

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 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, PA 19610**  
(Address of principal executive offices) (Zip Code)

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

**Not Applicable**  
(Former name, former address, and former fiscal year, if changed since last report)

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title	Outstanding as of October 31, 2012
Common Stock, par value \$.01 per share	76,690,695 (includes 286,255 shares of restricted stock)

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although Penn National Gaming, Inc. and its subsidiaries (collectively, the “Company”) believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors that could cause actual results to differ from expectations include, but are not limited to, risks related to the following: our ability to receive and maintain, or delays in obtaining, the regulatory approvals required to own, develop and/or operate our facilities, or other delays or impediments to completing our planned acquisitions or projects, including favorable resolution of any related litigation, including the appeal by the Ohio Roundtable addressing the legality of video lottery terminals in Ohio and certain lawsuits to protect our interests in Iowa; our ability to secure state and local permits and approvals necessary for construction; construction factors, including delays, unexpected remediation costs, local opposition and increased cost of labor and materials; our ability to successfully integrate Harrah’s St. Louis into our existing business; our ability to reach agreements with the thoroughbred and harness horseman in Ohio and to otherwise maintain agreements with the horseman in other jurisdictions, pari-mutuel clerks and other organized labor groups; the passage of state, federal or local legislation (including referenda) that would expand, restrict, further tax, prevent or negatively impact operations in or adjacent to the jurisdictions in which we do or seek to do business (such as the expansion of gaming under consideration in Maryland and Illinois or a smoking ban at any of our facilities); the effects of local and national economic, credit, capital market, housing, and energy conditions on the economy in general and on the gaming and lodging industries in particular; the activities of our competitors and the emergence of new competitors (traditional and internet based); increases in any form of taxation at any of our properties or at the corporate level; our ability to identify attractive acquisition and development opportunities and to agree to terms with partners for such transactions; the costs and risks involved in the pursuit of such opportunities and our ability to complete the acquisition or development of, and achieve the expected returns from, such opportunities; our expectations for the continued availability and cost of capital; the outcome of pending legal proceedings; changes in accounting standards; our dependence on key personnel; the impact of terrorism and other international hostilities; the impact of weather; and other factors as discussed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, subsequent Quarterly Reports on Form 10-Q and Current Reports on Form 8-K as filed with the United States Securities and Exchange Commission. The Company does not intend to update publicly any forward-looking statements except as required by law.

[Table of Contents](#)

**PENN NATIONAL GAMING, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

<a href="#">PART I.</a>	<a href="#">FINANCIAL INFORMATION</a>	4
<a href="#">ITEM 1.</a>	<a href="#">FINANCIAL STATEMENTS (Unaudited)</a>	4
	<a href="#">Condensed Consolidated Balance Sheets — September 30, 2012 and December 31, 2011</a>	4
	<a href="#">Condensed Consolidated Statements of Income — Three and Nine Months Ended September 30, 2012 and 2011</a>	5
	<a href="#">Condensed Consolidated Statements of Comprehensive Income — Three and Nine Months Ended September 30, 2012 and 2011</a>	6
	<a href="#">Condensed Consolidated Statements of Changes in Shareholders’ Equity — Nine Months Ended September 30, 2012 and 2011</a>	7
	<a href="#">Condensed Consolidated Statements of Cash Flows — Nine Months Ended September 30, 2012 and 2011</a>	8
	<a href="#">Notes to the Condensed Consolidated Financial Statements</a>	9
<a href="#">ITEM 2.</a>	<a href="#">MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</a>	22
<a href="#">ITEM 3.</a>	<a href="#">QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</a>	37
<a href="#">ITEM 4.</a>	<a href="#">CONTROLS AND PROCEDURES</a>	38
<a href="#">PART II.</a>	<a href="#">OTHER INFORMATION</a>	38
<a href="#">ITEM 1.</a>	<a href="#">LEGAL PROCEEDINGS</a>	38
<a href="#">ITEM 1A.</a>	<a href="#">RISK FACTORS</a>	38
<a href="#">ITEM 2.</a>	<a href="#">UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</a>	38
<a href="#">ITEM 3.</a>	<a href="#">DEFAULTS UPON SENIOR SECURITIES</a>	38
<a href="#">ITEM 4.</a>	<a href="#">MINE SAFETY DISCLOSURES</a>	38
<a href="#">ITEM 5.</a>	<a href="#">OTHER INFORMATION</a>	38
<a href="#">ITEM 6.</a>	<a href="#">EXHIBITS</a>	38
	<a href="#">SIGNATURES</a>	39
	<a href="#">EXHIBIT INDEX</a>	40

