been established for the product, after which point costs are capitalized. Our products reach technological feasibility when a working model of the software is available, which is shortly before release to manufacturing for production.

We incur significant regulatory approval costs for our games. Such costs are capitalized once technological feasibility has been established and are amortized over the estimated product life cycle, generally two years. Regulatory approval costs related to projects that are discontinued are expensed when such determination is made. Capitalized regulatory approval costs net, were \$6.3 million and \$5.4 million as of June 30, 2008 and 2007, respectively which are included in other noncurrent assets. Amortization expense for previously capitalized amounts totaled \$5.2 million, \$2.1 million and \$0.1 in fiscal 2008, 2007 and 2006, respectively.

We account for costs incurred to develop software for internal use in accordance with SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Consequently, any

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

costs incurred during preliminary project stages are expensed; costs incurred during the application development stages are capitalized and costs incurred during the post-implementation/operation stages are expensed. Unamortized capitalized software costs were approximately \$17.6 million and \$7.4 million as of June 30, 2008 and 2007, respectively which are included in Property, plant and equipment, net.

Gaming Operations Equipment and Property, Plant and Equipment

Property, plant and equipment and gaming operations equipment are stated at cost, net of accumulated depreciation. Depreciation of these assets is computed on a straight-line basis over the following estimated useful lives:

| | |
|--|--|
| Buildings and improvements | 10 to 40 years |
| Leasehold improvements | Lesser of term of lease or useful life |
| Machinery and equipment | 3 to 10 years |
| Gaming operations base gaming machines | 3 years |
| Gaming operations top boxes | 1 year |
| Furniture and fixtures | 10 years |

Significant replacements and improvements are capitalized. Other maintenance and repairs are expensed.

We review the carrying amount of these assets when 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 are 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.

Intangible Assets

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we classify intangible assets into three categories: (1) intangible assets with finite lives subject to amortization; (2) intangible assets with indefinite lives not subject to amortization; and (3) goodwill. We do not amortize intangible assets with indefinite lives and goodwill. We test intangible assets with finite lives for impairment when conditions exist that indicate the carrying value may not be recoverable. For intangible assets with indefinite lives and goodwill, we perform tests for impairment at least annually or more frequently when events or circumstances indicate that assets might be impaired. We perform our impairment tests of goodwill at our reporting unit level which is at the consolidated level. Such impairment tests for goodwill include comparing the fair value with

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its carrying value, including goodwill. The fair value of a reporting unit refers to the amount at which the unit as a whole could be bought or sold in a current transaction between willing parties. Fair values are derived using discounted cash flow analyses. When appropriate, we consider the assumptions that we believe hypothetical marketplace participants would use in estimating future cash flows. In addition, where applicable, an appropriate discount rate is used, based on our cost of capital rate or location-specific economic factors. In case the fair value is less than the carrying value of the assets, we record an impairment charge to reduce the carrying value of the assets to fair value.

We determine the useful lives of our identifiable finite lived intangible assets after considering the specific facts and circumstances related to each intangible asset. Factors we consider when determining useful lives

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

include the contractual term of any agreement, the history of the asset, our long-term strategy for the use of the asset, any laws or other local regulations which could impact the useful life of the asset and, other economic factors, including competition and specific market conditions. Intangible assets that are deemed to have definite lives are amortized, generally on a straight-line basis, over their useful lives. See Note 7, Intangible Assets.

We capitalize advances for royalty and licensing fees made in connection with licensing agreements we have for the use of third party intellectual property and technologies. 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 product sales if related to a product sale, or cost of gaming operations if related to placement or lease of gaming machines or licenses in gaming operations revenues. To the extent we determine that the products developed would not fully recover the minimum commitment amounts, we will record an immediate impairment charge in our Consolidated Statements of Income at the time of such determination.

WAP Jackpot Liabilities and Expenses

We record a WAP jackpot liability based on the actual volume of coin-in or gaming machine play plus the initial progressive meter liability (reset) on each system in each jurisdiction, discounted to net present value for non-instant pay jackpots. Jackpots are payable either immediately in the case of instant pay progressive jackpots or in equal installments over a 20-year period. For non-instant pay jackpots, winners may elect to receive a single payment for the present value of the jackpot, discounted at applicable interest rates, in lieu of annual installments. We defer jackpot expense for the reset liability on each WAP linked system, which is subsequently amortized as jackpot expense in cost of gaming operations as revenues are generated from the coin-in or gaming machine play. Our jackpot liabilities totaled \$11.3 million and \$11.6 million at June 30, 2008 and 2007, respectively. Our jackpot expense was \$17.9 million, \$13.3 million and \$13.3 million for fiscal 2008, 2007 and 2006, respectively. To fund our jackpot liabilities we maintain restricted cash, as described above.

Advertising Expense

The cost of advertising is charged to expense as incurred. The cost of advertising for fiscal 2008, 2007 and 2006 was \$1.0 million, \$1.0 million and \$0.9 million, respectively.

Accounting for Income Taxes

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Effective July 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*. Under FIN 48, the benefits of tax positions that are more likely than not of being sustained upon audit based on the technical merits of the tax position are recognized in our Consolidated Financial Statements; positions that do not meet this threshold are not recognized. For tax positions that are at least more likely than not of being sustained upon audit, the largest amount of the benefit that is more likely than not of being sustained is recognized in our Consolidated Financial Statements. Upon the adoption of FIN 48, we recorded a \$1.8 million increase in our liability for unrecognized tax benefits that was accounted for as a reduction in our retained earnings as of July 1, 2007.

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 income tax assets and liabilities based upon

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

differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Deferred income taxes are measured using the enacted tax rates that are assumed to be in effect when the differences reverse. We recognize accrued interest and penalties associated with uncertain tax positions as part of income tax expense.

