

PENN NATIONAL GAMING INC  
Form 10-K/A  
August 08, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-K/A**

(Amendment No. 1)

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-24206

## Penn National Gaming, Inc.

(Exact name of registrant as specified in its charter)

**Pennsylvania**

(State or other jurisdiction of  
incorporation or organization)

**23-2234473**

(I.R.S. Employer  
Identification No.)

**825 Berkshire Blvd., Suite 200**

**Wyomissing, Pennsylvania**

(Address of principal executive offices)

**19610**

(Zip Code)

Registrant's telephone number, including area code: **(610) 373-2400**

Securities registered pursuant to Section 12(b) of the Act:

**Title of each class**

None

**Name of each exchange on which registered**

None

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$.01 per share**

**Series B Preferred Stock, par value \$.01 per share**

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

As of June 30, 2012, the aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$2.9 billion. Such aggregate market value was computed by reference to the closing price of the common stock as reported on the NASDAQ Global Select Market on June 30, 2012. For purposes of making this calculation only, the registrant has defined affiliates as including all directors, executive officers and beneficial owners of more than ten percent of the common stock of the Company.

The number of shares of the registrant's common stock outstanding as of February 14, 2013 was 77,715,792.

### DOCUMENTS INCORPORATED BY REFERENCE

None.

Table of Contents

**TABLE OF CONTENTS**

|                 | <b>Page</b>  |
|-----------------|--|
| <b>PART II</b>  |  |
| <u>ITEM 8.</u>  | <u>Financial statements and supplementary data</u> 4   |
| <u>ITEM 9.</u>  | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> 41 |
| <u>ITEM 9A.</u> | <u>Controls and Procedures</u> 41  |
| <u>ITEM 9B.</u> | <u>Other Information</u> 44  |
| <b>PART IV</b>  |  |
| <u>ITEM 15.</u> | <u>Exhibits, Financial Statement Schedules</u> 44  |

Table of Contents

**EXPLANATORY NOTE**

The Registrant is filing this Amendment No. 1 on Form 10K/A ( Form 10K/A ) to its Annual Report on Form 10-K for the year ended December 31, 2012 ( Form 10-K ) to correct a typographical error in our audit opinion on pages 67 and 113 on our Form 10-K which had inadvertently omitted the reference to the consolidated statement of comprehensive income.

As required by Rule 12b-15, the Registrant's principal executive officer and principal financial officer are providing currently dated certifications on Exhibits 31.3, 31.4, 32.3 and 32.4. Accordingly, the Registrant hereby amends Item 15 in the Form 10-K to add such reports as Exhibits.

Except as described above, this Form 10-K/A does not amend, update or change any other items or disclosures in the Form 10-K, including any of the financial information disclosed in Parts II and IV of the Form 10-K, and does not purport to reflect any information or events subsequent to the filing thereof. As such, this Form 10-K/A speaks only as of the date the Form 10-K was filed, and the Company has not undertaken herein to amend, supplement or update any information contained in the Form 10-K to give effect to any subsequent events. Accordingly, this Form 10-K/A should be read in conjunction with the Form 10-K.

Table of Contents

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Report of Independent Registered Public Accounting Firm**

Board of Directors

Penn National Gaming, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 Penn National Gaming, Inc. and Subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2013 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania

February 22, 2013



Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Balance Sheets**

(in thousands, except share and per share data)

|   | December 31,        |                     |
|---|---------------------|---------------------|
|   | 2012                | 2011                |
| <b>Assets</b>   |                     |                     |
| <b>Current assets</b>   |                     |                     |
| Cash and cash equivalents   | \$ 260,467          | \$ 238,440          |
| Receivables, net of allowance for doubtful accounts of \$3,901 and \$4,115 at December 31, 2012 and December 31, 2011, respectively                             | 53,720              | 55,455              |
| Insurance receivable  |                     | 1,072               |
| Prepaid expenses  | 94,620              | 39,801              |
| Deferred income taxes   | 39,793              | 32,306              |
| Other current assets  | 38,540              | 48,715              |
| Total current assets  | 487,140             | 415,789             |
| <b>Property and equipment, net</b>  | <b>2,730,797</b>    | <b>2,277,200</b>    |
| <b>Other assets</b>   |                     |                     |
| Investment in and advances to unconsolidated affiliates   | 204,506             | 174,116             |
| Goodwill  | 1,380,689           | 1,180,359           |
| Other intangible assets   | 706,477             | 421,593             |
| Debt issuance costs, net of accumulated amortization of \$11,462 and \$4,860 at December 31, 2012 and December 31, 2011, respectively                           | 35,999              | 33,310              |
| Other assets  | 98,449              | 103,979             |
| Total other assets  | 2,426,120           | 1,913,357           |
| <b>Total assets</b>   | <b>\$ 5,644,057</b> | <b>\$ 4,606,346</b> |
| <b>Liabilities</b>  |                     |                     |
| <b>Current liabilities</b>  |                     |                     |
| Current maturities of long-term debt  | \$ 81,497           | \$ 44,559           |
| Accounts payable  | 38,268              | 39,582              |
| Accrued expenses  | 133,316             | 113,699             |
| Accrued interest  | 21,872              | 17,947              |
| Accrued salaries and wages  | 96,426              | 85,285              |
| Gaming, pari-mutuel, property, and other taxes  | 55,610              | 49,559              |
| Income taxes  |                     | 5,696               |
| Insurance financing   | 3,856               | 16,363              |
| Other current liabilities   | 68,774              | 53,650              |
| Total current liabilities   | 499,619             | 426,340             |
| <b>Long-term liabilities</b>  |                     |                     |
| Long-term debt, net of current maturities   | 2,649,073           | 1,998,606           |
| Deferred income taxes   | 216,357             | 167,576             |
| Noncurrent tax liabilities  | 20,393              | 33,872              |
| Other noncurrent liabilities  | 7,686               | 8,321               |
| Total long-term liabilities   | 2,893,509           | 2,208,375           |
| <b>Shareholders' equity</b>   |                     |                     |
| Preferred stock (\$.01 par value, 1,000,000 shares authorized, 12,275 shares issued and outstanding at December 31, 2012 and 2011)                              |                     |                     |
| Common stock (\$.01 par value, 200,000,000 shares authorized, 77,446,601 and 76,213,126 shares issued at December 31, 2012 and December 31, 2011, respectively) | 769                 | 756                 |
| Additional paid-in capital  | 1,451,965           | 1,385,355           |
| Retained earnings   | 795,173             | 583,202             |
| Accumulated other comprehensive income  | 3,022               | 2,318               |



Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Total shareholders' equity                        |    | 2,250,929 |    | 1,971,631 |
| <b>Total liabilities and shareholders' equity</b> | \$ | 5,644,057 | \$ | 4,606,346 |

See accompanying notes to the consolidated financial statements.

Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Statements of Operations**

(in thousands, except per share data)

| Year ended December 31,  | 2012         | 2011         | 2010         |
|--|--------------|--------------|--------------|
| <b>Revenues</b>  |              |              |              |
| Gaming   | \$ 2,590,533 | \$ 2,468,630 | \$ 2,242,515 |
| Food, beverage and other   | 438,837      | 400,258      | 334,808      |
| Management service fee   | 14,835       | 15,185       | 15,190       |
| Revenues   | 3,044,205    | 2,884,073    | 2,592,513    |
| Less promotional allowances  | (144,740)    | (141,816)    | (133,402)    |
| Net revenues   | 2,899,465    | 2,742,257    | 2,459,111    |
| <b>Operating expenses</b>  |              |              |              |
| Gaming   | 1,342,905    | 1,298,938    | 1,198,097    |
| Food, beverage and other   | 343,611      | 321,801      | 266,800      |
| General and administrative   | 532,241      | 423,718      | 411,415      |
| Depreciation and amortization  | 245,348      | 211,476      | 212,387      |
| Impairment losses  |              |              | 224,709      |
| Insurance recoveries, net of deductible charges  | (7,229)      | (13,257)     | (7,523)      |
| Total operating expenses   | 2,456,876    | 2,242,676    | 2,305,885    |
| Income from operations   | 442,589      | 499,581      | 153,226      |
| <b>Other income (expenses)</b>   |              |              |              |
| Interest expense   | (81,440)     | (99,564)     | (130,215)    |
| Interest income  | 948          | 423          | 1,579        |
| Gain (loss) from unconsolidated affiliates   | 3,804        | 7,364        | (25,974)     |
| Loss on early extinguishment of debt   |              | (17,838)     | (519)        |
| Other  | (1,375)      | (734)        | 6,421        |
| Total other expenses   | (78,063)     | (110,349)    | (148,708)    |
| <b>Income from operations before income taxes</b>  | 364,526      | 389,232      | 4,518        |
| Taxes on income  | 152,555      | 146,881      | 66,178       |
| <b>Net income (loss) including noncontrolling interests</b>  | 211,971      | 242,351      | (61,660)     |
| Less: Net loss attributable to noncontrolling interests  |              |              | (2,193)      |
| <b>Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and Subsidiaries</b>                 | \$ 211,971   | \$ 242,351   | \$ (59,467)  |
| <b>Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and Subsidiaries:</b> |              |              |              |
| Basic earnings (loss) per common share   | \$ 2.24      | \$ 2.52      | \$ (0.76)    |
| Diluted earnings (loss) per common share   | \$ 2.04      | \$ 2.26      | \$ (0.76)    |

See accompanying notes to the consolidated financial statements.

Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income**

(in thousands)

| <b>Year ended December 31,</b>  | <b>2012</b> | <b>2011</b> | <b>2010</b> |
|---|-------------|-------------|-------------|
| Net income (loss) including noncontrolling interests  | \$ 211,971  | \$ 242,351  | \$ (61,660) |
| Other comprehensive income, net of tax:   |             |             |             |
| Change in fair value of interest rate swap contracts  |             |             |             |
| Unrealized holding losses arising during the period on effective hedges, net of income tax benefit of \$250 and \$5,017, respectively |             | (448)       | (8,980)     |
| Less: Reclassification adjustments for losses included in net income, net of income taxes of \$5,488 and \$14,444, respectively       |             | 9,822       | 25,390      |
| Change in fair value of interest rate swap contracts, net   |             | 9,374       | 16,410      |
| Foreign currency translation adjustment during the period   | 425         | (287)       | 568         |
| Unrealized holding gains on corporate debt securities arising during the period   | 279         | 1,116       | 1,165       |
| Other comprehensive income  | 704         | 10,203      | 18,143      |
| Comprehensive income (loss)   | 212,675     | 252,554     | (43,517)    |
| Less: comprehensive loss attributable to noncontrolling interests   |             |             | (2,193)     |
| Comprehensive income (loss) attributable to the shareholders of Penn National Gaming, Inc. and Subsidiaries                           | \$ 212,675  | \$ 252,554  | \$ (41,324) |

See accompanying notes to the consolidated financial statements.

Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity**

(in thousands, except share data)

|  | Penn National Gaming, Inc. shareholders |                           |                        |                        |                                  |                      | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Noncontrolling<br>Interests | Total<br>Shareholders<br>Equity |
|--|---|---------------------------|------------------------|------------------------|----------------------------------|----------------------|--|-----------------------------|---------------------------------|
|  | Preferred Stock<br>Shares               | Preferred Stock<br>Amount | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid-In<br>Capital | Retained<br>Earnings |  |                             |                                 |
| Balance, December 31, 2009   | 12,500                                  | \$                        | 78,972,256             | \$ 786                 | \$ 1,480,476                     | \$ 397,407           | \$ (26,028)  | \$ (565)                    | \$ 1,852,076                    |
| Repurchase of preferred stock  | (225)                                   |                           |                        |                        | (11,200)                         |                      |  |                             | (11,200)                        |
| Repurchase of noncontrolling interest  |   |                           |                        |                        | (27,758)                         |                      |  | 2,758                       | (25,000)                        |
| Stock option activity, including tax benefit of \$4,071  |   |                           | 823,056                | 8                      | 35,875                           |                      |  |                             | 35,883                          |
| Share repurchases  |   |                           | (1,526,400)            | (15)                   | (35,843)                         |                      |  |                             | (35,858)                        |
| Restricted stock activity, including tax expense of \$760  |   |                           | 145,110                |                        | 5,382                            |                      |  |                             | 5,382                           |
| Change in fair value of interest rate swap contracts, net of income taxes of \$9,427                                 |   |                           |                        |                        |                                  |                      | 16,410   |                             | 16,410                          |
| Change in fair value of corporate debt securities  |   |                           |                        |                        |                                  |                      | 1,165  |                             | 1,165                           |
| Foreign currency translation adjustment  |   |                           |                        |                        |                                  |                      | 568  |                             | 568                             |
| Net loss   |   |                           |                        |                        |                                  | (59,467)             |  | (2,193)                     | (61,660)                        |
| Balance, December 31, 2010   | 12,275                                  |                           | 78,414,022             | 779                    | 1,446,932                        | 337,940              | (7,885)  |                             | 1,777,766                       |
| Stock option activity, including tax benefit of \$1,369  |   |                           | 695,915                | 7                      | 39,352                           |                      |  |                             | 39,359                          |
| Share repurchases  |   |                           | (2,981,406)            | (30)                   | (105,176)                        |                      |  |                             | (105,206)                       |
| Restricted stock activity, net, including tax benefit of \$1,188   |   |                           | 84,595                 |                        | 4,247                            |                      |  |                             | 4,247                           |
| Change in fair value of interest rate swap contracts, net of income taxes of \$5,238                                 |   |                           |                        |                        |                                  |                      | 9,374  |                             | 9,374                           |
| Change in fair value of corporate debt securities  |   |                           |                        |                        |                                  |                      | 1,116  |                             | 1,116                           |
| Foreign currency translation adjustment  |   |                           |                        |                        |                                  |                      | (287)  |                             | (287)                           |
| Cumulative-effect of adoption of amendments to ASC 924 regarding jackpot liabilities, net of income taxes of \$1,068 |   |                           |                        |                        |                                  | 2,911                |  |                             | 2,911                           |
| Net income   |   |                           |                        |                        |                                  | 242,351              |  |                             | 242,351                         |
| Balance, December 31, 2011   | 12,275                                  |                           | 76,213,126             | 756                    | 1,385,355                        | 583,202              | 2,318  |                             | 1,971,631                       |
| Stock option activity, including tax benefit of \$5,411  |   |                           | 1,241,091              | 13                     | 62,234                           |                      |  |                             | 62,247                          |
| Restricted stock activity, including tax benefit of \$670  |   |                           | (7,616)                |                        | 4,376                            |                      |  |                             | 4,376                           |
| Change in fair value of corporate debt securities  |   |                           |                        |                        |                                  |                      | 279  |                             | 279                             |
| Foreign currency translation adjustment  |   |                           |                        |                        |                                  |                      | 425  |                             | 425                             |
| Net income   |   |                           |                        |                        |                                  | 211,971              |  |                             | 211,971                         |
| Balance, December 31, 2012   | 12,275                                  | \$                        | 77,446,601             | \$ 769                 | \$ 1,451,965                     | \$ 795,173           | \$ 3,022   | \$                          | \$ 2,250,929                    |

See accompanying notes to the consolidated financial statements.

Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(in thousands)

| Year ended December 31,   | 2012        | 2011       | 2010        |
|---|-------------|------------|-------------|
| <b>Operating activities</b>   |             |            |             |
| Net income (loss) including noncontrolling interests  | \$ 211,971  | \$ 242,351 | \$ (61,660) |
| Adjustments to reconcile net income (loss) including noncontrolling interests to net cash provided by operating activities: |             |            |             |
| Depreciation and amortization   | 245,348     | 211,476    | 212,387     |
| Amortization of items charged to interest expense and interest income   | 6,898       | 9,601      | 12,581      |
| (Gain) loss on sale of fixed assets   | (1,690)     | 340        | 3,104       |
| (Gain) loss from unconsolidated affiliates  | (3,804)     | (7,364)    | 25,974      |
| Distributions of earnings from unconsolidated affiliates  | 9,400       |            |             |
| Loss on early extinguishment of debt  |             | 12,212     | 519         |
| Loss on police services contract termination at Hollywood Casino Aurora   |             |            | 6,624       |
| Gain on litigation settlement   |             |            | (9,619)     |
| Impairment loss on corporate debt securities  |             |            | 265         |
| Deferred income taxes   | 44,983      | 21,560     | (2,204)     |
| Charge for stock-based compensation   | 28,609      | 24,330     | 25,954      |
| Impairment losses   |             |            | 224,709     |
| Decrease (increase), net of businesses acquired   |             |            |             |
| Accounts receivable   | 1,887       | (6,064)    | (1,338)     |
| Insurance receivable  | 1,072       | (1,073)    | 28,673      |
| Prepaid expenses and other current assets   | 14,445      | (4,648)    | 3,585       |
| Other assets  | (12,331)    | (2,556)    | 10,160      |
| Increase (decrease), net of businesses acquired   |             |            |             |
| Accounts payable  | 1,334       | 397        | 477         |
| Accrued expenses  | 12,770      | 8,382      | 505         |
| Accrued interest  | 3,925       | (4,038)    | 648         |
| Accrued salaries and wages  | 10,285      | 8,961      | 7,824       |
| Gaming, pari-mutuel, property and other taxes   | 6,051       | 2,047      | 7,506       |
| Income taxes  | (70,721)    | 49,285     |             |
| Other current and noncurrent liabilities  | 12,903      | 2,849      | 6,827       |
| Other noncurrent tax liabilities  | (16,146)    | (683)      | (10,323)    |
| Net cash provided by operating activities   | 507,189     | 567,365    | 493,178     |
| <b>Investing activities</b>   |             |            |             |
| Expenditures for property and equipment, net of reimbursements  | (472,985)   | (293,081)  | (362,955)   |
| Proceeds from sale of property and equipment  | 5,323       | 12,966     | 1,627       |
| Insurance proceeds related to damaged property and equipment  |             | 3,862      | 4,821       |
| Purchase of outstanding loans of M Resorts LLC  |             |            | (230,500)   |
| Investment in joint ventures, net of proceeds received  | (36,000)    | (100,398)  | (63,632)    |
| Decrease (increase) in cash in escrow   | 24,625      | 28,975     | (30,224)    |
| Acquisitions of businesses and licenses, net of cash acquired   | (709,450)   | 8,874      | (55,895)    |
| Net cash used in investing activities   | (1,188,487) | (338,802)  | (736,758)   |
| <b>Financing activities</b>   |             |            |             |
| Proceeds from exercise of options   | 31,933      | 16,719     | 11,488      |
| Repurchase of common stock  |             | (105,206)  | (35,858)    |
| Repurchase of preferred stock   |             |            | (11,200)    |
| Proceeds from issuance of long-term debt, net of issuance costs   | 1,162,709   | 1,773,232  | 212,732     |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|   |               |                |                  |
|---|---------------|----------------|------------------|
| Principal payments on long-term debt                        | (494,891)     | (1,928,571)    | (383,476)        |
| Proceeds from other long-term obligations                   | 10,000        |                |                  |
| Proceeds from insurance financing                           | 4,746         | 17,406         | 18,271           |
| Payments on insurance financing                             | (17,253)      | (12,645)       | (13,421)         |
| Repurchase of noncontrolling interest                       |               |                | (25,000)         |
| Tax benefit from stock options exercised                    | 6,081         | 2,557          | 3,311            |
| Net cash provided by (used in) financing activities         | 703,325       | (236,508)      | (223,153)        |
| <b>Net increase (decrease) in cash and cash equivalents</b> | <b>22,027</b> | <b>(7,945)</b> | <b>(466,733)</b> |
| Cash and cash equivalents at beginning of year              | 238,440       | 246,385        | 713,118          |
| Cash and cash equivalents at end of year                    | \$ 260,467    | \$ 238,440     | \$ 246,385       |
| <b>Supplemental disclosure</b>                              |               |                |                  |
| Interest expense paid, net of amounts capitalized           | \$ 70,239     | \$ 93,140      | \$ 116,307       |
| Income taxes paid   | \$ 187,515    | \$ 90,702      | \$ 72,091        |

**Non-cash transaction:** On June 1, 2011, following the purchase of all of the outstanding debt of The M Resorts LLC in October 2010 and the receipt of requisite regulatory approvals, the Company acquired the business in exchange for the debt. This non-cash transaction at the acquisition date, resulted in the removal of the Company's loan receivable and increased property and equipment, net, total current assets, total other assets and total current liabilities by \$203.7 million, \$13.7 million, \$2.4 million and \$17.3 million, respectively.

See accompanying notes to the consolidated financial statements.

Table of Contents

**Penn National Gaming, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**1. Business and Basis of Presentation**

Penn National Gaming, Inc. ( Penn ) and subsidiaries (collectively, the Company ) is a diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. Penn is the successor to several businesses that have operated as Penn National Race Course since 1972. Penn was incorporated in Pennsylvania in 1982 as PNR Corp. and adopted its current name in 1994, when the Company became a public company. In 1997, the Company began its transition from a pari-mutuel company to a diversified gaming company with the acquisition of the Charles Town property and the introduction of video lottery terminals in West Virginia. Since 1997, the Company has continued to expand its gaming operations through strategic acquisitions (including the acquisitions of Hollywood Casino Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., Hollywood Casino Corporation, Argosy Gaming Company, Zia Park Casino, Sanford- Orlando Kennel Club and The M Resorts LLC (the M Resort )), greenfield projects (such as at Hollywood Casino at Penn National Race Course, Hollywood Casino Bangor and Hollywood Casino Perryville), and property expansions (such as Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). Most recently, the Company, along with its joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012 and in Ohio, the Company opened its Hollywood Casino Toledo facility on May 29, 2012 and its Hollywood Casino Columbus facility on October 8, 2012. Finally, on November 2, 2012, the Company acquired Harrah s St. Louis facility, which is currently in process of being rebranded to Hollywood Casino St. Louis.

As of December 31, 2012, the Company owned, managed, or had ownership interests in twenty-nine facilities in the following nineteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

**2. Proposed Spin-Off of Real Estate Assets through a Real Estate Investment Trust**

On November 15, 2012, the Company announced that it intends to pursue a plan to separate the majority of its gaming operating assets and real property assets into two publicly traded companies including an operating entity, Penn National Gaming ( PNG ), and, through a tax-free Spin-Off of its real estate assets to holders of its common stock, a newly formed publicly traded real estate investment trust ( REIT ) ( PropCo ), subject to required gaming regulatory body approvals.



## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

A REIT is not permitted to retain earnings and profits ( E&P ) accumulated during the years when the company or its predecessor was taxed as a regular C corporation. For PropCo to elect REIT status, PropCo must distribute to its shareholders its undistributed E&P attributable to taxable periods prior to its REIT election. The Company currently estimates that, if PropCo were to elect REIT status as of January 1, 2014, the aggregate amount of the special E&P taxable dividend would be approximately \$1.4 billion. The dividend will be paid in a combination of cash and PropCo common stock, which will consist of at least 20% in cash with the remainder in PropCo common stock.

As a result of the proposed Spin-Off, PropCo will initially own substantially all of the real property assets and will lease back most of those assets to PNG for use by its subsidiaries, under a triple net 35 year Master Lease agreement (including extensions) as well as own and operate Hollywood Casino Perryville and Hollywood Casino Baton Rouge via taxable REIT subsidiaries. PNG would own the gaming licenses, operate the leased gaming facilities and own and operate other assets, including the Casino Rama casino management contract, the 50% joint venture interest in Hollywood Casino at Kansas Speedway, seven non-casino racetracks and gaming equipment.

The Company has received a private letter ruling from the Internal Revenue Service relating to the tax treatment of the separation and the qualification of PropCo as a REIT. The private letter ruling is subject to certain qualifications and based on certain representations and statements made by the Company. If such representations and statements are untrue or incomplete in any material respect (including as a result of a material change in the proposed transaction or other relevant facts), the Company may not be able to rely on the private letter ruling.

Table of Contents

The completion of the proposed Spin-off is contingent, among other things, on receipt of regulatory approvals, the receipt of final approval by Penn's Board of Directors, execution of definitive documentation, the receipt of legal and accounting opinions, raising significant amounts of capital to finance the transaction, and other customary conditions. The Company may, at any time and for any reason until the proposed Spin-Off is complete, abandon the Spin-Off or modify or change the terms of the Spin-Off.

**3. Principles of Consolidation**

The consolidated financial statements include the accounts of Penn and its subsidiaries, including wholly-owned subsidiaries and subsidiaries that had a noncontrolling interest. Investment in and advances to unconsolidated affiliates are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

**4. Summary of Significant Accounting Policies**

**Cash and Cash Equivalents**

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

**Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk consist of cash and cash equivalents, corporate debt securities, interest rate swap contracts and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness. Marker balances issued to approved casino customers were \$6.7 million at December 31, 2012, compared to \$7.6 million at December 31, 2011.

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

The Company's receivables of \$53.7 million and \$55.5 million at December 31, 2012 and 2011, respectively, primarily consist of \$5.1 million and \$10.9 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at Hollywood Casino at Charles Town Races, \$11.8 million and \$11.2 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama, \$4.0 million and \$3.6 million, respectively, for racing settlements due from simulcasting at Hollywood Casino at Penn National Race Course, \$3.8 million and \$1.1 million, respectively, for reimbursement of payroll expenses paid on behalf of the Company's joint venture in Kansas, and markers issued to customers mentioned above.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

### **Fair Value of Financial Instruments**

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

#### *Cash and Cash Equivalents*

The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

Table of Contents*Investment in Corporate Debt Securities*

The fair value of the investment in corporate debt securities is estimated based on a third party broker quote. The investment in corporate debt securities is measured at fair value on a recurring basis.

*Long-term Debt*

The fair value of the Company's Term Loan B component of the senior secured credit facility and senior subordinated notes is estimated based on quoted prices in active markets and as such is a Level 1 measurement (see Note 19). The fair value of the remainder of the Company's senior secured credit facility approximates its carrying value as it is variable rate debt. The fair value of the Company's other long-term obligations approximates its carrying value.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| December 31,                            | 2012               |               | 2011               |               |
|---|--------------------|---------------|--------------------|---------------|
|   | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| <b>Financial assets:</b>                |                    |               |                    |               |
| Cash and cash equivalents               | \$ 260,467         | \$ 260,467    | \$ 238,440         | \$ 238,440    |
| Investment in corporate debt securities | 6,790              | 6,790         | 6,790              | 6,790         |
| <b>Financial liabilities:</b>           |                    |               |                    |               |
| Long-term debt                          |                    |               |                    |               |
| Senior secured credit facility          | 2,393,459          | 2,401,225     | 1,714,001          | 1,716,720     |
| Senior subordinated notes               | 325,000            | 368,875       | 325,000            | 353,438       |
| Other long-term obligations             | 10,000             | 10,000        | 1,949              | 1,949         |

See Note 19 for further information regarding the Company's assessment of the inputs used to measure the fair value for the investment in corporate debt securities.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

|                                    |               |
|------------------------------------|---------------|
| Land improvements                  | 5 to 15 years |
| Building and improvements          | 5 to 40 years |
| Furniture, fixtures, and equipment | 3 to 31 years |

Leasehold improvements are depreciated over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying value of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company may be required to record an impairment loss for these assets. Such an impairment loss would be recognized as a non-cash component of operating income.

Table of Contents

**Goodwill and Other Intangible Assets**

At December 31, 2012, the Company had \$1,380.7 million in goodwill and \$706.5 million in other intangible assets within its consolidated balance sheet, representing 24.5% and 12.5% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value in step 1 of the impairment test, then step 2 of the impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value of goodwill is less than the goodwill allocated for that reporting unit, an impairment loss is recognized.

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350, Intangibles-Goodwill and Other, the Company considers its gaming licenses, racing permits and the majority of its trademark intangible assets as indefinite-life intangible assets that do not require amortization based on the Company's future expectations to operate its gaming facilities indefinitely (notwithstanding the recent events in Iowa which the Company concluded was an isolated incident and the first time in the Company's history a gaming regulator has taken an action which could cause the Company to lose its gaming license) as well as its historical experience in renewing these intangible assets at minimal cost with various state gaming and racing commissions. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the indefinite-life intangible assets exceed their fair value, an impairment loss is recognized.

The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, which includes the use of forecasted adjusted EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of gain or loss from unconsolidated affiliates) and adjusted EBITDA multiples, as the Company believes that adjusted EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses adjusted EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an adjusted EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated adjusted EBITDA multiples or forecasted operations can materially affect these estimates.

Forecasted adjusted EBITDA levels (based on the Company's annual operating plan as determined in the fourth quarter) can be significantly impacted by the local economy in which the Company's reporting units operate. For example, increases in unemployment rates can result in decreased customer visitations and/or lower customer spend per visit. In addition, the impact of new legislation which approves gaming in nearby jurisdictions or further expands gaming in jurisdictions where the Company's reporting units currently operate can result in opportunities for the Company to expand its operations. However, it also has the impact of increasing competition for the Company's established properties which generally will have a negative effect on those locations' profitability once competitors become established as a certain level of cannibalization occurs absent an overall increase in customer visitations. Lastly, increases in gaming taxes approved by state regulatory bodies can negatively impact forecasted adjusted EBITDA.

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

The adjusted EBITDA multiple utilized by the Company in its goodwill impairment valuation methodology is determined based on the Company's current enterprise value, increased for a control premium. The control premium assumption is based on acquisitions of precedent transactions of comparable businesses. In evaluating the estimates derived by the market based approach, management assesses the relevance and reliability of the multiples by considering factors unique to its reporting units, including recent operating results, business plans, economic projections, anticipated future cash flows, and other market data. These considerations can lead the Company to modify its individual reporting units adjusted EBITDA multiple. EBITDA multiples can be significantly impacted by various factors, such as a company's present and future cost of capital, the future growth opportunities for the industry as well as for the company's reporting units, general market sentiment, investors' perceptions of senior management's effectiveness at deploying capital and managing overall operations, as well as pending or recently completed merger transactions.