[Table of Contents](#)

**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

**Condensed Consolidated Balance Sheets**  
(in thousands, except share and per share data)

	September 30, 2012 (unaudited)	December 31, 2011
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 217,432	\$ 238,440
Receivables, net of allowance for doubtful accounts of \$3,816 and \$4,115 at September 30, 2012 and December 31, 2011, respectively	56,851	55,455
Insurance receivable	—	1,072
Prepaid expenses	81,658	39,801
Deferred income taxes	36,146	32,306
Other current assets	47,040	48,715
Total current assets	<u>439,127</u>	<u>415,789</u>
<b>Property and equipment, net</b>	2,495,122	2,277,200
<b>Other assets</b>		
Investment in and advances to unconsolidated affiliates	208,748	174,116
Goodwill	1,176,358	1,180,359
Other intangible assets	526,382	421,593
Debt issuance costs, net of accumulated amortization of \$9,530 and \$4,860 at September 30, 2012 and December 31, 2011, respectively	28,656	33,310
Other assets	93,803	103,979
Total other assets	<u>2,033,947</u>	<u>1,913,357</u>
<b>Total assets</b>	<u>\$ 4,968,196</u>	<u>\$ 4,606,346</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Current maturities of long-term debt	\$ 46,974	\$ 44,559
Accounts payable	57,605	39,582
Accrued expenses	108,588	113,699
Accrued interest	11,409	17,947
Accrued salaries and wages	88,161	85,285
Gaming, pari-mutuel, property, and other taxes	59,480	49,559
Income taxes	—	5,696
Insurance financing	2,561	16,363
Other current liabilities	61,810	53,650
Total current liabilities	<u>436,588</u>	<u>426,340</u>
<b>Long-term liabilities</b>		
Long-term debt, net of current maturities	2,129,475	1,998,606
Deferred income taxes	174,155	167,576
Noncurrent tax liabilities	21,411	33,872
Other noncurrent liabilities	7,686	8,321
Total long-term liabilities	<u>2,332,727</u>	<u>2,208,375</u>
<b>Shareholders' equity</b>		
Preferred stock (\$.01 par value, 1,000,000 shares authorized, 12,275 shares issued and outstanding at September 30, 2012 and December 31, 2011)	—	—
Common stock (\$.01 par value, 200,000,000 shares authorized, 76,661,686 and 76,213,126 shares issued at September 30, 2012 and December 31, 2011, respectively)	761	756
Additional paid-in capital	1,420,169	1,385,355
Retained earnings	774,934	583,202
Accumulated other comprehensive income	3,017	2,318
Total shareholders' equity	<u>2,198,881</u>	<u>1,971,631</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 4,968,196</u>	<u>\$ 4,606,346</u>

See accompanying notes to the condensed consolidated financial statements.

[Table of Contents](#)

**Penn National Gaming, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Income**  
(in thousands, except per share data)  
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
Gaming	\$ 633,836	\$ 636,389	\$ 1,924,759	\$ 1,868,373
Food, beverage and other	103,735	109,681	326,598	289,361