Share-Based Compensation

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in fiscal 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|-------------------------------------|------|------|------|
| Risk-free interest rate | 3.3% | 4.8% | 4.6% |
| Expected life of options (in years) | 4.75 | 5.16 | 6.13 |
| Expected volatility | 0.35 | 0.36 | 0.37 |
| Dividend yield | 0.0% | 0.0% | 0.0% |

For fiscal 2008, 2007 and 2006, the expected life of each award granted was calculated using the simplified method in accordance with Staff Accounting Bulletin (SAB) No. 107 and as amended in SAB No. 110. The expected volatility rate has been calculated based on weekly closing prices of WMS common shares from July 1, 2003. In accordance with the guidance in SFAS No.123 (revised 2004), *Share-Based Payment* (SFAS 123R) we estimate expected volatility based on the historical realized volatility giving consideration to how future experience might reasonably be expected to differ from historical experience. We calculate the historical volatility beginning July 1, 2003, as we believe our stock price volatility prior to that date would be expected to differ significantly from subsequent stock price volatility as, prior to July 1, 2003, we focused on resolving issues in our legacy operating system software, whereas after that date we began introducing our new operating system, new gaming cabinet and new game themes, and re-emerging as the business we are today. See Note 12, *Equity Compensation Plan*. The risk-free interest rate is based on the implied yield currently available on U.S. Treasury zero coupon issues with a remaining term that approximates the expected life of the award. Expected dividend yield is based on historical dividend payments.

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

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

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

Selling and administrative expenses consist primarily of sales, marketing, distribution, installation and corporate support functions such as administration, information technology, legal, regulatory compliance, human resources and finance. The costs of distribution were \$20.4 million, \$17.2 million and \$16.2 million for the fiscal year ended 2008 2007 and 2006, respectively.

Use of Estimates

Our Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles. Such preparation requires us to make estimates and assumptions that affect the amounts reported in our Consolidated Financial Statements and Notes thereto. Actual results could differ from those estimates.

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Concentrations of Credit Risk

Financial instruments, which potentially subject us to concentrations of credit and market risk, consist primarily of cash equivalents and accounts and notes receivable. By policy, we place our cash equivalents only in high credit quality securities and limit the amounts invested in any one security. However, our overnight cash balances are held by our main commercial bank. The accounts and notes receivable are generally from a large number of customers with no significant concentration other than in the State of Nevada. No customer accounted for more than 10% of consolidated revenues in fiscal 2008, 2007 and 2006.

As of June 30, 2008, approximately 18% of our employees are covered by a collective bargaining agreement which expires on June 30, 2011.

Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. Subsequent to the issuance of SFAS 157, the FASB issued FASB Staff Position (FSP) 157-2 *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. For the instruments subject to the effective date delay under FSP 157-2, the effective date to adopt the fair value provisions for us will be July 1, 2009. We will continue to evaluate the impact of the provisions of SFAS 157 on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS 115*, (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities using different measurement techniques. The fair value measurement provisions are elective and can be applied to individual financial instruments. SFAS 159 requires additional disclosures related to the fair value measurements included in the entity's financial statements. We are required to adopt this statement beginning July 1, 2008 and we currently expect no material impact from the provisions of SFAS 159 on our Consolidated Financial Statements.

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

3. EARNINGS PER SHARE

Basic and diluted earnings per share are calculated as follows for the three fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|---|----------------|----------------|----------------|
| Net income | \$ 67.5 | \$ 48.9 | \$ 33.3 |
| After tax interest expense and amortization of issuance cost on convertible subordinated notes | 2.1 | 2.2 | 2.3 |
| Diluted earnings (numerator) | \$ 69.6 | \$ 51.1 | \$ 35.6 |
| Basic weighted average common shares outstanding | 50.2 | 48.4 | 47.1 |
| Dilutive effect of stock options | 1.5 | 2.4 | 1.0 |
| Dilutive effect of restricted common stock and warrants | 0.2 | 0.1 | 0.1 |
| Dilutive effect of convertible subordinated notes | 8.7 | 8.7 | 8.7 |
| Diluted weighted average common stock and common stock equivalents (denominator) | 60.6 | 59.6 | 56.9 |
| Basic earnings per share of common stock | \$ 1.34 | \$ 1.01 | \$ 0.71 |
| Diluted earnings per share of common stock and common stock equivalents | \$ 1.15 | \$ 0.86 | \$ 0.63 |
| Common stock equivalents excluded from the calculation of diluted earnings per share because their impact would render them anti-dilutive | 0.7 | 1.0 | 2.7 |

Included in the anti-dilutive common stock equivalents for fiscal 2007 and 2006 are warrants to purchase 375,000 shares of common stock that were issued in September 2003 as part of an inducement to a licensor to extend their license agreement with us. The warrants' exercise price is \$23.36 per share of our common stock, subject to adjustment.

4. BUSINESS ACQUISITIONS

In July 2007, we completed the acquisition of 100% of the outstanding stock of privately held Systems in Progress GmbH (SiP), an Austrian-based company focused on developing and selling gaming related systems, including linked progressive systems and slot accounting systems applicable for smaller international casino operators. The total consideration for SiP, including acquisition costs, was \$4.9 million. SiP's former majority shareholder is our customer and \$4.5 million of the total consideration resulted from extinguishing a receivable owed by that

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customer to us for the customer's entire equity ownership in SiP. Two minority shareholders were paid equal value in cash and shares of our common stock that in total aggregated approximately \$0.2 million. See Note 7, Intangible Assets. The final purchase price allocation resulted in \$3.1 million of identifiable intangible assets and \$1.8 million of goodwill. SiP operates as a separate subsidiary. The transaction was immaterial to our fiscal 2008 Consolidated Financial Statements and, therefore, pro forma financial information is not provided. The goodwill is expected to be deductible for tax purposes.

In July 2006, we completed the acquisition of 100% of the outstanding stock of privately held Orion Financement Company (Orion Gaming,) a Netherlands-based holding company that designs, manufactures and distributes casino-based gaming machines and OEM and AWP gaming machines. The total consideration for Orion Gaming, excluding acquisition costs, was 23.6 million (or approximately U.S. \$30.1 million), of which 8.6 million (U.S. \$10.9 million) was for debt retirement. Orion Gaming's stockholders each received

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

15.0 million, comprised of 7.5 million (U.S. \$9.6 million) in cash and 7.5 million (U.S. \$9.6 million) of our common stock (549,564 shares). Orion Gaming operates as a separate subsidiary. Pro forma financial information is not provided as this acquisition was not material to our Consolidated Financial Statements. We allocated the aggregate purchase price, including acquisition costs, of \$30.7 million to: tangible assets of \$11.8 million; identifiable intangibles and goodwill of \$25.1 million (included in Intangible assets); and total liabilities of \$6.2 million. The goodwill is expected to be non-deductible for tax purposes.