## Table of Contents

Assumptions and estimates about future adjusted EBITDA levels and multiples by individual reporting units are complex and subjective. They are sensitive to changes in underlying assumptions and can be affected by a variety of factors, including external factors, such as industry, geopolitical and economic trends, and internal factors, such as changes in the Company's business strategy, which may reallocate capital and resources to different or new opportunities which management believes will enhance the Company's overall value but may be to the detriment of an individual reporting unit.

Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

## **Debt Issuance Costs**

Debt issuance costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense using the effective interest method over the contractual term of the underlying indebtedness.

## **Comprehensive Income**

The Company accounts for comprehensive income in accordance with ASC 220, *Comprehensive Income*, which establishes standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in two separate but consecutive statements.

## **Income Taxes**

The Company accounts for income taxes in accordance with ASC 740, *Income Taxes* (ASC 740). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The Company has used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.



ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheets at December 31, 2012 and 2011.

#### **Accounting for Derivatives and Hedging Activities**

The Company has historically utilized fixed and variable-rate debt to finance its operations. Both funding sources have associated risks and opportunities, such as interest rate exposure, and the Company's risk management policy permits the use of derivatives to manage this exposure. The Company does not hold or issue derivative financial instruments for trading or speculative purposes. Thus, uses of derivatives are strictly limited to hedging and risk management purposes in connection with managing interest rate exposure. Acceptable derivatives for this purpose include interest rate swap contracts, futures, options, caps, and similar instruments.

When using derivatives, the Company has historically desired to obtain hedge accounting, which is conditional upon satisfying specific documentation and performance criteria. In particular, the underlying hedged item must expose the Company to risks associated with market fluctuations and the instrument used as the hedging derivative must generate offsetting effects in prescribed magnitudes. If these criteria are not met, a change in the market value of the financial instrument and all associated settlements would be recognized as gains or losses in the period of change.

Table of Contents

Under cash flow hedge accounting, effective derivative results are initially recorded in other comprehensive income ( OCI ) and later reclassified to earnings, coinciding with the income recognition relating to the variable interest payments being hedged (i.e., when the interest expense on the variable-rate liability is recorded in earnings). Any hedge ineffectiveness (which represents the amount by which hedge results exceed the variability in the cash flows of the forecasted transaction due to the risk being hedged) is recorded in current period earnings. Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities at fair value.

Previously, the Company had a number of interest rate swap contracts in place. These contracts served to mitigate income volatility for a portion of the Company's variable-rate funding. In effect, these interest rate swap contracts synthetically converted the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company received cash flows from the swap contract counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts' fixed rates. These two respective obligations were net-settled periodically. The fair value of the Company's interest rate swap contracts was measured at the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflected the Company's best estimate as to the Company's credit quality. There were no outstanding interest rate swap contracts as of December 31, 2012 and 2011.

Effective July 1, 2011, the Company de-designated its interest rate swap contracts that historically qualified for cash flow hedge accounting. This was due to the senior secured credit facility that the Company entered into in July 2011. As a result, the loss in OCI related to these swaps of \$4.7 million was amortized to interest expense over the swaps remaining lives. The total notional value of these swaps was \$440 million, with \$200 million expiring in October 2011 and the remainder maturing in December 2011. Subsequent to the de-designation date of July 1, 2011, the Company had accounted for changes in the fair value of these derivatives in earnings as a component of interest expense in the consolidated statements of operations. In addition, the Company had certain other derivative instruments that were not designated to qualify for hedge accounting, which expired in May 2011. The periodic change in the mark-to-market of these derivative instruments had been recorded in current period earnings in interest expense in the consolidated statements of operations.

Credit risk relating to derivative counterparties is mitigated by using multiple, highly rated counterparties, and the credit quality of each is monitored on an ongoing basis.

See Note 10 for additional information related to the Company's derivatives.

**Revenue Recognition and Promotional Allowances**

Gaming revenue is the aggregate net difference between gaming wins and losses, with liabilities recognized for funds deposited by customers before gaming play occurs, for chips and ticket-in, ticket-out coupons in the customers' possession, and for accruals related to the anticipated payout of progressive jackpots. Progressive slot machines, which contain base jackpots that increase at a progressive rate based on the number of coins played, are charged to revenue as the amount of the jackpots increase.

Food, beverage and other revenue, including racing revenue, is recognized as services are performed. Racing revenue includes the Company's share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, its share of wagering from import and export

simulcasting, and its share of wagering from its off-track wagering facilities ( OTWs ).

Revenue from the management service contract for Casino Rama is based upon contracted terms and is recognized when services are performed.

Revenues are recognized net of certain sales incentives in accordance with ASC 605-50, Revenue Recognition Customer Payments and Incentives. The Company records certain sales incentives and points earned in point-loyalty programs as a reduction of revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense.

Table of Contents

The amounts included in promotional allowances for the years ended December 31, 2012, 2011 and 2010 are as follows:

| Year ended December 31,      | 2012       | 2011           | 2010       |
|------------------------------|------------|----------------|------------|
|                              |            | (in thousands) |            |
| Rooms                        | \$ 26,612  | \$ 24,646      | \$ 23,980  |
| Food and beverage            | 108,250    | 106,687        | 99,024     |
| Other                        | 9,878      | 10,483         | 10,398     |
| Total promotional allowances | \$ 144,740 | \$ 141,816     | \$ 133,402 |

The estimated cost of providing such complimentary services for the years ended December 31, 2012, 2011 and 2010 are as follows:

| Year ended December 31,              | 2012      | 2011           | 2010      |
|--------------------------------------|-----------|----------------|-----------|
|                                      |           | (in thousands) |           |
| Rooms                                | \$ 9,814  | \$ 9,149       | \$ 9,188  |
| Food and beverage                    | 74,263    | 76,357         | 75,180    |
| Other                                | 6,056     | 6,430          | 6,544     |
| Total cost of complimentary services | \$ 90,133 | \$ 91,936      | \$ 90,912 |

**Gaming and Racing Taxes**

The Company is subject to gaming and pari-mutuel taxes based on gross gaming revenue and pari-mutuel revenue in the jurisdictions in which it operates. The Company primarily recognizes gaming and pari-mutuel tax expense based on the statutorily required percentage of revenue that is required to be paid to state and local jurisdictions in the states where or in which wagering occurs. In certain states in which the Company operates, gaming taxes are based on graduated rates. The Company records gaming tax expense at the Company's estimated effective gaming tax rate for the year, considering estimated taxable gaming revenue and the applicable rates. Such estimates are adjusted each interim period. If gaming tax rates change during the year, such changes are applied prospectively in the determination of gaming tax expense in future interim periods. Finally, the Company recognizes purse expense based on the statutorily required percentage of revenue that is required to be paid out in the form of purses to the winning owners of horseraces run at the Company's racetracks in the period in which wagering occurs. For the years ended December 31, 2012, 2011 and 2010, these expenses, which are recorded primarily within gaming expense in the consolidated statements of operations, were \$1.07 billion, \$1.06 billion, and \$975.7 million, respectively.

**Earnings Per Share**

The Company calculates earnings per share (EPS) in accordance with ASC 260, Earnings Per Share (ASC 260). Basic EPS is computed by dividing net income applicable to common stock, excluding net income attributable to noncontrolling interests, by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options and unvested restricted shares.

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

At December 31, 2012, the Company had outstanding 12,275 shares of Series B Redeemable Preferred Stock (the Preferred Stock), which the Company determined qualified as a participating security as defined in ASC 260. Under ASC 260, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with ASC 260, a company is required to use the two-class method when computing EPS when a company has a security that qualifies as a participating security. The two-class method is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company's common stock is computed by dividing net income attributable to the shareholders of Penn National Gaming, Inc. and Subsidiaries applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS for the Company's common stock is computed using the more dilutive of the two-class method or the if-converted method.

Table of Contents

The following table sets forth the allocation of net income for the years ended December 31, 2012 and 2011 under the two-class method:

| Year ended December, 31                  | 2012           |         | 2011 |         |
|--|----------------|---------|------|---------|
|  | (in thousands) |         |      |         |
| Net income                               | \$             | 211,971 | \$   | 242,351 |
| Net income applicable to preferred stock |                | 41,023  |      | 46,101  |
| Net income applicable to common stock    | \$             | 170,948 | \$   | 196,250 |

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the years ended December 31, 2012 and 2011:

| Year ended December 31,                                    | 2012           |         | 2011 |         |
|--|----------------|---------|------|---------|
|  | (in thousands) |         |      |         |
| <b>Determination of shares:</b>                            |                |         |      |         |
| Weighted-average common shares outstanding                 |                | 76,345  |      | 77,991  |
| Assumed conversion of dilutive employee stock-based awards |                | 2,464   |      | 1,782   |
| Assumed conversion of preferred stock                      |                | 24,995  |      | 27,278  |
| Diluted weighted-average common shares outstanding         |                | 103,804 |      | 107,051 |

The Company is required to adjust its diluted weighted-average common shares outstanding for the purpose of calculating diluted EPS as follows: 1) when the average price of the Company's common stock at the end of the reporting period is less than \$45, the diluted weighted-average common shares outstanding is increased by 27,277,778 shares (regardless of how much the stock price is below \$45); 2) when the average price of the Company's common stock at the end of the reporting period is between \$45 and \$67, the diluted weighted-average common shares outstanding is increased by an amount which can be calculated by dividing \$1.23 billion (face value) by the current price per share of the Company's common stock, which will result in an increase in the diluted weighted-average common shares outstanding of between 18,320,896 shares and 27,277,778 shares; and 3) when the average price of the Company's common stock at the end of the reporting period is above \$67, the diluted weighted-average common shares outstanding is increased by 18,320,896 shares (regardless of how much the stock price exceeds \$67). See Note 13 for discussion of the proposed Spin-Off transaction and its potential future impact on the calculation of diluted weighted-average common shares outstanding.

The following table presents the calculation of basic and diluted EPS for the Company's common stock:

| Year ended December 31,                            | 2012                                  |         | 2011 |         |
|--|---------------------------------------|---------|------|---------|
|  | (in thousands, except per share data) |         |      |         |
| <b>Calculation of basic EPS:</b>                   |                                       |         |      |         |
| Net income applicable to common stock              | \$                                    | 170,948 | \$   | 196,250 |
| Weighted-average common shares outstanding         |                                       | 76,345  |      | 77,991  |
| Basic EPS  | \$                                    | 2.24    | \$   | 2.52    |
| <b>Calculation of diluted EPS:</b>                 |                                       |         |      |         |
| Net income   | \$                                    | 211,971 | \$   | 242,351 |
| Diluted weighted-average common shares outstanding |                                       | 103,804 |      | 107,051 |
| Diluted EPS  | \$                                    | 2.04    | \$   | 2.26    |

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

Since the Company reported a net loss for the year ended December 31, 2010, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS. In addition, since the Company reported a loss from operations for the year ended December 31, 2010, the Preferred Stock was not deemed to be a participating security for the year ended December 31, 2010, pursuant to ASC 260. The basic weighted-average common shares outstanding for the year ended December 31, 2010 were 78,078,602.

Options to purchase 1,693,500 shares and 3,004,402 shares were outstanding during the years ended December 31, 2012 and 2011, respectively, but were not included in the computation of diluted EPS because they were antidilutive. Options to purchase 10,834,444 shares were outstanding during the year ended December 31, 2010, but the shares outstanding during 2010 were not included in the computation of diluted EPS because they were antidilutive since the Company reported a loss from operations for the year ended December 31, 2010.

Table of Contents**Stock-Based Compensation**

The Company accounts for stock compensation under ASC 718, Compensation Stock Compensation, which requires the Company to expense the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This expense is recognized ratably over the requisite service period following the date of grant.

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the United States ( U.S. ) Treasury spot rate with a term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 6.64 years, in order to match the expected life of the options at the grant date. Historically, at the grant date, there has been no expected dividend yield assumption since the Company has not paid any cash dividends on its common stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience.

The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2012, 2011 and 2010:

| <b>Year ended December 31,</b>         | <b>2012</b> | <b>2011</b> | <b>2010</b> |
|--|-------------|-------------|-------------|
| Risk-free interest rate                | 0.84%       | 1.04%       | 2.27%       |
| Expected volatility                    | 45.78%      | 47.60%      | 48.02%      |
| Dividend yield                         |             |             |             |
| Weighted-average expected life (years) | 6.64        | 5.82        | 5.73        |
| Forfeiture rate                        | 5.00%       | 5.00%       | 5.00%       |

**Segment Information**

In 2011, the Company realigned its reporting structure in connection with the hiring of a senior vice president of regional operations. The Company now has three senior vice presidents of regional operations who oversee various properties based primarily on their geographic locations and whom report directly to the Company's President and Chief Operating Officer. This event impacted how the Company's Chief Executive Officer, who is the Company's Chief Operating Decision Maker ( CODM ) as that term is defined in ASC 280, Segment Reporting ( ASC 280 ), measures and assesses the Company's business performance and has caused the Company to conclude that it now has reportable segments. Therefore, the Company has aggregated its properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains consistent with how the Company's CODM reviews and assesses the Company's financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, Argosy Casino Alton, Hollywood Casino Toledo, which opened on May 29, 2012, and Hollywood Casino Columbus, which opened on October 8, 2012. It also includes the Company's Casino Rama management service contract and the Mahoning Valley and Dayton Raceway projects in Ohio which the Company anticipates completing in 2014.



The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Casino Bangor, Hollywood Casino at Penn National Race Course, Zia Park Casino, and the M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, Boomtown Biloxi, Hollywood Casino St. Louis (formerly Harrah's St. Louis which was acquired from Caesars Entertainment on November 2, 2012), and includes the Company's 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway that opened on February 3, 2012.

The Other category consists of the Company's standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and the Company's joint venture interests in Sam Houston Race Park, Valley Race Park and Freehold Raceway. It also included the Company's joint venture interest in the Maryland Jockey Club which was sold in July 2011. If the Company is successful in obtaining gaming operations at these locations, they would be

Table of Contents

assigned to one of the Company's regional executives and reported in their respective reportable segment. The Other category also includes the Company's corporate overhead operations which does not meet the definition of an operating segment under ASC 280 and the Bullwhackers property.