Management service fee	4,347	4,476	11,404	11,830
Revenues	741,918	750,546	2,262,761	2,169,564
Less promotional allowances	(34,874)	(39,641)	(107,107)	(103,757)
Net revenues	707,044	710,905	2,155,654	2,065,807
<b>Operating expenses</b>				
Gaming	327,489	331,496	998,533	979,285
Food, beverage and other	80,875	87,952	253,664	231,801
General and administrative	137,615	108,897	368,863	314,695
Depreciation and amortization	62,399	52,195	172,527	159,583
Insurance recoveries, net of deductible charges	—	30	(7,229)	(13,219)
Total operating expenses	608,378	580,570	1,786,358	1,672,145
Income from operations	98,666	130,335	369,296	393,662
<b>Other income (expenses)</b>				
Interest expense	(19,953)	(23,514)	(55,819)	(78,649)
Interest income	218	68	683	217
Gain from unconsolidated affiliates	807	17,293	3,546	15,370
Loss on early extinguishment of debt	—	(17,838)	—	(17,838)
Other	(1,954)	2,737	(1,483)	393
Total other expenses	(20,882)	(21,254)	(53,073)	(80,507)
<b>Income from operations before income taxes</b>	77,784	109,081	316,223	313,155
Taxes on income	31,338	38,278	124,491	114,835
<b>Net income</b>	<u>\$ 46,446</u>	<u>\$ 70,803</u>	<u>\$ 191,732</u>	<u>\$ 198,320</u>
<b>Earnings per common share:</b>				
Basic earnings per common share	\$ 0.49	\$ 0.73	\$ 2.03	\$ 2.05
Diluted earnings per common share	\$ 0.44	\$ 0.66	\$ 1.81	\$ 1.85

See accompanying notes to the condensed consolidated financial statements.

5

[Table of Contents](#)

**Penn National Gaming, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Comprehensive Income**  
(in thousands) (unaudited)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Net income	\$ 46,446	\$ 70,803	\$ 191,732	\$ 198,320
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 \$9 and \$252, respectively	—	(16)	—	(446)
Less: Reclassification adjustments for losses included in net income, net of income taxes of \$999 and \$4,852, respectively	—	1,773	—	8,608
Change in fair value of interest rate swap contracts, net	—	1,757	—	8,162
Foreign currency translation adjustment during the period	732	(1,107)	565	(610)
Unrealized holding gains (losses) on corporate debt securities arising during the period	49	(546)	134	364
Other comprehensive income	781	104	699	7,916
Comprehensive income	<u>\$ 47,227</u>	<u>\$ 70,907</u>	<u>\$ 192,431</u>	<u>\$ 206,236</u>

See accompanying notes to the condensed consolidated financial statements.

6

[Table of Contents](#)

**Penn National Gaming, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Changes in Shareholders' Equity**  
(in thousands, except share data) (unaudited)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
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 \$2,317	—	—	462,009	5	27,714	—	—	27,719

Share activity	—	—	(755,517)	(8)	(27,028)	—	—	(27,036)
Restricted stock activity	—	—	95,995	—	3,319	—	—	3,319
Change in fair value of interest rate swap contracts, net of income taxes of \$4,600	—	—	—	—	—	—	8,162	8,162
Change in fair value of corporate debt securities	—	—	—	—	—	—	364	364
Foreign currency translation adjustment	—	—	—	—	—	—	(610)	(610)
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	—	—	—	—	—	198,320	—	198,320
Balance, September 30, 2011	<u>12,275</u>	<u>\$ —</u>	<u>78,216,509</u>	<u>\$ 776</u>	<u>\$ 1,450,937</u>	<u>\$ 539,171</u>	<u>\$ 31</u>	<u>\$ 1,990,915</u>
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 \$2,932	—	—	452,636	5	31,465	—	—	31,470
Restricted stock activity	—	—	(4,076)	—	3,349	—	—	3,349
Change in fair value of corporate debt securities	—	—	—	—	—	—	134	134
Foreign currency translation adjustment	—	—	—	—	—	—	565	565
Net income	—	—	—	—	—	191,732	—	191,732
Balance, September 30, 2012	<u>12,275</u>	<u>\$ —</u>	<u>76,661,686</u>	<u>\$ 761</u>	<u>\$ 1,420,169</u>	<u>\$ 774,934</u>	<u>\$ 3,017</u>	<u>\$ 2,198,881</u>

See accompanying notes to the condensed consolidated financial statements.