5. INVENTORIES

Inventories consisted of the following at June 30:

| | 2008 | 2007 |
|-----------------------------------|----------------|----------------|
| Raw materials and work-in-process | \$ 40.1 | \$ 52.5 |
| Finished goods | 19.8 | 26.8 |
| Total inventories | \$ 59.9 | \$ 79.3 |

Total legacy inventories were \$1.4 million and \$8.5 million at June 30, 2008 and 2007, respectively.

6. GAMING OPERATIONS EQUIPMENT AND PROPERTY, PLANT AND EQUIPMENT

The components of Gaming operations equipment were as follows at June 30:

| | 2008 | 2007 |
|--|----------------|----------------|
| Gaming operations equipment | \$ 245.3 | \$ 219.3 |
| Less accumulated depreciation | (169.9) | (129.3) |
| Net gaming operations equipment | \$ 75.4 | \$ 90.0 |

The components of Property, plant and equipment were as follows at June 30:

| | 2008 | 2007 |
|----------------------------|-------------|-------------|
| Land | \$ 11.3 | \$ 5.2 |
| Buildings and improvements | 59.5 | 43.5 |

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| | | |
|-----------------------------------|----------|---------|
| Machinery and equipment | 88.0 | 71.4 |
| Furniture and fixtures | 14.3 | 10.1 |
| Construction in process | 24.8 | 19.6 |
| | 197.9 | 149.8 |
| Less accumulated depreciation | (72.2) | (57.9) |
| Net property, plant and equipment | \$ 125.7 | \$ 91.9 |

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Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)****7. INTANGIBLE ASSETS***Goodwill*

The changes in the carrying amount of goodwill during fiscal 2008 include:

| | |
|---|-------------|
| Goodwill balance at June 30, 2007 | \$ 17.4 |
| Impact of SiP acquisition | 1.8 |
| Foreign currency translation adjustment | 2.7 |
| Goodwill balance at June 30, 2008 | \$ 21.9 |

Other Intangible Assets

The following table summarizes additions to other intangible assets during fiscal 2008. Other additions include capitalized legal costs and expenditures to third parties.

| | Business Combination | Other Additions | Total Additions |
|--|---------------------------------|----------------------------|----------------------------|
| Finite lived intangibles: | | | |
| Royalty advances for licensed brands and other | \$ | \$ 11.6 | \$ 11.6 |
| Licensed or acquired technologies | 3.1 | 3.3 | 6.4 |
| Patents | | 4.3 | 4.3 |
| Customer relationships | | | |
| Trademarks | | 0.3 | 0.3 |
| Total | \$ 3.1 | \$ 19.5 | \$ 22.6 |
| Indefinite lived intangibles: | | | |
| Acquired brand names | \$ | \$ | \$ |

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Additions to royalty advances and licensed or acquired technologies have a weighted-average life of 5.3 years. Technologies acquired as part of a business combination will be amortized over a period of five years. A majority of the other patent additions pertain to unissued patent applications and we anticipate that a majority of these patents will be amortized over four to seventeen years beginning in approximately July 2009.

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

Other intangible assets consisted of the following as of June 30:

| | 2008 | | | 2007 | | |
|--|-----------------|-----------------------------|----------------|-----------------|-----------------------------|----------------|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Finite lived intangible assets: | | | | | | |
| Royalty advances for licensed brands and other | \$ 72.9 | \$ (37.6) | \$ 35.3 | \$ 65.5 | \$ (31.5) | \$ 34.0 |
| Licensed or acquired technologies | 39.2 | (7.4) | 31.8 | 35.1 | (2.4) | 32.7 |
| Patents | 18.5 | (2.1) | 16.4 | 14.4 | (0.9) | 13.5 |
| Customer relationships | 5.2 | (1.7) | 3.5 | 4.4 | (0.7) | 3.7 |
| Trademarks | 0.9 | (0.3) | 0.6 | 0.7 | (0.1) | 0.6 |
| Total | \$ 136.7 | \$ (49.1) | \$ 87.6 | \$ 120.1 | \$ (35.6) | \$ 84.5 |
| Indefinite lived intangible assets: | | | | | | |
| Acquired brand names | \$ 3.6 | \$ | \$ 3.6 | \$ 3.0 | \$ | \$ 3.0 |

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

The following table reconciles Goodwill and Other intangible assets presented above to Intangible assets recorded on our Consolidated Balance Sheets at June 30:

| | 2008 | 2007 |
|--|-----------------|----------------|
| Goodwill | \$ 21.9 | \$ 17.4 |
| Finite lived intangible assets, net | 87.6 | 84.5 |
| Indefinite lived intangible assets | 3.6 | 3.0 |
| Less: royalty advances and licensed or acquired technologies, short-term | (6.8) | (7.9) |
| Total intangible assets | \$ 106.3 | \$ 97.0 |

Amortization expense for royalty advances and licensed or acquired technologies, patents and trademarks was \$19.9 million, \$13.3 million and \$8.7 million for fiscal 2008, 2007 and 2006, respectively. Fiscal 2008 includes a \$3.7 million pre-tax write-down to net realizable value of a technology license. If all of our remaining licensed or required technologies were to have no further value to us, we would record a charge of up to \$31.8 million.

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

| Year ended June 30, | |
|----------------------------|--------|
| 2009 | \$ 8.2 |
| 2010 | 7.0 |
| 2011 | 10.4 |
| 2012 | 10.3 |
| 2013 | 10.5 |

The estimated aggregate future intangible amortization as of June 30, 2008 does not reflect the significant commitments we have for future payments for royalty advances and licensed or acquired technologies. See Note 13, Commitments, Contingencies and Indemnifications.