See Note 16 for further information with respect to the Company's segments.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net income (loss) including noncontrolling interests to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with ASC 805, Business Combinations. The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company faces intense gaming competition in most of the markets where its properties operate. Various states are currently considering or implementing legislation to legalize or expand gaming. Such legislation presents potential opportunities for the Company to establish new properties; however, this also presents potential competitive threats to the Company's existing properties. For example, the Company's two largest properties in terms of net revenues will face or have faced new sources of significant competition in the near term. Namely, a casino scheduled to open in March 2013 in Cincinnati, Ohio will compete in the same market as Hollywood Casino Lawrenceburg and Hollywood Casino at Charles Town Races faced increased competition in June 2012 from the opening of a significant casino complex at the Arundel Mills mall in Anne Arundel, Maryland. Although these openings will have a significant impact on the Company's operations, they have less significance on the Company's operations than in recent periods due to the 2012 openings of Hollywood Casino Toledo and Hollywood Casino Columbus in Ohio as well as the November 2012 acquisition of Harrah's St. Louis gaming and lodging facility.

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations. See Note 11 for a discussion of the Company's status in regards to Argosy Casino Sioux City's gaming license, which expired in July 2012.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely

affected.

The Company is dependent on the economy of the U.S. in general, and any deterioration in the national economic, energy, credit and capital markets could have a material adverse effect on future results of operations.

The Company is dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

## **5. New Accounting Pronouncements**

In July 2012, the FASB issued amendments to provide an entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. The amendments also enhance the consistency of impairment testing guidance among long-lived asset categories by permitting an entity to assess qualitative factors to determine whether it is necessary to calculate the asset's fair value when testing an indefinite-lived intangible asset for impairment, which is equivalent to the impairment testing requirements for other long-lived assets. In accordance with these amendments, an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying

Table of Contents

amount. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued, however the Company did not early adopt this amendment.

In December 2011, the FASB issued amendments to enhance disclosures about offsetting and related arrangements. This information will enable the users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial and derivative instruments. These amendments are effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The disclosures required by these amendments should be provided retrospectively for all comparative periods presented. The Company adopted the guidance as of January 1, 2013, which did not have an impact on the consolidated financial statements.

In June 2011, the FASB issued amendments to guidance regarding the presentation of OCI. The amendments eliminate the option to present components of OCI as part of the statement of changes in stockholders' equity. The amendments require that comprehensive income be presented in either a single continuous statement or in two separate but consecutive statements. In a single continuous statement, the entity would present the components of net income and total net income, the components of OCI and a total of OCI, along with the total of comprehensive income in that statement. In the two-statement approach, the entity would present components of net income and total net income in the statement of net income and a statement of OCI would immediately follow the statement of net income and include the components of OCI and a total for OCI, along with a total for comprehensive income. The amendments also require the entity to present on the face of the financial statements any reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented. The amendments do not change the items that must be reported in OCI, when an item of OCI must be reclassified to net income or the option to present components of OCI either net of related tax effects or before related tax effects. The amendments, excluding the specific requirement to present on the face of the financial statements any reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented which was deferred by the FASB in December 2011, are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively. The Company adopted the guidance as of January 1, 2012, except for the deferred requirement to present reclassification adjustments in the statement(s) where the components of net income and the components of OCI are presented. The Company has presented comprehensive income in two separate but consecutive statements.

In February 2013, the FASB finalized the disclosure requirements on how entities should present financial information about reclassification adjustments from accumulated other comprehensive income. The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, companies would instead cross reference to the related footnote for additional information. The disclosures required by this amendment is effective for public entities for annual and interim reporting periods beginning after December 15, 2012.

**6. Acquisitions and Other Recent Business Ventures**

*Harrah's St. Louis Acquisition*

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

On November 2, 2012, the Company closed on the agreement to acquire 100% of the equity of Harrah's St. Louis gaming and lodging facility from Caesars Entertainment for a purchase price of \$617.9 million. While the acquisition was a stock transaction, it was treated as an asset transaction for tax purposes. This enables the Company to amortize the goodwill and other fair value adjustments for tax purposes. The acquisition reflects the continuing efforts of the Company to expand its regional operating platform with a facility in a large metropolitan market. The Company is currently in the process of transitioning the property to its Hollywood Casino-brand name. The purchase price of the transaction was funded through an add-on to the Company's senior secured credit facility. The preliminary purchase price allocation, net of cash acquired of \$13.5 million, resulted in an increase to goodwill and other intangible assets, property and equipment, net, total current assets, and total current liabilities, of \$386.4 million, \$225.1 million, \$2.9 million, and \$10.0 million, respectively based on their estimated fair values at November 2, 2012. The results of the St. Louis facility have been included in the Company's consolidated financial statements since the acquisition date.

Table of Contents

The St. Louis facility is located adjacent to the Missouri River in Maryland Heights, Missouri, directly off I-70 and approximately 22 miles northwest of downtown St. Louis. The facility is situated on 248 acres along the Missouri River and features approximately 109,000 square feet of gaming space with 2,164 slot machines, 57 table games, 21 poker tables, a 502 guestroom hotel, nine dining and entertainment venues and structured and surface parking.

*Sale of Maryland Jockey Club Interest*

In July 2011, the Company sold its joint venture interest in the Maryland Jockey Club. See Note 7 for further discussion.

*M Resort Transaction*

The Company purchased all of the outstanding bank and subordinated debt of the M Resort in October 2010 for \$230.5 million at which time the Company also secured the right to acquire the business of the M Resort in exchange for the property's outstanding debt obligations. On June 1, 2011, following the requisite regulatory approvals, the Company acquired the business in exchange for the debt. This non-cash transaction resulted in the removal of the Company's loan receivable and the purchase price allocation, net of cash acquired of \$28.0 million, resulted in an increase to property and equipment, net, total current assets, total other assets, and total current liabilities, of \$203.7 million, \$13.7 million, \$2.4 million, and \$17.3 million, respectively based on their estimated fair values at June 1, 2011.

*Texas Joint Venture Interest*

On April 8, 2011, the Company established a joint venture that owns and operates racetracks in Texas. See Note 7 for further discussion.

*Rosecroft Acquisition*

On February 28, 2011, the Company completed its acquisition of Rosecroft Raceway in Oxon Hill, Maryland following the completion of a bankruptcy auction and approval of the purchase by a U.S. Bankruptcy Court judge. Rosecroft Raceway, located approximately 13 miles south of Washington, D.C., is situated on approximately 125 acres just outside the Washington I-495 Beltway in Prince George's county. The Rosecroft facility features a 5/8-mile standardbred race track with a seven race paddock, a 53,000 square foot grandstand building, and a 96,000 square foot three story clubhouse building with dining facilities. In August 2011, Rosecroft Raceway re-opened for simulcasting and live standardbred racing resumed in late January 2012.

**7. Investment In and Advances to Unconsolidated Affiliates**

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

As of December 31, 2012, investment in and advances to unconsolidated affiliates primarily included the Company's 50% interest in Freehold Raceway, its 50% investment in Kansas Entertainment, LLC ( Kansas Entertainment ), which is a joint venture with International Speedway Corporation ( International Speedway ), and its 50% joint venture with MAXXAM, Inc. ( MAXXAM ) that owns and operates racetracks in Texas. These investments are more fully described below.

### *Kansas Entertainment*

Kansas Entertainment opened its Hollywood-themed facility on February 3, 2012. The facility features a 95,000 square foot casino with approximately 2,000 slot machines, 40 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment facilities. The Company and International Speedway shared equally in the cost of developing and constructing the facility. The Company's share of the project incurred as of December 31, 2012 was \$139.0 million, inclusive of licensing fees. During the years ended December 31, 2012, 2011 and 2010, the Company funded \$39.1 million, \$70.9 million, and \$30.6 million, respectively, for capital expenditures and other operating expenses. During the year ended December 31, 2012, the Company received distributions from Kansas Entertainment totaling \$13.0 million.

The Company determined that Kansas Entertainment qualified as a variable interest entity ( VIE ) at December 31, 2012 and 2011. The Company did not consolidate its investment in Kansas Entertainment at, and for the years ended December 31, 2012 and 2011, as the Company determined that it did not qualify as the primary beneficiary of Kansas Entertainment at, and for the years ended December 31, 2012 and 2011, primarily as it did not have the ability to direct the

Table of Contents

activities of Kansas Entertainment that most significantly impacted Kansas Entertainment's economic performance without the input of International Speedway. In addition, the Company determined that International Speedway had substantive participating rights in Kansas Entertainment at, and for the years ended December 31, 2012 and 2011.

*Texas Joint Venture*

On April 8, 2011, following final approval by the Texas Racing Commission, the Company completed its investment in a joint venture with MAXXAM that owns and operates the Sam Houston Race Park in Houston, Texas and the Valley Race Park in Harlingen, Texas, and holds a license for a planned racetrack in Laredo, Texas. Under the terms of the joint venture, the Company secured a 50% interest in the joint venture, which has sole ownership of the above facilities including interests in 323 acres at Sam Houston Race Park, 80 acres at Valley Race Park, and an option to purchase 135 acres for the planned racetrack in Laredo, Texas.

Sam Houston Race Park, opened in April 1994, is located 15 miles northwest from downtown Houston along Beltway 8. Sam Houston Race Park hosts thoroughbred and quarter horse racing and offers daily simulcast operations, as well as hosts various special events, private parties and meetings, concerts and national touring festivals throughout the year. Valley Race Park, which was opened in 1990 and acquired by Sam Houston Race Park in 2000, is a 91,000 square foot dog racing and simulcasting facility located in Harlingen, Texas.

The Company intends to work collaboratively with MAXXAM to strengthen and enhance the existing racetrack operations as well as pursue other opportunities, including the potential for gaming operations at the pari-mutuel facilities, to maximize the overall value of the business. As part of the agreement for the joint venture, the Company agreed to fund, upon the legalization of gaming, a loan to the joint venture for up to \$375 million to cover development costs that cannot be financed through third party debt. This loan commitment is in place through December 31, 2015, however it may be extended to December 31, 2016 in order to obtain gaming referendum approval in the event gaming legislation approval has occurred prior to December 31, 2015. If the joint venture elects to utilize the loan, the rates to be paid will be LIBOR plus 800 to 900 basis points for a senior financing and an additional 500 to 600 basis points for a subordinated financing.

The Company determined that the Texas joint venture did not qualify as a VIE at December 31, 2012 and 2011. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the joint venture at, and for the years ended December 31, 2012 and 2011, primarily as it did not have the ability to direct the activities of the joint venture that most significantly impacted the joint venture's economic performance without the input of MAXXAM. Therefore, the Company did not consolidate its investment in the joint venture at, and for the years ended December 31, 2012 and 2011.

*New Jersey Joint Venture*

During the year ended December 31, 2011, the Company recorded a \$5.9 million charge to reflect its share of a goodwill impairment recorded at its New Jersey joint venture. As of December 31, 2012 and 2011, the Company's investment balance was \$10.9 million and \$11.2 million, respectively. The Company believes the investment balance is realizable based on its share of the underlying fair value of the business.



## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

The Company determined that the New Jersey joint venture did not qualify as a VIE at December 31, 2012 and 2011. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the joint venture at, and for the years ended December 31, 2012 and 2011, primarily as it did not have the ability to direct the activities of the joint venture that most significantly impacted the joint venture's economic performance without the input of Greenwood Limited Jersey, Inc. Therefore, the Company did not consolidate its investment in the joint venture at, and for the years ended December 31, 2012 and 2011.

### *Sale of Maryland Jockey Club Interest*

In July 2011, the Company sold its joint venture interest in Maryland RE & R LLC, a joint venture with MI Developments, Inc. that owned and operated the Maryland Jockey Club. This transaction resulted in a gain of \$20.2 million which was included in gain (loss) from unconsolidated affiliates within the consolidated statement of operations for the year ended December 31, 2011.

For the year ended December 31, 2010, the Company's share of losses in the Maryland Jockey Club included a \$14.4 million charge for the Company's share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 as a result of the negative outcome related to the zoning referendum in which voters approved a casino complex at the Arundel Mills mall in Anne Arundel, Maryland.

Table of Contents**8. Property and Equipment**

Property and equipment, net, consists of the following:

| December 31,                       | 2012         | (in thousands) | 2011         |
|------------------------------------|--------------|----------------|--------------|
| Land and improvements              | \$ 442,882   |                | \$ 362,402   |
| Building and improvements          | 2,283,230    |                | 1,715,144    |
| Furniture, fixtures, and equipment | 1,240,898    |                | 1,021,362    |
| Leasehold improvements             | 17,229       |                | 16,910       |
| Construction in progress           | 30,531       |                | 256,459      |
| Total property and equipment       | 4,014,770    |                | 3,372,277    |
| Less accumulated depreciation      | (1,283,973)  |                | (1,095,077)  |
| Property and equipment, net        | \$ 2,730,797 |                | \$ 2,277,200 |

During the year ended December 31, 2012, total property and equipment, before accumulated depreciation, increased by \$642.5 million primarily due to expenditures for Hollywood Casino Toledo, which opened on May 29, 2012, and Hollywood Casino Columbus, which opened on October 8, 2012, as well as the acquisition of Harrah's St. Louis facility on November 2, 2012.

Depreciation expense, for property and equipment as well as capital leases, totaled \$244.5 million, \$209.3 million, and \$206.6 million in 2012, 2011 and 2010, respectively. Interest capitalized in connection with major construction projects was \$8.4 million, \$5.6 million, and \$5.5 million in 2012, 2011 and 2010, respectively.

On May 4, 2010, in a statewide election in Ohio, the voters determined that the Company's casino in Columbus will be located at the site of the former Delphi Automotive plant along Columbus's West Side. As a result of the election, the Company initiated the process to sell the parcel of land that it purchased in Columbus's Arena District, the original site approved by voters, and reclassified the land as held for sale. The Company obtained an appraisal to determine the estimated fair market value of the land and recorded a pre-tax impairment charge of \$31.3 million (\$20.1 million, net of taxes) during the year ended December 31, 2010, which was comprised of the difference between the land's estimated fair market value less costs to sell and its carrying value. The Company engaged a qualified external real estate appraiser to assist in the valuation of the land, which was based on the sales prices of properties with similar characteristics to the Company's property in the Columbus Arena District. This land was sold in August 2011, which did not have a significant impact on the Company's consolidated statement of operations.

**9. Goodwill and Other Intangible Assets**

A reconciliation of goodwill and accumulated goodwill impairment losses is as follows (in thousands):

|                             |    |           |
|-----------------------------|----|-----------|
| Balance at January 1, 2011: |    |           |
| Goodwill                    | \$ | 2,019,613 |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|  |    |           |
|--|----|-----------|
| Accumulated goodwill impairment losses |    | (833,857) |
| Goodwill, net                          | \$ | 1,185,756 |
| Other                                  |    | (5,397)   |
| Balance at December 31, 2011:          |    |           |
| Goodwill                               | \$ | 2,014,216 |
| Accumulated goodwill impairment losses |    | (833,857) |
| Goodwill, net                          | \$ | 1,180,359 |
| Goodwill acquired                      |    | 205,664   |
| Other                                  |    | (5,334)   |
| Balance at December 31, 2012:          |    |           |
| Goodwill                               | \$ | 2,214,546 |
| Accumulated goodwill impairment losses |    | (833,857) |
| Goodwill, net                          | \$ | 1,380,689 |

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

### Table of Contents

Goodwill consists mainly of goodwill from the acquisitions of Hollywood Casino Corporation in March 2003, Argosy Gaming Company in October 2005, Zia Park Casino in April 2007, and Harrah's St. Louis facility in November 2012.