[Table of Contents](#)

**Penn National Gaming, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
(in thousands) (unaudited)

Nine Months Ended September 30,	2012	2011
<b>Operating activities</b>		
Net income	\$ 191,732	\$ 198,320
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	172,527	159,583
Amortization of items charged to interest expense	4,904	7,964
Gain on sale of fixed assets	(1,206)	(89)
Gain from unconsolidated affiliates	(3,546)	(15,370)
Distributions of earnings from unconsolidated affiliates	8,500	—
Loss on early extinguishment of debt	—	12,212
Deferred income taxes	4,447	24,946
Charge for stock-based compensation	22,195	18,456
(Increase) decrease, net of businesses acquired		
Accounts receivable	(3,754)	6,522
Insurance receivable	1,072	(955)
Prepaid expenses and other current assets	12,002	3,212
Other assets	(7,714)	(1,646)
(Decrease) increase, net of businesses acquired		
Accounts payable	(2,269)	3,599
Accrued expenses	(5,111)	(3,229)
Accrued interest	(6,538)	(11,496)
Accrued salaries and wages	2,876	(3,455)
Gaming, pari-mutuel, property and other taxes	9,921	4,367
Income taxes	(56,533)	34,700
Other current and noncurrent liabilities	7,525	2,493
Other noncurrent tax liabilities	(13,270)	(2,062)
Net cash provided by operating activities	<u>337,760</u>	<u>438,072</u>
<b>Investing activities</b>		
Expenditures for property and equipment, net of reimbursements	(364,952)	(203,509)
Proceeds from sale of property and equipment	3,144	11,643
Insurance proceeds related to damaged property and equipment	—	3,862
Investment in joint ventures, net of proceeds received	(39,600)	(74,198)
Decrease in cash in escrow	15,800	29,900
Acquisitions of businesses and gaming licenses, net of cash acquired	(105,016)	9,585
Net cash used in investing activities	<u>(490,624)</u>	<u>(222,717)</u>
<b>Financing activities</b>		
Proceeds from exercise of options	9,692	10,265
Repurchase of common stock	—	(27,036)
Proceeds from issuance of long-term debt, net of issuance costs	256,984	1,651,610
Principal payments on long-term debt	(133,950)	(1,881,872)
Increase in other long-term obligations	10,000	—
Proceeds from insurance financing	—	892
Payments on insurance financing	(13,802)	(10,095)
Tax benefit from stock options exercised	2,932	2,317
Net cash provided by (used in) financing activities	<u>131,856</u>	<u>(253,919)</u>
<b>Net decrease in cash and cash equivalents</b>	<u>(21,008)</u>	<u>(38,564)</u>
Cash and cash equivalents at beginning of year	238,440	246,385

Cash and cash equivalents at end of period	\$ 217,432	\$ 207,821
--	------------	------------

#### Supplemental disclosure

Cash paid for interest	\$ 65,460	\$ 85,381
Cash paid for income taxes	\$ 186,436	\$ 70,386

See accompanying notes to the condensed consolidated financial statements.

#### [Table of Contents](#)

### Penn National Gaming, Inc. and Subsidiaries Notes to the Condensed Consolidated Financial Statements (Unaudited)

#### 1. Organization 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. As of September 30, 2012, the Company owns, manages, or has ownership interests in twenty-seven 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. On October 8, 2012, the Company opened its twenty-eighth facility with Hollywood Casino Columbus in Ohio.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with United States (“U.S.”) generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The condensed consolidated financial statements include the accounts of Penn and its subsidiaries. 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.

The preparation of financial statements in conformity with GAAP 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.

Operating results for the nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2011 should be read in conjunction with these condensed consolidated financial statements. The December 31, 2011 financial information has been derived from the Company’s audited consolidated financial statements.

#### 2. Summary of Significant Accounting Policies

##### 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.

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 Financial Accounting Standards Board (the “FASB”) Accounting Standards Codification (“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 three and nine months ended September 30, 2012 and 2011 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Rooms	\$ 6,535	\$ 7,231	\$ 19,094	\$ 17,970

Food and beverage	26,089	29,586	80,804	78,275
Other	2,250	2,824	7,209	7,512
Total promotional allowances	<u>\$ 34,874</u>	<u>\$ 39,641</u>	<u>\$ 107,107</u>	<u>\$ 103,757</u>