8. OTHER ACCRUED LIABILITIES

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The components of other accrued liabilities were as follows at June 30:

| | 2008 | 2007 |
|--------------------------------------|---------|---------|
| Accrued WAP jackpot liability | \$ 11.3 | \$ 11.6 |
| Current income taxes payable | 9.2 | 1.0 |
| Accrued royalties and licensing fees | 7.8 | 6.5 |
| Accrued common stock repurchase | 5.0 | |
| Other accrued liabilities | 13.7 | 11.3 |
| Total other accrued liabilities | \$ 47.0 | \$ 30.4 |

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Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(tabular amounts in millions of U.S. dollars and millions of shares, except per share amounts)****9. INCOME TAXES**

The following is a summary of income before income taxes of U.S. and international operations for the fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|---------------|-----------------|----------------|----------------|
| United States | \$ 106.1 | \$ 69.4 | \$ 48.0 |
| International | (0.5) | 2.3 | 1.2 |
| Total | \$ 105.6 | \$ 71.7 | \$ 49.2 |

Significant components of the provision for income taxes were as follows for the fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|---|----------------|----------------|----------------|
| Current: | | | |
| Federal | \$ 32.2 | \$ 12.4 | \$ 17.1 |
| State | 3.7 | 1.0 | 1.2 |
| Foreign | 0.4 | 1.1 | 0.2 |
| Total current | 36.3 | 14.5 | 18.5 |
| Deferred: | | | |
| Federal | (6.1) | (0.2) | (2.7) |
| State | (0.5) | (0.4) | (0.6) |
| Foreign | (0.4) | | (0.5) |
| Total deferred | (7.0) | (0.6) | (3.8) |
| Tax benefit from exercise of stock options | 8.8 | 8.9 | 1.2 |
| Income tax provision, net | \$ 38.1 | \$ 22.8 | \$ 15.9 |

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 tax purposes. Significant components of our deferred income tax assets and liabilities at June 30 were:

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| | 2008 | 2007 |
|--|----------------|----------------|
| Deferred income tax assets resulting from: | | |
| Current: | | |
| Receivables valuation | \$ 1.2 | \$ 0.8 |
| Inventory valuation | 2.5 | 3.4 |
| Accrued liabilities and other items not currently deductible | 3.6 | 5.2 |
| Total current deferred income tax assets | 7.3 | 9.4 |
| Non-current: | | |
| Share-based payment expense | 10.8 | 6.7 |
| Book over tax depreciation | 20.7 | 13.0 |
| Other non-current | 3.4 | 0.2 |
| Total non-current deferred income tax assets | 34.9 | 19.9 |
| Deferred tax liabilities resulting from: | | |
| Capitalized regulatory approval and software development costs | (8.1) | (4.5) |
| Capitalized patents and trademarks | (8.1) | (4.9) |
| Total non-current deferred income tax liabilities | (16.2) | (9.4) |
| Total net deferred income tax assets | \$ 26.0 | \$ 19.9 |

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

No deferred tax provision has been recorded for United States taxes related to approximately \$11.1 million of undistributed earnings of certain foreign subsidiaries, which are considered to be permanently reinvested. Determination of the deferred income tax liability on these unremitted earnings is not practicable because such liability, if any, is dependent on circumstances existing if and when the remittance occurs.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

The provision for income taxes differs from the amount computed using the statutory United States Federal income tax rate as follows for the fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|---|-------|-------|-------|
| Statutory Federal income tax rate | 35.0% | 35.0% | 35.0% |
| State income taxes, net of federal benefit | 2.9 | 2.8 | 2.9 |
| Manufacturer's deduction | (1.7) | (0.7) | (1.3) |
| Research and development tax credits | (1.4) | (4.1) | (2.0) |
| Permanent items | 0.5 | 0.5 | 0.8 |
| Change of prior years' taxes | 0.9 | (0.2) | (0.4) |
| Export sales deductions | | (0.8) | (1.7) |
| Reversal of valuation allowance, primarily relating to South African losses | | | (1.2) |
| Other, net | (0.1) | (0.7) | 0.2 |
| Effective tax rate | 36.1% | 31.8% | 32.3% |

Effective July 1, 2007, we adopted FIN 48. Under FIN 48, the benefits of tax positions that are more likely than not of being sustained upon audit based on the technical merits of the tax position are recognized in our Consolidated Financial Statements; positions that do not meet this threshold are not recognized. For tax positions that are at least more likely than not of being sustained upon audit, the largest amount of the benefit that is more likely than not of being sustained is recognized in our Consolidated Financial Statements. Upon the adoption of FIN 48, we recorded a \$1.8 million increase in our liability for unrecognized tax benefits that was accounted for as a reduction in our retained earnings as of July 1, 2007. The reconciliation of the beginning and ending gross unrecognized tax benefits, excluding accrued interest and penalties of \$0.6 million, is as follows:

| | |
|--|--------|
| Balance at July 1, 2007 - date of adoption | \$ 5.2 |
| Additions related to prior year tax positions | |
| Reductions related to prior year tax positions | (0.2) |

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| | |
|---|---------------|
| Additions related to current year positions | 0.8 |
| Reductions due to settlements and payments | |
| Reductions due to lapse of Statute | |
| Balance at June 30, 2008 | \$ 5.8 |

Of the total unrecognized tax benefits, including accrued interest and penalties of \$0.6 million, \$6.2 million (net of the federal benefit) represents the portion that, if recognized, would reduce the effective tax rate. Of this total, \$0.3 million of interest and penalties was recorded in our Consolidated Statements of Income for the year

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

ended June 30, 2008. We file tax returns in various jurisdictions and do not anticipate a significant change in the amount of unrecognized tax benefits within the next twelve months.

We, or one of our subsidiaries, files income tax returns in the U.S. federal, various state, local and foreign jurisdictions. We are no longer subject to any significant U.S. federal, state, local or foreign income tax examinations by tax authorities for years before fiscal 2004.

10. CONVERTIBLE SUBORDINATED NOTES AND REVOLVING CREDIT FACILITY

Convertible Subordinated Notes

At June 30, 2008, we had \$115 million of convertible subordinated notes outstanding, bearing interest at 2.75% maturing on July 15, 2010. The notes are exchangeable at any time into an aggregate of 8.7 million shares of our common stock at a conversion price of \$13.19 per share, subject to adjustment. The notes are subordinated in right of payment to all existing and future senior debt and are effectively subordinated to all of the indebtedness and liabilities of our subsidiaries. The notes are not callable. We pay interest on the notes semi-annually on January 15 and July 15 of each year, aggregating \$3.2 million annually. The conversion of the 2.75% convertible subordinated notes to common stock is dependent on individual holders' choices to convert, which is dependent on the spread of the market price of our stock above the conversion strike price of \$13.19 per share, and such conversion would reduce our annual interest expense. None of the holders have converted any of their convertible subordinated notes into our common stock. Our convertible notes are conventional convertible debt instruments in which the holder may only realize the value of the conversion option by exercising the option and receiving a fixed number of shares of our common stock.