During the year ended December 31, 2012, goodwill increased by \$200.3 million, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

During the year ended December 31, 2010, due to decreased earning projections at the Company's properties in the Chicagoland regional market resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax impairment charge of \$144.6 million (\$144.6 million, net of taxes) and \$44.2 million (\$28.4 million, net of taxes) for Hollywood Casino Aurora and Hollywood Casino Joliet, respectively, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Aurora and Hollywood Casino Joliet was impaired.

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of other intangible assets at December 31, 2012 and 2011:

| December 31,                      | 2012                       |                             |                   | 2011                       |                             |                   |
|-----------------------------------|----------------------------|-----------------------------|-------------------|----------------------------|-----------------------------|-------------------|
|                                   | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net Book<br>Value | (in thousands)             |                             |                   |
|                                   | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net Book<br>Value | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net Book<br>Value |
| Indefinite-life intangible assets | \$ 699,969                 | \$                          | \$ 699,969        | \$ 421,260                 | \$                          | \$ 421,260        |
| Other intangible assets           | 56,661                     | 50,153                      | 6,508             | 49,666                     | 49,333                      | 333               |
| <b>Total</b>                      | <b>\$ 756,630</b>          | <b>\$ 50,153</b>            | <b>\$ 706,477</b> | <b>\$ 470,926</b>          | <b>\$ 49,333</b>            | <b>\$ 421,593</b> |

Indefinite-life intangible assets consist mainly of gaming licenses and racing permits.

During the year ended December 31, 2012, indefinite-life intangible assets increased by \$278.7 million, primarily due to the gaming licenses for Hollywood Casino Toledo, which opened on May 29, 2012, and Hollywood Casino Columbus, which opened on October 8, 2012, as well as the acquisition of Harrah's St. Louis facility on November 2, 2012.

The Company's intangible asset amortization expense was \$0.8 million, \$2.2 million, and \$5.8 million for the years ended December 31, 2012, 2011 and 2010, respectively.

During the year ended December 31, 2010, the Company wrote-off the Argosy trademark intangible asset for \$4.4 million (\$2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2012 (in thousands):

|       |    |       |
|-------|----|-------|
| 2013  | \$ | 3,536 |
| 2014  |    | 2,953 |
| 2015  |    | 19    |
| Total | \$ | 6,508 |

Table of Contents

The Company's remaining goodwill and other intangible assets by reporting unit at December 31, 2012 is shown below (in thousands):

| Reporting Unit                | Remaining Goodwill and<br>other intangible assets<br>at December 31, 2012 |           |
|-------------------------------|---|-----------|
| Hollywood Casino St. Louis    | \$  | 385,769   |
| Hollywood Casino Lawrenceburg |   | 362,491   |
| Hollywood Casino Aurora       |   | 207,207   |
| Hollywood Casino Joliet       |   | 204,825   |
| Argosy Casino Riverside       |   | 159,296   |
| Zia Park Casino               |   | 145,591   |
| Argosy Casino Alton           |   | 135,511   |
| Argosy Casino Sioux City      |   | 92,795    |
| Hollywood Casino Baton Rouge  |   | 75,521    |
| Others                        |   | 318,160   |
| Total                         | \$  | 2,087,166 |

**10. Long-term Debt and Derivatives**

Long-term debt, net of current maturities, is as follows:

| December 31,  | 2012           |           | 2011 |           |
|---|----------------|-----------|------|-----------|
|   | (in thousands) |           |      |           |
| Senior secured credit facility                                | \$             | 2,394,963 | \$   | 1,715,750 |
| \$325 million 83/4% senior subordinated notes due August 2019 |                | 325,000   |      | 325,000   |
| Other long-term obligations                                   |                | 10,000    |      | 1,949     |
| Capital leases  |                | 2,111     |      | 2,215     |
|   |                | 2,732,074 |      | 2,044,914 |
| Less current maturities of long-term debt                     |                | (81,497)  |      | (44,559)  |
| Less discount on senior secured credit facility Term Loan B   |                | (1,504)   |      | (1,749)   |
|   | \$             | 2,649,073 | \$   | 1,998,606 |

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2012 (in thousands) (which does not contemplate the redemption of debt obligations that are anticipated to occur in connection with the proposed Spin-Off transaction):

|                        |    |           |
|------------------------|----|-----------|
| 2013                   | \$ | 81,497    |
| 2014                   |    | 108,998   |
| 2015                   |    | 122,755   |
| 2016                   |    | 890,264   |
| 2017                   |    | 12,773    |
| Thereafter             |    | 1,515,787 |
| Total minimum payments | \$ | 2,732,074 |

**Senior Secured Credit Facility**

On July 14, 2011, the Company entered into a new \$2.15 billion senior secured credit facility. The Company utilized the proceeds from this facility and cash on hand to retire its previous senior secured credit facility obligation (which had significant principal repayments due at the end of 2011 and 2012) as well as its \$250 million 63/4% senior subordinated notes. As a result of these two transactions, the Company incurred debt extinguishment charges of \$17.8 million related to debt issuance cost write-offs and the call premium on the \$250 million senior subordinated notes for the year ended December 31, 2011.

On November 1, 2012, the Company raised \$915 million of additional funds and increased its revolver capacity through an add-on to its senior secured credit facility. As of December 31, 2012, the senior secured credit facility was comprised of a \$785 million revolving credit facility that will mature in July 2016, a \$1.1 billion variable rate Term Loan A

Table of Contents

due in July 2016 and a \$1.252 billion variable rate Term Loan B due in July 2018. The proceeds from the issuance of the add-on to the senior secured credit facility were utilized to complete the acquisition of Harrah's St. Louis gaming and lodging facility from Caesars Entertainment which closed on November 2, 2012 and for working capital purposes.

The interest rates payable on the facilities are based on the leverage ratios of the Company as defined in the debt agreements, however, based on current borrowing levels, the Company will pay LIBOR plus 175 basis points on the revolver and Term Loan A and LIBOR plus 275 basis points on Term Loan B (subject to a 1% LIBOR floor).

The Company's senior secured credit facility had a gross outstanding balance of \$2,395.0 million at December 31, 2012, consisting of \$100.0 million drawn under the revolving credit facility, a \$1,042.5 million Term Loan A facility, and a \$1,252.5 million Term Loan B facility. Additionally, at December 31, 2012, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$75.3 million, resulting in \$609.7 million of available borrowing capacity as of December 31, 2012 under the revolving credit facility.

**83/4% Senior Subordinated Notes**

In August 2009, the Company completed an offering of \$325 million 83/4% senior subordinated notes that mature on August 15, 2019. Interest on the \$325 million 83/4% senior subordinated notes is payable on February 15 and August 15 of each year. The \$325 million 83/4% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries and were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. At any time prior to August 15, 2014, the Company may redeem all or part of the 83/4% senior subordinated notes at par plus the present value (discounted at the treasury rate plus 50 basis points) of scheduled interest payments through August 15, 2014, along with accrued and unpaid interest, if any, at the date of redemption. On or after August 15, 2014, the Company may redeem all or part of the 83/4% senior subordinated notes at a redemption price of 104.375% which gradually reduces to par by 2017.

**Other Long-Term Obligations**

In September 2012, the Company received \$10 million under a subscription agreement entered into between A3 Gaming Investments, LLC, an investment vehicle owned by the previous owner of the M Resort (A3 Gaming Investments), and LV Gaming Ventures, LLC, a wholly-owned subsidiary of the Company and holder of the assets of the M Resort (LV Gaming Ventures). The subscription agreement entitles A3 Gaming Investments to invest in a limited liability membership interest in LV Gaming Ventures which matures on October 1, 2016. The investment entitles A3 Gaming Investments to annual payments and a settlement value based on the earnings levels of the M Resort. In accordance with ASC 480, Distinguishing Liabilities from Equity, the Company determined that this obligation is a financial instrument and as such should be recorded as a liability within debt. Changes in the settlement value, if any, will be accreted to interest expense through the maturity date of the instrument.

In April 2010, the Company entered into a termination contract with the city of Aurora, Illinois, whereby the Company would pay \$7 million in lieu of perpetual annual payments (of approximately \$1 million) to have off duty Aurora police officials provide security at Hollywood Casino Aurora each day. Payments of \$1.5 million were made on June 1, 2010 and September 1, 2010 and payments of \$2.0 million were made on



## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

June 1, 2011 and 2012. This liability was discounted using an estimate of the Company's incremental borrowing rate over the term of the obligation. The accretion of this discount was recorded in interest expense in the consolidated statements of operations.

### **Covenants**

The Company's senior secured credit facility and \$325 million 83/4% senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, interest coverage, senior leverage and total leverage ratios. In addition, the Company's senior secured credit facility and \$325 million 83/4% senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, engage in mergers or consolidations, and otherwise restrict corporate activities.

At December 31, 2012, the Company was in compliance with all required financial covenants.

Table of Contents**Interest Rate Swap Contracts**

There were no outstanding interest rate swap contracts as of December 31, 2012 and 2011. The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2011 was as follows (in thousands):

| <b>Derivatives in a Cash Flow Hedging Relationship</b> | <b>Gain (Loss) Recognized in OCI on Derivative (Effective Portion)</b> | <b>Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</b> | <b>Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</b> | <b>Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)</b> | <b>Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)</b> |
|--|--|---|---|---|---|
| Interest rate swap contracts                           | \$ (672)   | Interest expense  | \$ (8,173)  | None  | \$  |
| Total  | \$ (672)   |   | \$ (8,173)  |   | \$  |

| <b>Derivatives Not Designated as Hedging Instruments</b> | <b>Location of Gain (Loss) Recognized in Income on Derivative</b> | <b>Gain (Loss) Recognized in Income on Derivative</b> |
|--|---|---|
| Interest rate swap contracts                             | Interest expense  | \$ (10)   |
| Total  |   | \$ (10)   |

Unrealized losses for the Company's interest rate swap contracts within accumulated other comprehensive loss within the consolidated balance sheet at December 31, 2010 was \$9.4 million. The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2010 was as follows (in thousands):

| <b>Derivatives in a Cash Flow Hedging Relationship</b> | <b>Gain (Loss) Recognized in OCI on Derivative (Effective Portion)</b> | <b>Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</b> | <b>Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</b> | <b>Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)</b> | <b>Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)</b> |
|--|--|---|---|---|---|
| Interest rate swap contracts                           | \$ (13,998)  | Interest expense  | \$ (24,424)   | None  | \$  |
| Total  | \$ (13,998)  |   | \$ (24,424)   |   | \$  |

| <b>Derivatives Not Designated as Hedging Instruments</b> | <b>Location of Gain (Loss) Recognized in Income on Derivative</b> | <b>Gain (Loss) Recognized in Income on Derivative</b> |
|--|---|---|
| Interest rate swap contracts                             | Interest expense  | \$ (60)   |
| Total  |   | \$ (60)   |

In addition, during the years ended December 31, 2011 and 2010, the Company amortized to interest expense \$7.2 million and \$15.4 million, respectively, in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, Derivatives and Hedging.

**11. Commitments and Contingencies**

**Litigation**

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. The Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claims.

## Table of Contents

Gaming licenses in Iowa are typically issued jointly to a gaming operator and a local charitable organization known as a QSO. The agreement between the Company's gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. ( Belle ), and its QSO, Missouri River Historical Development, Inc. ( MRHD ), expired in early July 2012. On July 12, 2012, when presented with an extension of the Company's QSO/operating agreement for the Sioux City facility through March 2015, the Iowa Racing and Gaming Commission ( IRGC ) failed to approve the extension and urged a shorter extension. In mid-August 2012, MRHD offered a revised contract to the Company that would require a yearly renewal from the IRGC and stated that MRHD would be able to continue searching for an operator for a new land-based casino. The Company rejected this contract offer and at the August 23, 2012 IRGC meeting urged the IRGC to reconsider the original extension offer through March 2015. The IRGC did not act on this request and concluded that the casino can continue to operate without an effective operating agreement until such time as a hearing is set by the IRGC to decide if the gaming licenses should not be continued. No such hearing has been scheduled at this time. The IRGC also announced at the July 12, 2012 meeting the schedule for requests for proposals for a new land-based Woodbury County casino. Applications and financing proposals were due by November 5, 2012 and the IRGC is expected to award that license to a gaming operator and a QSO by April 18, 2013. The Belle has filed three lawsuits against the IRGC's recent actions, namely refusing to consider the Belle's request to replace MRHD with another non-profit partner and opening up the gaming license to bidding for a land-based casino, its failure to approve the 2015 extension agreement and any extension, and announcing a process would be instituted to revoke the Belle's license.

In addition, the Belle filed suit against MRHD for a breach of contract and seeking to enjoin MRHD from disavowing the 2015 extension agreement it signed and the exclusivity obligations in the agreement. The injunction request was denied on October 29, 2012. MRHD submitted a proposal with another gaming operator to develop a land-based facility in Sioux City. Without prejudice to its legal claims, the Belle is participating in this request for proposals. On November 5, 2012, the Company announced that it had submitted to the IRGC two proposals for a new gaming and entertainment destination in Woodbury County for the IRGC's consideration. The first proposal, Hollywood Casino Sioux City, would feature a 33,000 square-foot casino floor with 750 slot machines, 20 table games and a 5-table poker room, as well as various dining and entertainment amenities and a multi-purpose event center. The second proposal, Hollywood Casino Siouxland, is similar in size and scope to the Hollywood Casino Sioux City downtown project, but would lie south of Sioux City and would include a 150-room hotel as part of the Phase One construction. Argosy Casino Sioux City had remaining goodwill and other intangible assets of \$92.8 million at December 31, 2012. Additionally, this facility had net revenues and income from operations of \$57.1 million and \$16.6 million, respectively, for the year ended December 31, 2012, which represented 2% and 4% of the Company's consolidated results. Although the Company believes one of its two proposals has a strong chance of being selected by the IRGC, any disruptions to Argosy Casino Sioux City's operations related to the items described above or the selection of another gaming operator to develop and operate the land-based casino license would result in non-cash impairment charges in future periods as well as the loss of future earnings associated from this property.

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the County ) filed suit against Kansas Penn Gaming, LLC ( KPG, a wholly owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and currently seeks in excess of \$50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the \$25 million privilege fee (which is included in current assets) paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied. Following discovery, both parties have filed dispositive motions and the motions were argued on April 20, 2012. In September 2012, the judge ruled in favor of the County on its motion for summary judgment. At December 31, 2012, the Company has accrued \$6.4 million, which is included in accrued expenses within the consolidated balance sheet, based on settlement discussions between the two parties that took place in January 2013.