The estimated cost of providing such complimentary services for the three and nine months ended September 30, 2012 and 2011 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Rooms	\$ 2,337	\$ 2,615	\$ 7,000	\$ 6,639
Food and beverage	18,095	20,383	54,750	56,647
Other	1,393	1,792	4,344	4,586
Total cost of complimentary services	<u>\$ 21,825</u>	<u>\$ 24,790</u>	<u>\$ 66,094</u>	<u>\$ 67,872</u>

### 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 three and nine months ended September 30, 2012, these expenses, which are recorded primarily within gaming expense in the condensed consolidated statements of income, were \$258.1 million and \$801.6 million, respectively, as compared to \$267.1 million and \$801.6 million for the three and nine months ended September 30, 2011, 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.

At September 30, 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 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 three and nine months ended September 30, 2012 and 2011 under the two-class method:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Net income	\$ 46,446	\$ 70,803	\$ 191,732	\$ 198,320
Net income applicable to preferred stock	8,990	13,433	37,165	37,619
Net income applicable to common stock	<u>\$ 37,456</u>	<u>\$ 57,370</u>	<u>\$ 154,567</u>	<u>\$ 160,701</u>

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 three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Determination of shares:				
Weighted-average common shares outstanding	76,336	78,242	76,196	78,264
Assumed conversion of dilutive employee stock-based awards	2,227	1,929	2,400	1,787
Assumed conversion of preferred stock	27,278	27,278	27,278	27,278
Diluted weighted-average common shares outstanding	<u>105,841</u>	<u>107,449</u>	<u>105,874</u>	<u>107,329</u>

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 price of the Company's Common Stock 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 price of the Company's Common Stock 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 price of the Company's Common Stock 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).

Options to purchase 4,353,529 shares and 3,132,000 shares were outstanding during the three and nine months ended September 30, 2012, respectively, but were not included in the computation of diluted EPS because they were antidilutive. Options to purchase 2,786,303 shares and 2,855,652 shares were outstanding during the three and nine months ended September 30, 2011, respectively, but were not included in the computation of diluted EPS because they were antidilutive.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
(in thousands, except per share data)				
<b>Calculation of basic EPS:</b>				
Net income applicable to common stock	\$ 37,456	\$ 57,370	\$ 154,567	\$ 160,701
Weighted-average common shares outstanding	76,336	78,242	76,196	78,264
Basic EPS	\$ 0.49	\$ 0.73	\$ 2.03	\$ 2.05
<b>Calculation of diluted EPS:</b>				
Net income	\$ 46,446	\$ 70,803	\$ 191,732	\$ 198,320
Diluted weighted-average common shares outstanding	105,841	107,449	105,874	107,329
Diluted EPS	\$ 0.44	\$ 0.66	\$ 1.81	\$ 1.85

### 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. Stock based compensation expense for the three and nine months ended September 30, 2012 was \$6.9 million

### [Table of Contents](#)

and \$22.2 million, respectively, as compared to \$6.1 million and \$18.5 million for the three and nine months ended September 30, 2011, respectively. 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 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. There is no expected dividend yield 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 September 30, 2012 and 2011:

	2012	2011
Risk-free interest rate	0.84%	2.04%
Expected volatility	45.78%	47.24%
Dividend yield	—	—
Weighted-average expected life (years)	6.64	5.77
Forfeiture rate	5.00%	5.00%

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 September 30, 2012, there was \$12.4 million of total unrecognized compensation cost that will be recognized over the grants remaining weighted average vesting period of 3.1 years. For the three and nine months ended September 30, 2012, the Company recognized \$1.0 million and \$3.5 million, respectively, of compensation expense associated with these awards, as compared to \$0.5 million and \$1.5 million for the three and nine months ended September 30, 2011, respectively.

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 September 30, 2012, there was \$9.8 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period of 2.9 years. For the three and nine months ended September 30, 2012, the Company recognized \$0.5 million and \$3.0 million, respectively, of compensation expense associated with these awards, as compared to \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2011, respectively.

### Accounting for Derivatives and Hedging Activities



The Company uses 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 September 30, 2012 and December 31, 2011. See Note 7 for details on the effect of derivative instruments on the condensed consolidated statements of income for the three and nine months ended September 30, 2011.