As of June 30, 2008, the fair value of the convertible subordinated notes was \$259.6 million. The fair value of our convertible fixed rate debt is significantly dependent on the market price of our common stock into which it can be converted.

We have no maturities of debt or sinking fund requirements through June 30, 2010.

Revolving Credit Facility

We have a multi-year revolving credit agreement, as amended, that provides for \$100 million of unsecured borrowing through December 31, 2009, including the potential to expand the line up to \$125 million. Up to \$10 million of the credit facility is available for the issuance of letters

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of credit. The credit agreement requires that we maintain certain financial ratios, which could limit our ability to acquire companies, declare dividends or make any distribution to holders of any shares of capital stock, or purchase or otherwise acquire such shares of our common stock. At June 30, 2008, approximately \$103.4 million was available for such purposes under the most restrictive of these covenants. On June 30, 2008, we amended our revolving credit agreement to allow for an increase in annual capital expenditures over the life of the agreement. No amounts were outstanding under the revolving credit facility as of June 30, 2008 and 2007.

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

11. STOCKHOLDERS EQUITY

General

Our authorized common stock consists of 100.0 million shares at \$0.50 par value. Additionally, we have 5.0 million shares of \$0.50 par value preferred stock authorized. The preferred stock is issuable in series, and the relative rights and preferences and the number of shares in each series are to be established by our Board of Directors.

Common Stock Repurchase Program

During the fiscal year ended June 30, 2008, we purchased 1,208,971 shares of our common stock for approximately \$40 million at an average cost of \$33.08 per share. On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. See Note 19, Subsequent Events. As of June 30, 2008, prior to such authorization increase, we had approximately \$10 million available under the then existing program.

12. EQUITY COMPENSATION PLAN

General

We currently have one equity compensation plan under which new grants may be made: our Amended and Restated 2005 Incentive Plan (the Plan), which was originally approved by our stockholders in fiscal 2005 and approved, as amended, in fiscal 2007. The Plan consolidated shares available under our previous stock option plans into the new Plan, although outstanding equity grants under the previous plans are still governed by those individual plans. The Plan permits us to grant options to purchase shares of our common stock, restricted stock, and other stock awards. Options may be granted as incentive stock options, designed to meet the requirements of Section 422 of the Internal Revenue Code or they may be non-qualified options that do not meet the requirements of that section. The Compensation Committee of our Board of Directors determines, or at times recommends to the Board: which of the eligible directors, officers, employees, consultants and advisors receive equity awards; the terms, including any vesting periods or performance requirements of the awards; and the size of the awards. The non-employee members of our Board of Directors determine any award made to non-employee directors.

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We issue new shares and shares from treasury for shares delivered under the Plan. The parameters of our share repurchase activity are not established solely with reference to the dilutive impact of deliveries made under the Plan. However, we expect that, over time, share purchases may partially offset the dilutive impact of deliveries to be made under the Plan.

A maximum of 12.8 million shares were authorized for awards under our plans. As of June 30, 2008, 2.4 million shares of common stock remained available for possible future issuance under our Plan.

The purpose of the Plan is to encourage our employees, non-employee directors, consultants and advisors to acquire an ownership interest in our common stock and to enable these individuals to realize benefits from an increase in the value of our common stock. We believe that this benefit provides these individuals with greater incentive to work to improve our business and encourages their continued provision of services to us and, generally, promotes our interests and those of our stockholders.

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

A summary of information with respect to share-based compensation is as follows, for the fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|---|---------|---------|---------|
| Share-based compensation expense included in pre-tax income | \$ 15.2 | \$ 12.4 | \$ 12.2 |
| Income tax benefit related to share-based compensation | (5.8) | (4.7) | (4.6) |
| Share-based compensation expense included in net income | \$ 9.4 | \$ 7.7 | \$ 7.6 |
| Diluted earnings per share impact of share-based compensation expense | \$ 0.16 | \$ 0.13 | \$ 0.13 |

Stock Options

Pursuant to the Plan, for stock options, the exercise price per share with respect to each option is determined by the Compensation Committee and is not less than the fair market value of our common stock on the date on which the stock option is granted. The Plan has a term of 10 years, unless terminated earlier, and stock options granted under the Plan prior to December 2006 have terms up to 10 years, whereas stock options granted under the Plan beginning in December 2006 have terms up to 7 years. Vesting generally occurs equally over one to four years on the grant-date anniversary. Compensation expense is recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award. On occasion, we may issue stock options that immediately vest, in which case compensation expense equal to the total fair value of the option grant is immediately recognized. Stock option activity was as follows for fiscal 2008:

| | Number of Stock Options | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value(1) |
|--|-------------------------------|---|---|------------------------------------|
| Stock options outstanding at June 30, 2007 | 5.3 | \$ 18.16 | | |
| Granted | 0.7 | 32.29 | | |
| Exercised | (1.3) | 16.41 | | |
| Expired or Cancelled Forfeited | (0.1) | 24.45 | | |
| Stock options outstanding at June 30, 2008 | 4.6 | \$ 20.53 | 6.1 | \$ 44.2 |
| Stock options exercisable at June 30, 2008 | 2.8 | \$ 17.93 | 5.7 | \$ 33.7 |

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

Other information pertaining to stock options was as follows for the years ended June 30:

| | 2008 | 2007 | 2006 |
|---|----------|---------|---------|
| Weighted average grant-date fair value per share of stock options granted | \$ 10.73 | \$ 8.40 | \$ 7.97 |
| Total grant-date fair value of stock options vested | 8.3 | 7.9 | 8.2 |
| Total intrinsic value of stock options exercised | 23.4 | 23.0 | 3.1 |

For fiscal 2008, 2007 and 2006, cash received from the exercise of stock options was \$21.0 million, \$26.7 million and \$4.2 million, respectively, and the income tax benefit realized from exercise of stock options was \$8.8 million, \$8.9 million and \$1.2 million, respectively. As of June 30, 2008, there was \$8.6 million of total stock option compensation expense related to nonvested stock options not yet recognized, which is expected to be recognized over a weighted average period of 2.6 years.