## **Operating Lease Commitments**

The Company is liable under numerous operating leases for assets including an airplane, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was \$29.7 million, \$28.9 million, and \$30.5 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The leases for land consist of annual base lease rent payments plus, in some instances, a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

Table of Contents

The Company has an operating lease with the City of Bangor which covers the permanent facility that opened on July 1, 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision, which is equal to 3% of gross slot revenue. The final term of the lease, which commenced with the opening of the permanent facility, is for an initial term of fifteen years, with three ten-year renewal options.

On March 23, 2007, BTN, Inc. ( BTN ), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the Amended Lease ) with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093. BTN also leases approximately 5 acres of submerged tidelands at the casino site from the State of Mississippi, which expires in 2039 but has a thirty year renewal option.

The Company through its acquisition of the M Resort assumed a lease agreement for approximately 5 acres of land at the property. The lease commenced on July 1, 2005 and is for twenty years, with two five-year renewal options. Under the lease agreement, the base rent is subject to annual increases over the life of the lease based on the consumer price index but is limited to 103% of the previous year's rent.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2012 are as follows (in thousands):

| <b>Year ending December 31,</b> |           |               |
|---------------------------------|-----------|---------------|
| 2013                            | \$        | 7,456         |
| 2014                            |           | 5,201         |
| 2015                            |           | 3,768         |
| 2016                            |           | 3,142         |
| 2017                            |           | 2,605         |
| Thereafter                      |           | 32,104        |
| <b>Total</b>                    | <b>\$</b> | <b>54,276</b> |

**Capital Expenditure Commitments**

The Company's current construction program for 2013 calls for capital expenditures of approximately \$259.6 million, of which the Company was contractually committed to spend approximately \$20.8 million at December 31, 2012.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation. The matching contributions for the profit-sharing plan for the years ended December 31, 2012, 2011 and

2010 were \$3.7 million, \$3.7 million, and \$3.5 million, respectively.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at Hollywood Casino at Charles Town Races. Hollywood Casino at Charles Town Races makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle, 1.0% of net video lottery revenue up to a base and, after the base is met, it reverts to 0.5% and 0.84% of table and poker revenue, respectively. The contributions for the two plans at Hollywood Casino at Charles Town Races for the years ended December 31, 2012, 2011 and 2010 were \$3.9 million, \$3.8 million, and \$3.1 million, respectively.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and/or their annual bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with

Table of Contents

respect to participant deferral and Company contribution amounts. The Company's matching contributions for the non-qualified deferred compensation plan for the years ended December 31, 2012, 2011 and 2010 were \$2.7 million, \$2.3 million, and \$1.8 million, respectively. The Company's deferred compensation liability, which was included in other current liabilities within the consolidated balance sheets, was \$52.4 million and \$41.2 million at December 31, 2012 and 2011, respectively.

**Labor Agreements**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In Ohio, the Company is required to have horsemen consent for simulcast exports and on certain simulcast imports. In addition, in order to operate gaming machines and table games in West Virginia, the Company must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At Hollywood Casino at Charles Town Races, the Company has an agreement with the Charles Town Horsemen that expires on December 31, 2013, and an agreement with the breeders that expires on June 30, 2013. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Union of Mutuel Clerks, which expired on December 31, 2010 and has been extended on a month-to-month basis while negotiations are in process.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expires on January 31, 2016. The Company had a collective bargaining agreement with Local 137 of the Sports Arena Employees at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expired on December 31, 2011. In August 2012, Local 137 of the Sports Arena Employees announced that they entered into a voluntary supervision agreement with their international union, Laborers International Union of North America. Currently, the Company has not received communication from the new union representatives. The Company also has an agreement in place with Local 137 of the Sports Arena Employees with respect to pari-mutuel clerks and admission personnel at the Company's OTWs that expires on August 31, 2013.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expired on December 31, 2012. Although the Company is not required to have an agreement in place, it is in the process of negotiating a new agreement prior to the commencement of live racing which is expected to occur in May 2013.

The Company's agreement with the Ohio Harness Horsemen Association at Raceway Park expires on December 31, 2013, and the Company's agreement with the Ohio Horsemen's Protective and Benevolent Association at Beulah Park expires on December 31, 2013. Rosecroft Raceway entered into agreements with the Cloverleaf Standardbred Owners Association and Maryland Standardbred Breeder's Association as of July 5, 2011, both of which expire on December 31, 2022, with provisions for earlier termination under certain conditions.

Across certain of the Company's properties, the Seafarers Entertainment and Allied Trade Union (SEATU) represents approximately 1,800 of the Company's employees under agreements that expire at various times between May 2013 and July 2021. For Hollywood Casino Lawrenceburg, the SEATU agreement expired in June 2012 and has been extended on a monthly basis while negotiations are in process. At Hollywood Casino Joliet, the Hotel Employees and Restaurant Employees Union Local 1 represents approximately 260 employees under a collective bargaining agreement which expires on March 31, 2015. In addition, at some of the Company's properties, the Seafarer International Union of North



## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the Security Police and Fire Professionals of America, the International Brotherhood of Electronic Workers Locals No. 176 and 649, the Chicago and Midwest Regional Joint Board affiliated with Workers United, the Local No. 27 United Food and Commercial Workers, Laborers International Union of North America Public Serviced Employees Local 1290PE, and the United Industrial, Service, Transportation, Professional and Government Workers of North America represent certain of the Company's employees under collective bargaining agreements that expire at various times between July 2013 and February 2020. None of these particular unions represent more than 75 of the Company's employees.

If the Company fails to maintain operative agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and OTWs and, in West Virginia, the Company will not be permitted to operate its gaming machines and table games unless the state intervenes or changes the statute. In addition, the Company's simulcasting agreements are subject to the horsemen's approval. If the Company fails to renew or modify existing agreements on satisfactory terms, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company

Table of Contents

has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**12. Income Taxes**

Deferred tax assets and liabilities are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated balance sheets. These temporary differences result in taxable or deductible amounts in future years.

The components of the Company's deferred tax assets and liabilities are as follows:

| Year ended December 31,                                      | 2012           | 2011         |
|--|----------------|--------------|
|  | (in thousands) |              |
| Deferred tax assets:   |                |              |
| Stock-based compensation expense                             | \$ 48,098      | \$ 37,752    |
| Accrued expenses   | 64,047         | 53,050       |
| Deferred tax assets resulting from unrecognized tax benefits | 10,839         | 12,231       |
| Net operating losses   | 6,935          | 6,165        |
| Accumulated other comprehensive loss                         | 2,709          | 59           |
| Gross deferred tax assets                                    | 132,628        | 109,257      |
| Less valuation allowance                                     | (3,221)        | (3,160)      |
| Net deferred tax assets                                      | 129,407        | 106,097      |
| Deferred tax liabilities:                                    |                |              |
| Property, plant and equipment                                | (174,285)      | (123,525)    |
| Intangibles  | (131,686)      | (117,842)    |
| Net deferred tax liabilities                                 | (305,971)      | (241,367)    |
| Net:   | \$ (176,564)   | \$ (135,270) |
| Reflected on consolidated balance sheets:                    |                |              |
| Current deferred tax assets, net                             | \$ 39,793      | \$ 32,306    |
| Noncurrent deferred tax liabilities, net                     | (216,357)      | (167,576)    |
| Net deferred taxes   | \$ (176,564)   | \$ (135,270) |

For income tax reporting, the Company has gross state net operating loss carryforwards aggregating approximately \$138 million available to reduce future state income taxes, primarily for the Commonwealth of Pennsylvania and the States of Mississippi, Colorado and Maryland as of December 31, 2012. The tax benefit associated with these net operating loss carryforwards is approximately \$5.7 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits and income and loss projections in the applicable jurisdictions, a \$3.2 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2013 to December 31, 2031.

In addition, certain subsidiaries have accumulated gross state net operating loss carryforwards aggregating approximately \$953.4 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2012 attributable to these net operating losses was approximately \$59.5 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2012. In the event of any benefit from realization of these net operating losses,

\$9.4 million would be treated as an increase to equity, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2013 to December 31, 2031.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

Table of Contents

The provision for income taxes charged to operations for the years ended December 31, 2012, 2011 and 2010 was as follows:

| Year ended December 31,               | 2012              | 2011              | 2010             |
|---------------------------------------|-------------------|-------------------|------------------|
|                                       | (in thousands)    |                   |                  |
| <b>Current tax expense</b>            |                   |                   |                  |
| Federal                               | \$ 96,490         | \$ 106,982        | \$ 55,008        |
| State                                 | 14,448            | 23,392            | 11,630           |
| Foreign                               | (3,366)           | (5,053)           | 1,744            |
| <b>Total current</b>                  | <b>107,572</b>    | <b>125,321</b>    | <b>68,382</b>    |
| <b>Deferred tax (benefit) expense</b> |                   |                   |                  |
| Federal                               | 44,874            | 24,893            | (4,996)          |
| State                                 | 109               | (3,333)           | 2,792            |
| <b>Total deferred</b>                 | <b>44,983</b>     | <b>21,560</b>     | <b>(2,204)</b>   |
| <b>Total provision</b>                | <b>\$ 152,555</b> | <b>\$ 146,881</b> | <b>\$ 66,178</b> |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2012, 2011 and 2010:

| Year ended December 31,         | 2012         | 2011         | 2010           |
|---------------------------------|--------------|--------------|----------------|
| <b>Percent of pretax income</b> |              |              |                |
| Federal taxes                   | 35.0%        | 35.0%        | 35.0%          |
| State and local income taxes    | 1.4%         | 3.4%         | 197.1%         |
| Permanent differences           | 5.3%         | 2.2%         | 1263.1%        |
| Foreign                         | 0.2%         | (1.6)%       | 16.1%          |
| Other miscellaneous items       | (0.1)%       | (1.3)%       | (46.5)%        |
|                                 | <b>41.8%</b> | <b>37.7%</b> | <b>1464.8%</b> |

| Year ended December 31,                | 2012              | 2011              | 2010             |
|--|-------------------|-------------------|------------------|
|  | (in thousands)    |                   |                  |
| <b>Amount based upon pretax income</b> |                   |                   |                  |
| Federal taxes                          | \$ 127,584        | \$ 136,205        | \$ 1,581         |
| State and local income taxes           | 5,044             | 13,398            | 8,905            |
| Permanent differences                  | 19,223            | 8,405             | 57,058           |
| Foreign                                | 886               | (6,223)           | 729              |
| Other miscellaneous items              | (182)             | (4,904)           | (2,095)          |
|  | <b>\$ 152,555</b> | <b>\$ 146,881</b> | <b>\$ 66,178</b> |

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

|  | <b>Noncurrent<br/>tax liabilities<br/>(in thousands)</b> |
|--|--|
| Balance at December 31, 2010                                 | \$ 36,846  |
| Additions based on current year positions                    | 4,309  |
| Additions based on prior year positions                      | 3,178  |
| Decreases due to settlements and/or reduction in liabilities | (10,422)   |
| Currency translation adjustments                             | (39)   |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|   |    |          |
|---|----|----------|
| Balance at December 31, 2011                              |    | 33,872   |
| Additions based on current year positions                 |    | 2,465    |
| Additions based on prior year positions                   |    | 5,919    |
| Payments made on account                                  |    | (13,123) |
| Decreases due to settlements and/or reduction in reserves |    | (9,639)  |
| Currency translation adjustments                          |    | 899      |
| Balance at December 31, 2012                              | \$ | 20,393   |

Table of Contents

During the year ended December 31, 2012, the Company recorded \$2.5 million of tax reserves and accrued interest related to current year uncertain tax positions. In regards to prior year tax positions, the Company recorded \$5.9 million of tax reserves and accrued interest and reversed \$7.7 million and \$1.9 million of previously recorded tax reserves and accrued interest, respectively, for uncertain tax positions that have settled and/or closed. The Company recorded a federal deferred tax benefit of \$0.4 million in the current year associated with its uncertain tax positions. Overall, the Company recorded a net tax benefit of \$1.6 million in connection with its uncertain tax positions for the year ended December 31, 2012.

Included in the liability for unrecognized tax benefits at December 31, 2012 and 2011 were \$19.9 million and \$21.5 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

Included in the liability for unrecognized tax benefits at December 31, 2012 and 2011 were \$0.9 million and (\$39) thousand, respectively, of currency translation adjustments for foreign currency tax positions.

The Company is required under ASC 740 to disclose its accounting policy for classifying interest and penalties, the amount of interest and penalties charged to expense each period, as well as the cumulative amounts recorded in the consolidated balance sheets. The Company will continue to classify any income tax-related penalties and interest accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of operations.

During the years ended December 31, 2012 and 2011, the Company recognized approximately \$88 thousand and \$0.3 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to settlements and/or reductions in previously recorded liabilities, the Company had reductions in previously accrued interest and penalties of \$1.3 million, net of deferred taxes. These accruals are included in noncurrent tax liabilities and prepaid expenses within the consolidated balance sheets at December 31, 2012 and 2011, respectively.

The Company is currently in various stages of the examination process in connection with its open audits. Generally, it is difficult to determine when these examinations will be closed, but the Company reasonably expects that its ASC 740 liabilities will not significantly change over the next twelve months.

As of December 31, 2012, the Company is subject to U.S. federal income tax examinations for the tax years 2009, 2010, and 2011. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

At December 31, 2012, prepaid expenses within the consolidated balance sheet included prepaid income taxes of \$68.4 million.

**13. Shareholders Equity**

### **Repurchase of Common Stock**

The Company's Board of Directors has authorized a common stock repurchase program of up to \$300 million, of which \$160.2 million remains available. This program is in effect until the annual meeting of shareholders to be held in 2013, unless extended or shortened by the Board of Directors.

The Company did not repurchase any shares of its common stock in 2012. During the year ended December 31, 2011, the Company repurchased 2,981,406 shares of its common stock in open market transactions for approximately \$105.2 million at an average price of \$35.29 per share. During the year ended December 31, 2010, the Company repurchased 1,526,400 shares of its common stock in open market transactions for approximately \$35.9 million at an average price of \$23.49 per share.

### **\$1.25 billion, Zero Coupon Preferred Equity Investment**

On June 15, 2007, the Company announced that it had entered into a merger agreement that, at the effective time of the transactions contemplated thereby, would have resulted in the Company's shareholders receiving \$67.00 per share. Specifically, the Company, PNG Acquisition Company Inc. ( Parent ) and PNG Merger Sub Inc., a wholly-owned subsidiary of Parent ( Merger Sub ), announced that they had entered into an Agreement and Plan of Merger, dated as of June 15, 2007 (the Merger Agreement ), that provided, among other things, for Merger Sub to be merged with and into the Company, as a result of which the Company would have continued as the surviving corporation and would have become a wholly-owned subsidiary of Parent. Parent is indirectly owned by certain funds managed by affiliates of Fortress Investment Group LLC ( Fortress ) and Centerbridge Partners, L.P. ( Centerbridge ).