### 3. 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 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. Management does not believe that these amendments will have an impact on the consolidated financial statements.

In June 2011, the FASB issued amendments to guidance regarding the presentation of comprehensive income. 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,

---

[Table of Contents](#)

and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively. The Company adopted the guidance, 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, as of January 1, 2012. The Company has presented comprehensive income in two separate but consecutive statements.

#### 4. Pending Acquisition and Wholly Owned Development Projects

On May 7, 2012, the Company announced that it has entered into a definitive agreement to acquire 100% of the equity of Harrah's St. Louis gaming and lodging facility from Caesars Entertainment for a purchase price of approximately \$610 million. While the acquisition is a stock transaction, it will be treated as an asset transaction for tax purposes. This will enable 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. Upon closing the Company will re-brand Harrah's St. Louis with its Hollywood-themed brand. The purchase price of the transaction, which closed on November 2, 2012, was funded through an add-on to the Company's senior secured credit facility. See Note 14 for further details. Harrah's St. Louis 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 over 294 acres along the Missouri River and features approximately 109,000 square feet of gaming space with approximately 2,100 slot machines, 59 table games, 21 poker tables, a 500 guestroom hotel, nine dining and entertainment venues and structured and surface parking.

On May 29, 2012 and October 8, 2012, the Company opened its Hollywood Casino Toledo and Hollywood Casino Columbus projects in Ohio. As a result, during 2012, the Company capitalized \$105 million of costs which were recorded within other intangible assets on the condensed consolidated balance sheet.

#### 5. Investment In and Advances to Unconsolidated Affiliates

As of September 30, 2012, investment in and advances to unconsolidated affiliates represents 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. that owns and operates racetracks in Texas. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further details of accounting for investments in and advances to unconsolidated affiliates.

##### *Kansas Entertainment*

Kansas Entertainment opened its \$391 million facility, inclusive of licensing fees, 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. During the nine months ended September 30, 2012, the Company funded \$39.1 million for capital expenditures and other operating expenses, as compared to \$22.8 million and \$44.2 million during the three and nine months ended September 30, 2011, respectively. The Company received its first distribution from Kansas Entertainment which totaled \$8.5 million during the three months ended September 30, 2012.

#### 6. Property and Equipment

Property and equipment, net, consists of the following:

	September 30, 2012	December 31, 2011
	(in thousands)	
Land and improvements	\$ 378,864	\$ 362,402
Building and improvements	1,905,986	1,715,144
Furniture, fixtures, and equipment	1,112,515	1,021,362
Leasehold improvements	16,919	16,910
Construction in progress	314,333	256,459
Total property and equipment	3,728,617	3,372,277
Less accumulated depreciation	(1,233,495)	(1,095,077)
Property and equipment, net	<u>\$ 2,495,122</u>	<u>\$ 2,277,200</u>

14

#### [Table of Contents](#)

Total property and equipment, before accumulated depreciation, increased by \$356.3 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.

Depreciation expense, for property and equipment, totaled \$62.4 million and \$172.3 million for the three and nine months ended September 30, 2012, respectively, as compared to \$51.8 million and \$157.6 million for the three and nine months ended September 30, 2011, respectively. Interest capitalized in connection with major construction projects was \$2.4 million and \$8.3 million for the three and nine months ended September 30, 2012, respectively, as compared to \$1.7 million and \$3.5 million for the three and nine months ended September 30, 2011, respectively.

#### 7. Long-term Debt and Derivatives

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

	September 30, 2012	December 31, 2011
	(in thousands)	
Senior secured credit facility	\$ 1,840,875	\$ 1,715,750
\$325 million 8 ¾% senior subordinated notes due August 2019	325,000	325,000
Other long-term obligations	10,000	1,949
Capital leases	2,140	2,215
	<u>2,178,015</u>	<u>2,044,914</u>
Less current maturities of long-term debt	(46,974)	(44,559)

The following is a schedule of future minimum repayments of long-term debt as of September 30, 2012 (in thousands):

Within one year	\$ 46,974
1-3 years	142,074
3-5 years	959,235
Over 5 years	1,029,732
Total minimum payments	<u>\$ 2,178,015</u>

### Senior Secured Credit Facility

The Company's senior secured credit facility had a gross outstanding balance of \$1,840.9 million at September 30, 2012, consisting of \$444.0 million drawn under the revolving credit facility, a \$656.3 million Term Loan A facility, and a \$740.6 million Term Loan B facility. Additionally, at September 30, 2012, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$24.1 million, resulting in \$231.9 million of available borrowing capacity as of September 30, 2012 under the revolving credit facility. On November 1, 2012, the Company increased the size of its senior secured credit facility. See Note 14 for further details.