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

In fiscal 2005, the Board of Directors approved a Director Emeritus Program for directors who reach age 75 or have served on the Board of Directors for at least 20 years. The Director Emeritus Program is being phased in to maintain continuity and avoid losing the benefit of valuable experience. For fiscal 2008, 2007 and 2006, 37,500, 37,500 and 37,500, respectively, fully vested five-year stock options were issued to three directors emeritus upon their retirement from the Board.

Restricted Stock Grants

Upon the recommendation of our Compensation Committee, our Board of Directors has, on occasion, granted restricted stock to our employees, officers, or directors to motivate them to devote their full energies to our success, to reward them for their services and to align their interests with the interests of our stockholders.

Under the Plan, participants may be granted restricted stock, representing an unfunded, unsecured right, which is nontransferable except in the event of death of the participant, to receive shares of our common stock on the date specified in the participant's award agreement. The restricted stock granted under this plan is subject to vesting generally occurring equally over three to five years on the grant-date anniversary. Compensation expense is recognized on a straight-line basis over the vesting period for the entire award. Restricted stock activity was as follows:

| | Restricted Stock Shares | Weighted Average Grant- Date Fair Value(1) |
|------------------------------------|--|---|
| Nonvested balance at June 30, 2007 | 0.3 | \$ 23.09 |
| Granted | 0.2 | 30.65 |
| Vested | (0.2) | 21.75 |
| Nonvested balance at June 30, 2008 | 0.3 | \$ 27.60 |

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

As of June 30, 2008, there was \$6.8 million of total restricted share compensation expense related to nonvested awards not yet recognized, which is expected to be recognized over a weighted average period of 2.6 years.

Equity-Based Performance Units

As of June 30, 2008, there were 267,311 equity-based performance units outstanding with a weighted average grant-date fair value per unit of \$21.50. The equity-based performance units contain performance goals set by the Board of Directors based on certain performance criteria over the following periods: thirty-six month period ending June 30, 2009 for 177,400 units and thirty-six month period ending June 30, 2010 for 89,911 units. The number of shares of stock to be awarded to participants is dependent upon the achievement of the performance goals and the extent to which each goal is achieved or exceeded, requires a minimum threshold performance before any shares are issued and can result in shares issued up to 200% of the targeted number of shares under each grant. Based on the applicable performance criteria achieved for the thirty-six month period ended June 30, 2008, no payout was made under the 102,300 units previously awarded to the participants. In fiscal 2008, we recorded a provision for equity-based performance units outstanding of \$2.7 million that relate to the thirty-six month periods ended June 30, 2009 and 2010 based on the current assessment of achievement of the performance goals. Additional charges will be recorded in future periods depending on the assessment of achievement of the performance goals. Prior to fiscal 2008, we had concluded the achievement of the performance goals was not probable and therefore a provision related to the performance units was not required.

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

In fiscal 2005, non-management members of the Board of Directors were awarded an aggregate of 39,824 units of deferred stock under the Plan, of which 24,890 units remain outstanding as of June 30, 2008. The deferred stock units vest immediately and shares of our common stock will be issued upon each director's departure from the Board. Grantees are not entitled to vote their deferred stock units or to receive cash dividends, but they are entitled to receive make whole payments on any declared and paid dividends on our common stock.

Warrants

In fiscal 2004, our Board of Directors, as part of the inducement to a licensor to extend their license agreement with us, approved a grant of warrants to purchase 375,000 shares of our common stock valued at \$3.9 million using the Black-Scholes pricing model and certain assumptions at the date of issuance. The warrants' exercise price is \$23.36 per share of our common stock, subject to adjustment. The warrants are non-cancelable and vest with respect to 20% of the underlying shares in each year commencing on January 1, 2007 until fully vested on January 1, 2011, subject to earlier vesting under specified circumstances. The warrants expire on September 14, 2013. During fiscal 2008, 2007 and 2006, we expensed \$0.5 million in each year for the value of warrants issued in connection with the extended license agreement.

13. COMMITMENTS, CONTINGENCIES AND INDEMNIFICATIONS

Future minimum rental commitments under non-cancelable operating leases were as follows as of June 30, 2008:

| | |
|------------|----------------|
| 2009 | \$ 3.9 |
| 2010 | 3.6 |
| 2011 | 3.2 |
| 2012 | 3.1 |
| 2013 | 3.2 |
| Thereafter | 7.4 |
| | \$ 24.4 |

Rent expense for fiscal 2008, 2007 and 2006 was \$3.9 million, \$4.5 million and \$3.7 million, respectively. We include stated scheduled rent increases in calculating future minimum lease payments under non-cancellable operating leases and the minimum lease payments are recognized

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as rent expense on a straight-line basis over the minimum lease term. We have an option to purchase the facility that we rent in Las Vegas, NV which, if we elected to exercise, would occur between May and November of 2010 or in May 2012.

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

At June 30, 2008, we had total royalty and license fee commitments, advances and payments made and potential future royalty and license fee payments as follows:

| | Minimum Commitments |
|---|--------------------------------|
| Total royalty and license fee commitments, including contingent payments of \$3.2 million | \$ 130.0 |
| Advances and payments made | (109.0) |
| Potential future payments, including contingent payments of \$3.2 million | \$ 21.0 |

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

See Note 7, *Intangible Assets* for the related assets that are recorded on our Consolidated Balance Sheets.

As of June 30, 2008, we estimate that potential future royalty payments in each fiscal year will be as follows:

| | Minimum Commitments |
|--------------|--------------------------------|
| 2009 | \$ 9.6 |
| 2010 | 5.6 |
| 2011 | 5.3 |
| 2012 | 0.4 |
| 2013 | 0.1 |
| Thereafter | |
| Total | \$ 21.0 |

Indemnifications

We have agreements in which we may be obligated to indemnify other parties with respect to certain matters. Generally, these indemnification provisions are included in sales orders and agreements arising in the normal course of business under which we customarily agree to hold the indemnified party harmless against claims arising from a breach of representations related to matters such as title to assets sold and licensed, defective equipment or certain intellectual property rights. Payments by us under such indemnification provisions are generally conditioned on the other party making a claim. Such claims are typically subject to challenge by us and to dispute resolution procedures specified in the particular sales order or contract. Further, our obligations under these agreements may be limited in terms of time and/or amount and, in some instances, we may have recourse against third parties. It is not possible to predict the maximum potential amount of future payments under these indemnification agreements due to the conditional nature of the obligations and the unique facts of each particular agreement. Historically, we have not made any payments under these agreements that have been material individually or in the aggregate. As of June 30, 2008, we were not aware of any obligations arising under indemnification agreements that would require material payments, except for the matter disclosed in Note 14, *Litigation*.