Table of Contents

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of \$1.475 billion, consisting of a nonrefundable \$225 million cash termination fee and a \$1.25 billion, zero coupon, preferred equity investment (the Investment ). On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of the Preferred Stock. During the year ended December 31, 2010, the Company repurchased 225 shares of Preferred Stock for \$11.2 million.

The Investment is generally non-voting, but possesses voting rights with respect to certain extraordinary events. The Investment is entitled to vote with the common stock on an as-converted basis with respect to any change-in-control or other significant transaction if the consideration to be paid to shareholders is less than \$45 per share (which amount is subject to adjustment in certain circumstances). In addition, the approval of holders of a majority of the Investment shares is required to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. At December 31, 2012, the Investment had an aggregate liquidation preference equal to \$1.23 billion, the aggregate purchase price paid for the Investment shares (the Purchase Price ), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the common stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

The Company is required to redeem, for either cash or common shares at the Company's election, all of the outstanding shares of the Investment on June 30, 2015, unless a change-in-control transaction in which all holders of shares of the common stock receive consideration in the transaction has occurred prior to that time. In the event of such a change-in-control transaction, the holders of the Investment will receive cash and/or other consideration in such transaction (the same consideration as the holders of common stock receive) with a value equal to the net present value of the Purchase Price, subject to increase or decrease in the event that the value of the consideration paid to the holders of the common stock is greater than \$67 per share or less than \$45 per share, respectively, which thresholds are subject to adjustment in certain circumstances.

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the common stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than \$67 per share or less than \$45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the common stock. At December 31, 2012, the redemption price was \$1.23 billion (25.0 million shares of common stock if the Company elected to redeem through the issuance of common stock).

The holders of the Investment are subject to the Investor Rights Agreement, dated as of July 3, 2008, by and among the Company, FIF V PFD LLC, an affiliate of Fortress, Centerbridge, DB Investment Partners, Inc. and WF Investments Holdings, LLC, formerly Wachovia Investment Holdings, LLC. (the Investor Rights Agreement ), which, among other things, contains a voting agreement requiring certain Investment holders to vote all of their shares of common stock as directed by the Company and a standstill agreement restricting the activities of certain Investment holders. In addition, Investment holders who may receive 20% or more of the outstanding common stock upon redemption would be subject to Subchapter 25G of the Pennsylvania Business Corporation Law of 1988, as amended (the Control Share Statute ). The Control Share Statute prohibits any person or group that acquires more than 20% of the voting power of the Company from voting any securities held by such person or group unless the shareholders vote to accord voting rights to such securities within 90 days of the time such threshold was exceeded. Under the Investment terms, unless such shareholder approval is obtained, the Investment holders shall execute and deliver a proxy in favor of an attorney-in-fact to be designated by the Board of Directors covering the number of shares of common stock necessary to avoid the application of the Control Share Statute.



## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

The Investor Rights Agreement also provides that until Fortress and its affiliates own less than two-thirds of the shares of the Investment issued to them on October 30, 2008, Fortress and the Company must take all action in their power to appoint one designee of the purchasers (the Purchaser Designee ) as a Class II director on the Board of Directors and to use all commercially reasonable efforts to cause the election of the Purchaser Designee at every meeting thereafter at which a Class II director is to be elected. The initial Purchaser Designee is Wesley R. Edens. Mr. Edens is the founding principal and Co-Chairman of the Board of Directors of Fortress.

Table of Contents

Under the terms of the Investor Rights Agreement, the Company agreed to file a short-form registration statement with the U.S. Securities and Exchange Commission for the registration and sale of Investment shares and certain shares of common stock owned by the purchasers ( Registrable Securities ), which it filed on December 30, 2008. The Company is required to keep the shelf registration statement continuously effective under the Securities Act of 1933, as amended, until the earlier of (i) such time as all Registrable Securities have been sold and (ii) such time as the purchasers beneficially own (as defined in the Investor Rights Agreement) less than 2.5% of the common stock on a fully-diluted basis (including common shares issuable upon redemption of the Investment shares at maturity). The purchasers and any permitted transferees of Registrable Securities are also entitled to four demand registrations and unlimited piggyback registration during the term of the Investor Rights Agreement.

Under the Investor Rights Agreement, each Investment holder has preemptive rights with respect to certain sales of common stock, stock options or securities convertible into common stock for so long as such holder beneficially owns at least two-thirds of the shares of the Investment issued to it on October 30, 2008.

**Impact of Proposed Spin-Off on Preferred Equity Investment**

As part of the proposed Spin-Off transaction described further in Note 2, the Company entered into an agreement (the Exchange Agreement ) with FIF V PFD LLC, an affiliate of Fortress, providing for the potential exchange of shares of the Company s Preferred Stock for shares of a new class of preferred stock, Series C Convertible Preferred Stock ( Series C ), in contemplation of the potential Spin-Off.

The Exchange Agreement provides Fortress with the right to exchange its 9,750 shares of Preferred Stock for fractional shares of Series C at an exchange ratio that treats each such fractional share (and therefore each share of common stock into which such fractional share is convertible) as worth \$67 per share, which is the ceiling price at which the shares of preferred stock are redeemable by the Company at maturity. Each fractional share of Series C will automatically convert into a share of common stock upon sale to a third party not affiliated with Fortress. Any shares of Series B not exchanged for shares of Series C prior to the second business day before the record date established for the distribution of PropCo common stock in the Spin-Off shall automatically be exchanged for shares of Series C on such date. Subsequently, the Company will have the right to purchase from Fortress, prior to the record date for the Spin-Off, a number of shares of Series C, at a price of \$67 per fractional share of Series C, such that, immediately following the consummation of the Spin-Off, Fortress will own not more than 9.9% of PropCo s common stock. The Company may terminate the Exchange Agreement at any time prior to the Spin-Off if it determines, in its sole discretion, to abandon the Spin-Off, provided that Fortress would keep any shares of Series C it received in exchange for preferred stock prior to termination.

Under the terms of the Statement with Respect to Shares of Series C Convertible Preferred Stock of the Company (the Series C Designation ), the Series C is nonvoting stock, provided, however, that the Series C Designation cannot be altered or amended so as to adversely affect any right or privilege held by the holders of Series C shares without the consent of a majority of the shares of Series C then outstanding. Holders of Series C will participate in dividends paid to the holders of common stock of the Company on an as-converted basis. Each fractional share of Series C will automatically convert into a share of common stock upon sale to a third party not affiliated with the original holder.

As mentioned above, the Company, Fortress and certain other holders of preferred stock are party to an Investor Rights Agreement, dated July 3, 2008 (the Investor Rights Agreement ), that grants those holders certain rights with respect to the Company. In connection with the Exchange Agreement, Fortress and the Company entered into the Supplementary Investor Rights Agreement, which provides that, as between Fortress and the Company, the Series C shares will be governed by the Investor Rights Agreement, and modifies certain other existing arrangements between the Company and Fortress. The Supplementary Investor Rights Agreement provides Fortress with additional registration rights, beyond those currently set forth in the Investor Rights Agreement, including additional opportunities to sell shares of Series C stock in a registered offering.

the right to select the managing underwriter in an underwritten offering prior to the Spin-Off and an increase in the registration expenses borne by the Company. The Supplementary Investor Rights Agreement also provides that, following the completion of the Spin-Off, the following rights and obligations under the Investor Rights Agreement would be eliminated: Fortress's right to nominate a director, the obligation of Fortress to vote its shares of common stock in accordance with the recommendations of the Company's board of directors, the restriction on hedging activities and certain information rights.

Additionally, the Exchange Agreement provides that, following the Spin-Off, PropCo and Fortress will enter into an investor rights agreement on similar terms to the Investor Rights Agreement as modified by the Supplemental Investor Rights Agreement.

Table of Contents

Finally, in January 2013, the Company signed an agreement with Centerbridge pursuant to which the Company will repurchase their 2,300 shares of Preferred Stock at par in advance of the Spin-Off and the Company repurchased 225 shares of Preferred Stock from WF Investment Holdings, LLC at a slight discount to par.

**14. Noncontrolling Interests**

In November 2009, the Company entered into a Funding and Option Agreement with Lakes Entertainment, Inc. ( Lakes ), permitting Lakes to invest up to a 10% equity interest in each of the Company s facilities in Columbus and Toledo, Ohio.

During the year ended December 31, 2010, Lakes made no contribution to the Company towards the facilities, and its portion of the net loss for the facilities was \$2.2 million.

On July 16, 2010, the Company paid \$25 million to Lakes to terminate the agreement. In exchange for this payment, Lakes agreed to relinquish all of its rights, title and interests held in connection with these two facilities. In accordance with ASC 810, Consolidation, the Company accounted for this change in ownership interest as an adjustment through equity attributable to the parent. Therefore, the Company recorded the \$25 million payment and the cumulative \$2.8 million loss attributable to noncontrolling interests from previous periods to additional paid in capital.

**15. Stock-Based Compensation**

On April 16, 2003, the Company s Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the 2003 Plan ). On May 22, 2003, the Company s shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permitted the grant of options to purchase common stock and other market-based and performance-based awards. Up to 12,000,000 shares of common stock were available for awards under the 2003 Plan. The 2003 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the common stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the common stock on the date an option is granted for nonqualified stock options. This plan will remain in place until it terminates in 2013. However the shares which remained available for issuance under such plan as of November 12, 2008 are no longer available for issuance and all future equity awards will be pursuant to the 2008 Long Term Incentive Compensation Plan (the 2008 Plan ) described below.

On August 20, 2008, the Company s Board of Directors adopted and approved the 2008 Plan. On November 12, 2008, the Company s shareholders approved the 2008 Plan. The 2008 Plan permits the Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. On June 9, 2011, the Company s shareholders approved an amendment to the 2008 Plan to increase the aggregate number of shares of common stock that may be issued by 2,350,000 to 9,250,000. Awards of stock options and stock appreciation rights will be counted against the 9,250,000 limit as one share of common stock for each share granted. However, each share awarded in the form of restricted stock, or any other full value stock award, will be counted as issuing 2.44 shares of common stock for purposes of determining the number of shares available for issuance under the plan. Any awards that are not settled in shares of common stock shall not

count against this limit. At December 31, 2012, there were 1,487,780 options available for future grants under the 2008 Plan.

Stock options that expire between January 12, 2013 and April 19, 2019, have been granted to officers, directors and employees to purchase common stock at prices ranging from \$11.88 to \$61.82 per share. All options were granted at the fair market value of the common stock on the date the options were granted. The Company issues new authorized common shares to satisfy stock option exercises as well as restricted stock lapses.

## Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

### Table of Contents

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2012:

|                                  | Number of<br>Option Shares | Weighted-Average<br>Exercise Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic Value<br>(in thousands) |
|----------------------------------|----------------------------|------------------------------------|---|--|
| Outstanding at December 31, 2009 | 9,966,125                  | \$ 27.83                           | 5.67  | \$ 33,038                                      |
| Granted                          | 1,868,500                  | 27.19                              |   |  |
| Exercised                        | (823,056)                  | 13.96                              |   |  |
| Canceled                         | (177,125)                  | 28.84                              |   |  |
| Outstanding at December 31, 2010 | 10,834,444                 | \$ 28.75                           | 5.16  | \$ 76,807                                      |
| Granted                          | 1,631,000                  | 35.47                              |   |  |
| Exercised                        | (695,915)                  | 24.02                              |   |  |
| Canceled                         | (161,500)                  | 26.96                              |   |  |
| Outstanding at December 31, 2011 | 11,608,029                 | \$ 30.00                           | 4.53  | \$ 100,337                                     |
| Granted                          | 1,466,000                  | 38.11                              |   |  |
| Exercised                        | (1,241,091)                | 25.98                              |   |  |
| Canceled                         | (27,250)                   | 28.41                              |   |  |
| Outstanding at December 31, 2012 | 11,805,688                 | \$ 31.44                           | 3.97  | \$ 208,848                                     |

Included in the above are common stock options that were issued in 2003 to the Company's Chairman outside of the Company's stock option plans. These options were issued at \$7.95 per share, and were exercisable through February 6, 2013. At December 31, 2011 and 2010, the number of these common stock options that were outstanding was 23,750, and they were exercised on November 9, 2012.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2012, 2011 and 2010 were \$17.19, \$16.68, and \$12.92, respectively.

| Exercisable at December 31, | Number of<br>Option Shares | Weighted-Average<br>Exercise Price |
|-----------------------------|----------------------------|------------------------------------|
| 2012                        | 7,892,688                  | \$ 30.55                           |
| 2011                        | 7,490,154                  | 30.26                              |
| 2010                        | 6,586,882                  | 29.85                              |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2012, 2011 and 2010 was \$23.2 million, \$9.5 million, and \$15.1 million, respectively.

At December 31, 2012, there were 7,892,688 shares that were exercisable, with a weighted-average exercise price of \$30.55, a weighted-average remaining contractual term of 3.47 years, and an aggregate intrinsic value of \$146.7 million.

The following table summarizes information about stock options outstanding at December 31, 2012:

|  | \$11.88 to<br>\$29.22 | Exercise Price Range<br>\$29.34 to<br>\$35.15 | \$35.75 to<br>\$61.82 | Total<br>\$11.88 to<br>\$61.82 |
|--|-----------------------|---|-----------------------|--------------------------------|
| <b>Outstanding options</b>                             |                       |   |                       |                                |
| Number outstanding                                     | 4,779,919             | 4,116,268                                     | 2,909,501             | 11,805,688                     |
| Weighted-average remaining contractual life<br>(years) | 2.90                  | 4.43  | 5.08                  | 3.97                           |
| Weighted-average exercise price                        | \$ 25.29              | \$ 32.68                                      | \$ 39.78              | \$ 31.44                       |
| <b>Exercisable options</b>                             |                       |   |                       |                                |
| Number outstanding                                     | 3,535,544             | 3,033,643                                     | 1,323,501             | 7,892,688                      |
| Weighted-average exercise price                        | \$ 25.27              | \$ 31.81                                      | \$ 41.75              | \$ 30.55                       |

Table of Contents

The following table contains information on restricted stock awards issued under the plans for the three-year period ended December 31, 2012:

|                                  | <b>Number of<br/>Award Shares</b> |
|----------------------------------|-----------------------------------|
| Outstanding at December 31, 2009 | 552,690                           |
| Awarded                          | 165,110                           |
| Released                         | (203,734)                         |
| Canceled                         | (20,000)                          |
| Outstanding at December 31, 2010 | 494,066                           |
| Awarded                          | 97,005                            |
| Released                         | (234,772)                         |
| Canceled                         | (1,010)                           |
| Outstanding at December 31, 2011 | 355,289                           |
| Awarded                          |                                   |
| Released                         | (144,762)                         |
| Canceled                         |                                   |
| Outstanding at December 31, 2012 | 210,527                           |

Compensation costs related to stock-based compensation for the years ended December 31, 2012, 2011 and 2010 totaled \$28.6 million pre-tax (\$19.9 million after-tax), \$24.7 million pre-tax (\$17.8 million after-tax) and \$26.0 million pre-tax (\$19.1 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2012 and 2011, the total compensation cost related to nonvested awards not yet recognized equaled \$35.0 million and \$40.1 million, respectively, including \$33.3 million and \$34.2 million for stock options, respectively, and \$1.7 million and \$5.9 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

Beginning in the fourth quarter of 2010, the Company began issuing cash-settled phantom stock unit awards, which vest over a period of four to five years. Cash-settled phantom stock unit awards entitle employees and directors to receive cash based on the fair value of the Company's common stock on the vesting date. These phantom stock unit awards are accounted for as liability awards and are re-measured at fair value each reporting period until they become vested with compensation expense being recognized over the requisite service period in accordance with ASC 718-30 Compensation Stock Compensation, Awards Classified as Liabilities. As of December 31, 2012, there was \$13.8 million of total unrecognized compensation cost that will be recognized over the grants remaining weighted average vesting period of 2.88 years. For the years ended December 31, 2012, 2011 and 2010, the Company recognized \$5.9 million, \$2.1 million and \$0.4 million, respectively, of compensation expense associated with these awards.