### 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 entitled 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.

### [Table of Contents](#)

### Covenants

The Company's senior secured credit facility and \$325 million 8<sup>3</sup>/<sub>4</sub>% 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 8<sup>3</sup>/<sub>4</sub>% 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 September 30, 2012, the Company was in compliance with all required financial covenants.

### Interest Rate Swap Contracts

There were no outstanding interest rate swap contracts as of September 30, 2012 and December 31, 2011. The effect of derivative instruments on the condensed consolidated statement of income for the three months ended September 30, 2011 was as follows (in thousands):

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

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Interest rate swap contracts	Interest expense	\$ (36)
Total		<u>\$ (36)</u>

The effect of derivative instruments on the condensed consolidated statement of income for the nine months ended September 30, 2011 was as follows (in thousands):

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

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Interest rate swap contracts	Interest expense	\$ (39)
Total		<u>\$ (39)</u>

In addition, during the three and nine months ended September 30, 2011, the Company amortized to interest expense \$2.8 million and \$5.3 million, respectively, in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, "Derivatives and Hedging."

[Table of Contents](#)

**8. Income Taxes**

A reconciliation of the liability for unrecognized tax benefits is as follows:

	<b>Noncurrent tax liabilities</b>
	<b>(in thousands)</b>
Balance at January 1, 2012	\$ 33,872
Additions based on current year positions	77
Additions based on prior year positions	3,772
Payments made on account	(12,839)
Decreases due to settlements and/or reduction in reserves	(4,377)
Currency translation adjustments	906
Balance at September 30, 2012	<u>\$ 21,411</u>

The decrease in the Company's liability for unrecognized tax benefits during the nine months ended September 30, 2012 was primarily due to payments the Company made to the Canada Revenue Agency ("CRA") relating to reassessments issued of a Canadian subsidiary of Penn for the 2004 through 2006 taxation years. The Company has appealed these reassessments and believes the matter will be ultimately settled in Competent Authority.

The Company's effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 40.3% and 39.4% for the three and nine months ended September 30, 2012, respectively, as compared to 35.1% and 36.7% for the three and nine months ended September 30, 2011, respectively. The primary reason for the increase for the nine months ended September 30, 2012 is due to the reversal of previously recorded unrecognized tax benefit reserves in the second quarter of 2011 as well as favorable state income tax benefits resulting from the impact of certain subsidiary restructurings completed in the third quarter of 2011. The increase in the effective tax rate for the three months ended September 30, 2012 compared to the corresponding period in the prior year is due to the previously mentioned lobbying expenses partially offset by unrecognized tax benefit reversals recorded during the three months ended September 30, 2012.

At September 30, 2012, prepaid expenses within the condensed consolidated balance sheet include prepaid income taxes of \$53.1 million.

**9. 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.

Gaming licenses in Iowa are typically issued jointly to a gaming operator and a local charitable organization known as a Qualified Sponsoring Organization ("QSO"). The agreement between the Company's gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the "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 MHRD 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

[Table of Contents](#)

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 will be 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. Further, the Belle's ability to continue its

operations may also be impacted by its ability to renew or extend its existing docking lease, which expires in January 2013, or to locate a suitable site to construct a land-based facility and the results of the request for proposal process initiated by the IRGC (with submissions due November 5, 2012). Subsequent to September 30, 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. Argosy Casino Sioux City has goodwill and other intangible assets of \$92.8 million at September 30, 2012. Additionally, this facility had net revenues and income from operations of \$43.4 million and \$13.4 million, respectively, for the nine months ended September 30, 2012, which represented 2.0% and 3.6% of the Company's consolidated results. Any disruptions in Argosy Casino Sioux City's operations related to the items described above could result in a significant non-cash impairment charge 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. The amount in damages to be paid will be determined at an upcoming 2013 trial. The Company plans to appeal the adverse ruling on liability after the trial for damages has concluded. The Company believes it has meritorious defenses against the suit upon appeal, intends to vigorously defend itself and does not believe a loss is probable.