We have agreements with our directors and certain officers that require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We have also agreed to indemnify certain former officers and directors of acquired companies. We maintain director and officer insurance, which may cover our liabilities arising from these indemnification obligations in certain circumstances. As of June 30, 2008, we were not aware of any obligations arising under these agreements that would require material payments.

Performance Bonds

We have performance bonds outstanding of \$1.0 million at June 30, 2008 to one customer related to product sales, and we are liable to the issuer in the event of exercise due to our non-performance under the contract. Events of non-performance do not include the financial performance of our products.

Self-Insurance

We are self-insured for various levels of workers' compensation, electronic errors and omissions liability, automobile collision insurance, as well as employee medical, dental, prescription drug and disability coverage.

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WMS INDUSTRIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

We purchase stop-loss coverage to protect against unexpected claims. Accrued insurance claims and reserves include estimated settlements for known claims, and estimates of claims incurred but not reported.

14. LITIGATION

On October 2, 2003, La Societe de Loteries du Quebec (Loto-Quebec) filed claims against us and Video Lottery Consultants Inc., a subsidiary of IGT (VLC) in the Superior Court of the Province of Quebec, Quebec City District (200-06-000017-015). The pleadings allege that Loto-Quebec would be entitled to be indemnified by the manufacturers of Loto-Quebec 's VLTs, specifically WMS and VLC, if the class action plaintiffs, described below, are successful in the pending class action lawsuit against Loto-Quebec. In July 2008, we entered into a settlement agreement with Loto-Quebec under which Loto-Quebec agreed to suspend the action in warranty against us in exchange for our agreement to continue cooperating with the defense of the class action lawsuit against Loto-Quebec and, in the event of an adverse outcome in such lawsuit against Loto-Quebec, to arbitration of any warranty claim by Loto-Quebec. The settlement agreement reserves all of our defenses against Loto-Quebec.

The class action lawsuit discussed in Loto-Quebec 's claim was brought on May 18, 2001 against Loto-Quebec in the Superior Court of the Province of Quebec. It alleges that the members of the class developed a pathological gambling addiction by using Loto-Quebec 's VLTs and that Loto-Quebec, as owner, operator and distributor of VLTs, failed to warn players of the alleged dangers associated with VLTs. Spielo Manufacturing Inc., another manufacturer of VLTs, voluntarily intervened to support Loto-Quebec 's position. Class status was granted by the Court on May 6, 2002, authorizing Jean Brochu to act as the representative plaintiff. The class, which is currently undetermined, but potentially comprising more than 119,000 members, is requesting damages totaling almost \$700 million Canadian dollars, plus interest. The trial is set to begin in September 2008. It is too early to assess the outcome of these actions and to determine whether any further claim will be pursued by Loto-Quebec under the terms of our settlement agreement.

15. INFORMATION ON GEOGRAPHIC AREAS

Revenues derived from customers in the United States accounted for approximately 76%, 75% and 79% of our total revenues for the fiscal years ended June 30, 2008, 2007 and 2006, respectively. The United States had more than 90% of our total long-lived assets as of June 30, 2008, 2007 and 2006. No other country in which we conduct business had greater than 10% of our total revenues or long-lived assets for the periods presented.

Geographic revenue information is determined by country of destination. Our operations outside the United States include: gaming operations equipment located in Canada, Europe and South Africa; sales and distribution offices in Argentina, Austria, Canada, China, Italy, South Africa, Spain and the United Kingdom; a sales, distribution and production facility in the Netherlands; and game development studios in Australia, the Netherlands and the United Kingdom. Substantially all of our revenues from customers outside the United States are denominated in U.S. dollars. At June 30, 2008, 2007 and 2006, 27.3%, 21.6% and 37.1%, respectively, of trade accounts and notes receivable were from customers

located outside of the United States.

16. RETIREMENT PLANS

We sponsor 401(k) defined contribution plans within the United States. The plans cover full-time employees and provide for our contributions of up to 4.5 percent of covered employees' compensation as defined in the plan. Our expense for the defined contribution plans totaled \$3.7 million, \$2.6 million and \$2.3 million in fiscal 2008, 2007 and 2006, respectively.

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

We have two frozen defined benefit pension plans related to previously discontinued operations. Pension expense for these plans was not significant in the aggregate. In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This statement requires an employer to recognize the over-funded or under-funded status of a defined benefit and postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The adoption of SFAS No. 158 had no material effect on our net income or cash flows.

17. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Additional cash flow information was as follows for the fiscal years ended June 30:

| | 2008 | 2007 | 2006 |
|--|---------|---------|---------|
| Income taxes paid | \$ 21.9 | \$ 15.5 | \$ 17.4 |
| Interest paid | 3.4 | 3.4 | 3.2 |
| Gaming operations equipment transferred to inventory | 1.9 | 4.4 | 4.8 |

18. HURRICANE DAMAGE

During the September 2005 quarter, two hurricanes devastated the Gulf Coast of Louisiana and Mississippi, which affected our facilities and our customers' facilities. We reopened our Gulfport facility in November 2005, but incurred, and continue to incur hurricane-related revenue loss. Historically, our participation revenue per day in the Mississippi and Louisiana markets is over 40% higher than the our overall average.

We carry both property and business interruption insurance. We expect damage to our leased facility in Gulfport to be covered by our property insurance, after the deductible. In fiscal 2005, we received the first property insurance payment from the insurance company. We have assessed the usability of the inventory and participation gaming machines damaged in our Gulfport facility and added damaged items to our property claim.