Additionally, starting in 2011, the Company has issued stock appreciation rights to certain employees, which vest over a period of four years. The Company's stock appreciation rights are accounted for as liability awards since they will be settled in cash. The fair value of these awards is calculated during each reporting period and estimated using the Black-Scholes option pricing model based on the various inputs discussed previously. As of December 31, 2012, there was \$11.4 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period of 2.75 years. For the years ended December 31, 2012 and 2011, the Company recognized \$4.4 million and \$1.4 million, respectively, of compensation expense associated with these awards.





Table of Contents**16. Segment Information**

The following tables present certain information with respect to the Company's segments. Intersegment revenues between the Company's segments were not material in any of the periods presented below.

|   | Midwest    | East/West    | Southern Plains<br>(in thousands) | Other     | Total        |
|---|------------|--------------|-----------------------------------|-----------|--------------|
| <b>Year ended December 31, 2012</b>                     |            |              |                                   |           |              |
| Net revenues  | \$ 949,464 | \$ 1,345,621 | \$ 571,246                        | \$ 33,134 | \$ 2,899,465 |
| Income (loss) from operations                           | 206,462    | 291,627      | 132,153                           | (187,653) | 442,589      |
| Depreciation and amortization                           | 92,689     | 88,688       | 49,408                            | 14,563    | 245,348      |
| Gain (loss) from unconsolidated affiliates              |            |              | 5,210                             | (1,406)   | 3,804        |
| Capital expenditures                                    | 388,639    | 43,234       | 35,534                            | 5,578     | 472,985      |
| <b>Year ended December 31, 2011</b>                     |            |              |                                   |           |              |
| Net revenues  | 826,436    | 1,290,732    | 590,709                           | 34,380    | 2,742,257    |
| Income (loss) from operations                           | 211,356    | 263,423      | 137,580                           | (112,778) | 499,581      |
| Depreciation and amortization                           | 62,844     | 85,723       | 53,764                            | 9,145     | 211,476      |
| (Loss) gain from unconsolidated affiliates              |            |              | (4,834)                           | 12,198    | 7,364        |
| Capital expenditures                                    | 206,081    | 51,701       | 25,488                            | 9,811     | 293,081      |
| <b>Year ended December 31, 2010</b>                     |            |              |                                   |           |              |
| Net revenues  | 825,847    | 997,262      | 602,257                           | 33,745    | 2,459,111    |
| (Loss) income from operations                           | (39,514)   | 181,175      | 125,318                           | (113,753) | 153,226      |
| Depreciation and amortization                           | 64,402     | 79,244       | 59,777                            | 8,964     | 212,387      |
| Loss from unconsolidated affiliates                     |            |              | (2,242)                           | (23,732)  | (25,974)     |
| Impairment losses                                       | 220,236    |              |                                   | 4,473     | 224,709      |
| Capital expenditures                                    | 198,282    | 118,398      | 41,215                            | 5,060     | 362,955      |
| <b>Balance sheet at December 31, 2012</b>               |            |              |                                   |           |              |
| Total assets  | 2,318,283  | 1,198,391    | 1,680,773                         | 446,610   | 5,644,057    |
| Investment in and advances to unconsolidated affiliates |            | 87           | 138,514                           | 65,905    | 204,506      |
| Goodwill and other intangible assets, net               | 1,025,505  | 226,047      | 779,787                           | 55,827    | 2,087,166    |
| <b>Balance sheet at December 31, 2011</b>               |            |              |                                   |           |              |
| Total assets  | 1,897,164  | 1,265,438    | 1,034,506                         | 409,238   | 4,606,346    |
| Investment in and advances to unconsolidated affiliates |            | 110          | 107,204                           | 66,802    | 174,116      |
| Goodwill and other intangible assets, net               | 925,822    | 226,234      | 394,018                           | 55,878    | 1,601,952    |

**17. Summarized Quarterly Data (Unaudited)**

The following table summarizes the quarterly results of operations for the years ended December 31, 2012 and 2011:

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|                                   | Fiscal Quarter |   |            |            |
|-----------------------------------|----------------|---|------------|------------|
|                                   | First          | Second<br>(in thousands, except per share data) | Third      | Fourth     |
| <b>2012</b>                       |                |   |            |            |
| Net revenues                      | \$ 736,059     | \$ 712,551                                      | \$ 707,044 | \$ 743,811 |
| Income from operations            | 142,615        | 128,015   | 98,666     | 73,293     |
| Net income                        | 78,619         | 66,667  | 46,446     | 20,239     |
| Earnings per common share:        |                |   |            |            |
| Basic earnings per common share   | \$ 0.83        | \$ 0.70   | \$ 0.49    | \$ 0.21    |
| Diluted earnings per common share | \$ 0.74        | \$ 0.63   | \$ 0.44    | \$ 0.19    |
| <b>2011</b>                       |                |   |            |            |
| Net revenues                      | \$ 667,023     | \$ 687,879                                      | \$ 710,905 | \$ 676,450 |
| Income from operations            | 122,735        | 140,592   | 130,335    | 105,919    |
| Net income                        | 51,528         | 75,989  | 70,803     | 44,031     |
| Earnings per common share:        |                |   |            |            |
| Basic earnings per common share   | \$ 0.53        | \$ 0.79   | \$ 0.73    | \$ 0.46    |
| Diluted earnings per common share | \$ 0.48        | \$ 0.71   | \$ 0.66    | \$ 0.41    |

Table of Contents

During the fourth quarter and third quarter of 2012, the Company incurred non-deductible lobbying costs of \$26.0 million and \$19.1 million, respectively, associated with its unsuccessful efforts to oppose an expansion of gaming in the state of Maryland.

**18. Related Party Transactions**

The Company currently leases 49,928 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and Chief Executive Officer. Rent expense for the years ended December 31, 2012, 2011 and 2010 amounted to \$1.0 million, \$0.9 million, and \$0.9 million, respectively. The leases for the office space all expire in May 2019, and the lease for the warehouse space expires in July 2013. The future minimum lease commitments relating to these leases at December 31, 2012 are \$7.3 million.

**19. Fair Value Measurements**

ASC 820, Fair Value Measurements and Disclosures, establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions, as there is little, if any, related market activity.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

The following tables set forth the assets measured at fair value on a recurring basis, by input level, in the consolidated balance sheets at December 31, 2012 and 2011 (in thousands):

| Balance Sheet Location | Quoted Prices in Active Markets for | Significant Other Observable Inputs | Significant Unobservable Inputs | December 31, 2012 Total |
|------------------------|-------------------------------------|-------------------------------------|---------------------------------|-------------------------|
|------------------------|-------------------------------------|-------------------------------------|---------------------------------|-------------------------|

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

|   |              | Identical Assets or<br>Liabilities (Level 1) | (Level 2) | (Level 3) |    |          |
|---|--------------|--|-----------|-----------|----|----------|
| <b>Assets:</b>                          |              |  |           |           |    |          |
| Investment in corporate debt securities | Other assets | \$   | \$        | 6,790     | \$ | \$ 6,790 |

|   | Balance Sheet<br>Location | Quoted Prices in<br>Active Markets for<br>Identical Assets or<br>Liabilities (Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) | December 31, 2011<br>Total |          |
|---|---------------------------|--|---|---|----------------------------|----------|
| <b>Assets:</b>                          |                           |  |   |   |                            |          |
| Investment in corporate debt securities | Other assets              | \$   | \$  | 6,790   | \$                         | \$ 6,790 |

The valuation technique used to measure the fair value of the investment in corporate debt securities was the market approach. See Note 4 for a description of the input used in calculating the fair value measurement of investment in corporate debt securities.

There were no long-lived assets measured at fair value on a non-recurring basis during the years ended December 31, 2012 and 2011.

Table of Contents

**20. Insurance Recoveries and Deductibles**

*Hollywood Casino Joliet Fire*

On March 20, 2009, Hollywood Casino Joliet, which was undergoing a \$55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and the Company began construction of a new land-based pavilion. In December 2010, the first phase of the new permanent land-based pavilion was opened to the public and in January 2011 the final phase, including a sports bar, was completed.

At the time of the fire, the Company carried a builders' risk insurance policy for the on-going renovations with a policy limit of \$57 million, inclusive of \$14 million for delay in completion and \$43 million for property damage. The builders' risk insurance policy included a \$50,000 property damage deductible and a 30-day delay in completion deductible for the peril of fire. In addition, the Company carried comprehensive business interruption and property damage insurance for the operational components of Hollywood Casino Joliet with an overall limit of \$228 million. The operational insurance policy included a \$2.5 million property damage deductible and a 48-hour business interruption deductible for the peril of fire.

The Company received \$81.2 million in insurance proceeds related to the fire at Hollywood Casino Joliet, with \$18.6 million and \$42.0 million received during the years ended December 31, 2011 and 2010, respectively. As the insurance recovery amount exceeded the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Hollywood Casino Joliet in 2010, the Company recorded a pre-tax gain of \$18.5 million and \$7.5 million during the years ended December 31, 2011 and 2010, respectively. During the second quarter of 2011, the insurance claim for the fire at Hollywood Casino Joliet was settled and no further proceeds will be received.

*Hollywood Casino Tunica Flood*

On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. Due to the flooding, access to the property was temporarily cut off and the property sustained minor damage. The property reopened on May 25, 2011.

At the time of the flood, the Company carried property insurance coverage with a flood limit of \$300 million for both property damage and business interruption applicable to this event. This coverage included a \$5 million property damage and two day business interruption deductible for the peril of flood.

The Company received \$15.4 million in insurance proceeds related to the flood at Hollywood Casino Tunica, with \$8.4 million and \$7.0 million received during the years ended December 31, 2012 and 2011, respectively. As the insurance recovery amount exceeded the net book value of assets believed to be damaged and other costs incurred as a result of the flood in 2012, the Company recorded a pre-tax gain of \$7.2 million during the year ended December 31, 2012. During the second quarter of 2012, the insurance claim for the flood at Hollywood Casino Tunica was settled and as such no further proceeds will be received.

During the year ended December 31, 2011, the Company recorded a \$5.2 million pre-tax loss for the insurance deductibles for property damage and business interruption.

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

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

The Company's management, under the supervision and with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's 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), as of December 31, 2012, which is the end of the period covered by this Annual Report on Form 10-K/A. In designing and

Table of Contents

evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well-designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2012 to ensure that information required to be disclosed by the Company in reports we file or submit under the Exchange Act is (i) recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the United States Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2012, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, 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.

Our management assessed the effectiveness of our internal control over financial reporting, and concluded that it was effective as of December 31, 2012. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*.

Ernst & Young LLP, the Company's independent registered public accounting firm, that audited the consolidated financial statements included in this Annual Report on Form 10-K/A issued an attestation report on the Company's internal control over financial reporting which immediately follows this report.



Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors

Penn National Gaming, Inc. and Subsidiaries

We have audited Penn National Gaming, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Penn National Gaming, Inc. and Subsidiaries' 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, Penn National Gaming, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, 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 Penn National Gaming, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31,

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-K/A

2012 of Penn National Gaming, Inc. and Subsidiaries and our report dated February 22, 2013 expressed an unqualified opinion.

/s/ ERNST & YOUNG LLP  
Philadelphia, Pennsylvania  
February 22, 2013

Table of Contents

**ITEM 9B. OTHER INFORMATION**

None

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) 1 and 2.

Financial Statements and Financial Statement Schedules. The following is a list of the Consolidated Financial Statements of the Company and its subsidiaries and supplementary data filed as part of Item 8 hereof:  
Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets as of December 31, 2012 and 2011  
Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010  
Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011 and 2010  
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2012, 2011 and 2010  
Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010  
All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. Exhibits, Including Those Incorporated by Reference.

The exhibits to this Report are listed on the accompanying index to exhibits and are filed as part of this annual report on Form 10-K/A.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PENN NATIONAL GAMING, INC.

By: */s/ PETER M. CARLINO*  
 Peter M. Carlino  
*Chairman of the Board and*  
*Chief Executive Officer*

Dated: August 8, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>  | <b>Title</b>   | <b>Date</b>    |
|---|--|----------------|
| <i>/s/ PETER M. CARLINO</i><br>Peter M. Carlino                 | Chairman of the Board, Chief Executive Officer and Director<br>(Principal Executive Officer) | August 8, 2013 |
| <i>/s/ WILLIAM J. CLIFFORD</i><br>William J. Clifford           | Senior Vice President Finance and Chief Financial Officer<br>(Principal Financial Officer)   | August 8, 2013 |
| <i>/s/ DESIREE A. BURKE</i><br>Desiree A. Burke                 | Vice President and Chief Accounting Officer (Principal<br>Accounting Officer)                | August 8, 2013 |
| <i>/s/ HAROLD CRAMER</i><br>Harold Cramer                       | Director   | August 8, 2013 |
| <i>/s/ WESLEY R. EDENS</i><br>Wesley R. Edens                   | Director   | August 8, 2013 |
| <i>/s/ DAVID A. HANDLER</i><br>David A. Handler                 | Director   | August 8, 2013 |
| <i>/s/ JOHN M. JACQUEMIN</i><br>John M. Jacquemin               | Director   | August 8, 2013 |
| <i>/s/ RONALD J. NAPLES</i><br>Ronald J. Naples                 | Director   | August 8, 2013 |
| <i>/s/ SAUL V. REIBSTEIN</i><br>Saul V. Reibstein               | Director   | August 8, 2013 |
| <i>/s/ BARBARA Z. SHATTUCK KOHN</i><br>Barbara Z. Shattuck Kohn | Director   | August 8, 2013 |



**EXHIBIT INDEX**

| <b>Exhibit</b> | <b>Description of Exhibit</b>  |
|----------------|--|
| 23.2*          | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.   |
| 31.3*          | CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.                            |
| 31.4*          | CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.                            |
| 32.3*          | CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes- Oxley Act of 2002. |
| 32.4*          | CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes- Oxley Act of 2002. |

---

\* Filed herewith.