The property insurance carries a deductible that was expensed in fiscal 2005. There is no deductible for the business interruption insurance and this coverage began 48 hours after elected officials ordered the evacuation of the areas. During fiscal 2006, we received business interruption insurance proceeds of \$1.0 million, representing an initial reimbursement for losses arising from Hurricane Katrina, which we recorded in interest and other income, net on our Consolidated Statements of Income. We began litigation against the insurance company in the Mississippi courts in the September 2006 quarter. We continue to pursue our insurance claims, but cannot presently estimate the amount or timing of any additional payment, or the results of any litigation. We have not recorded and will not record any amount for unreimbursed business interruption

claims until an agreement is reached with our insurer as to the amount of the recovery.

19. SUBSEQUENT EVENTS

Share Repurchase Authorization

On August 4, 2008, our Board of Directors authorized the repurchase of an additional \$100 million of our common stock over the following twenty-four months. This authorization increases the existing program, previously authorized on August 6, 2007, from \$50 million to \$150 million and, as of August 26, 2008, we have a total open authorization of approximately \$107 million. Pursuant to the authorization, purchases may be made from time to time in the open market, through block purchases or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on market conditions.

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Table of Contents**WMS INDUSTRIES INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

20. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial information is as follows for fiscal 2008 and 2007:

| | Sept. 30 2007 | Dec. 31 2007 | Mar. 31 2008 | June 30 2008 |
|--|---------------------|-----------------|--------------------|-----------------|
| Fiscal 2008 Quarters | | | | |
| Revenues | \$ 132.5 | \$ 159.2 | \$ 172.8 | \$ 185.6 |
| Gross profit, excluding depreciation expense | 79.6 | 93.5 | 101.4 | 111.7 |
| Net income | 11.1 | 16.0 | 18.8 | 21.6 |
| Earnings per share: | | | | |
| Basic | \$ 0.22 | \$ 0.32 | \$ 0.37 | \$ 0.43 |
| Diluted | \$ 0.19 | \$ 0.27 | \$ 0.32 | \$ 0.36 |
| Weighted-average common shares: | | | | |
| Basic | 49.8 | 50.2 | 50.5 | 50.5 |
| Diluted | 60.8 | 61.0 | 60.9 | 60.8 |
| | Sept. 30 2006 | Dec. 31 2006 | Mar. 31 2007 | June 30 2007 |
| Fiscal 2007 Quarters | | | | |
| Revenues | \$ 110.6 | \$ 134.6 | \$ 136.6 | \$ 158.0 |
| Gross profit, excluding depreciation expense | 62.6 | 73.5 | 77.7 | 91.2 |
| Net income | 7.1 | 12.2 | 12.9 | 16.7 |
| Earnings per share: | | | | |
| Basic | \$ 0.15 | \$ 0.25 | \$ 0.26 | \$ 0.34 |
| Diluted | \$ 0.13 | \$ 0.22 | \$ 0.23 | \$ 0.29 |
| Weighted-average common shares: | | | | |
| Basic | 47.6 | 48.0 | 49.1 | 49.5 |
| Diluted | 57.5 | 58.7 | 59.6 | 60.3 |

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The June 2008 quarter includes a \$2.3 million after-tax, or \$.04 per diluted share, impact to write down to net realizable value a licensed technology.

The September 2007 and December 2007 quarters include tax benefits arising from research and development tax credit legislation which expired December 31, 2007.

The September 2006 quarter includes a \$1.0 million after-tax, or \$0.02 per diluted share, impact for charges associated with management separation costs.

The December 2006 quarter includes a \$0.7 million, or \$0.01 per dilutive share benefit related to the period January 1, 2006 through June 30, 2006, due to the retroactive reinstatement of the research and development tax credit legislation.

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Table of Contents**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS****Years Ended June 30, 2008, 2007 and 2006**

| Column A | Column B | Column C Additions | | Column D Deductions | Column E |
|----------------------------|---|--|------------------------------------|---|-----------------------------------|
| | Balance at Beginning of Period | Charged to Costs and Expenses | Charged to Other Accounts | Amounts Written off or Reclassified(1) | Balance at End of Period |
| Allowance for receivables: | | | | | |
| 2008 | \$ 2,474,000 | \$ 3,454,000 | \$ | \$ 2,880,000 | \$ 3,048,000 |
| 2007 | \$ 2,629,000 | \$ 1,677,000 | \$ | \$ 1,832,000 | \$ 2,474,000 |
| 2006 | \$ 2,488,000 | \$ 260,000 | \$ | \$ 119,000 | \$ 2,629,000 |

(1) Fiscal 2007 includes a \$300,000 reclassification to other non-current assets.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 28th day of August, 2008.

WMS INDUSTRIES INC.

By: */s/ BRIAN R. GAMACHE*
Brian R. Gamache
Chairman of the Board & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been duly signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Positions | Date |
|---|---|-----------------|
| <i>/s/ BRIAN R. GAMACHE</i> Brian R. Gamache | Chairman of the Board and Chief Executive Officer (Principal Executive Officer) | August 28, 2008 |
| <i>/s/ SCOTT D. SCHWEINFURTH</i> Scott D. Schweinfurth | Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer) | August 28, 2008 |
| <i>/s/ JOHN P. McNICOLAS, JR.</i> John P. McNicholas, Jr. | Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer) | August 28, 2008 |
| <i>/s/ LOUIS J. NICASTRO</i> Louis J. Nicastro | Founding Director | August 28, 2008 |
| <i>/s/ EDWARD W. RABIN, JR.</i> Edward W. Rabin, Jr. | Lead Director | August 28, 2008 |
| <i>/s/ HAROLD H. BACH, JR.</i> Harold H. Bach, Jr. | Director | August 28, 2008 |
| <i>/s/ ROBERT J. BAHASH</i> Robert J. Bahash | Director | August 28, 2008 |
| <i>/s/ PATRICIA M. NAZEMETZ</i> Patricia M. Nazemetz | Director | August 28, 2008 |

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| | | |
|---------------------------------|----------|-----------------|
| /s/ NEIL D. NICASTRO | Director | August 28, 2008 |
| Neil D. Nicaastro | | |
| /s/ IRA S. SHEINFELD | Director | August 28, 2008 |
| Ira S. Sheinfeld | | |
| /s/ BOBBY L. SILLER | Director | August 28, 2008 |
| Bobby L. Siller | | |
| /s/ WILLIAM J. VARESCHI, JR. | Director | August 28, 2008 |
| William J. Vareschi, Jr. | | |