## 10. Segment Information

The Company has aggregated its properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how the Company's Chief Operating Decision Maker 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 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 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, and the Company's 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway. Additionally, beginning in the third quarter of 2012, transaction costs associated with the Harrah's St. Louis acquisition are reported in this segment.

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 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, "Segment Reporting," and Bullwhackers.

## [Table of Contents](#)

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 (in thousands)	Other	Total
<b>Three months ended September 30, 2012</b>					
Net revenues	\$ 247,287	\$ 324,603	\$ 128,604	\$ 6,550	\$ 707,044
Income (loss) from operations	55,088	68,078	26,496	(50,996)	98,666
Depreciation and amortization	24,791	22,430	11,028	4,150	62,399
Gain (loss) from unconsolidated affiliates	—	—	1,036	(229)	807
Capital expenditures	94,562	8,376	6,770	1,066	110,774
<b>Three months ended September 30, 2011</b>					
Net revenues	205,333	350,278	148,722	6,572	710,905
Income (loss) from operations	49,167	72,276	36,604	(27,712)	130,335
Depreciation and amortization	15,731	21,556	12,735	2,173	52,195
(Loss) gain from unconsolidated affiliates	—	—	(1,973)	19,266	17,293
Capital expenditures	70,490	15,056	5,875	4,838	96,259
<b>Nine months ended September 30, 2012</b>					
Net revenues	670,373	1,043,884	415,729	25,668	2,155,654
Income (loss) from operations	148,509	228,700	108,739	(116,652)	369,296
Depreciation and amortization	61,989	66,455	33,627	10,456	172,527
Gain (loss) from unconsolidated affiliates	—	—	3,991	(445)	3,546
Capital expenditures	305,521	34,917	19,583	4,931	364,952

**Nine months ended September 30, 2011**

Net revenues	633,547	957,275	450,322	24,663	2,065,807
Income (loss) from operations	171,651	201,500	105,397	(84,886)	393,662
Depreciation and amortization	46,983	63,238	42,240	7,122	159,583
(Loss) gain from unconsolidated affiliates	—	—	(3,098)	18,468	15,370
Capital expenditures	138,228	40,511	17,929	6,841	203,509

**Balance sheet at September 30, 2012**

Total assets	2,275,464	1,220,582	1,054,192	417,958	4,968,196
Investment in and advances to unconsolidated affiliates	—	87	141,794	66,867	208,748
Goodwill and other intangible assets, net	1,026,838	226,047	394,018	55,837	1,702,740

**Balance sheet at December 31, 2011**

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

**11. 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.

*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 12). The fair value of the

[Table of Contents](#)

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):

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 217,432	\$ 217,432	\$ 238,440	\$ 238,440
Investment in corporate debt securities	6,790	6,790	6,790	6,790
<b>Financial liabilities:</b>				
<b>Long-term debt</b>				
Senior secured credit facility	1,839,309	1,842,727	1,714,001	1,716,720
Senior subordinated notes	325,000	365,625	325,000	353,438
Other long-term obligations	10,000	10,000	1,949	1,949

**12. 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 condensed consolidated balance sheets at September 30, 2012 and December 31, 2011 (in thousands):

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	September 30, 2012 Total
<b>Assets:</b>					
Investment in corporate debt securities	Other assets	\$ —	\$ 6,790	\$ —	\$ 6,790

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2011 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 11 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 nine months ended September 30, 2012.

[Table of Contents](#)

**13. Insurance Recoveries and Deductibles**

*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 has received \$15.4 million in insurance proceeds related to the flood at Hollywood Casino Tunica, with \$8.4 million received during the nine months ended September 30, 2012. 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, the Company recorded a pre-tax gain of \$7.2 million during the nine months ended September 30, 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.

**14. Subsequent Events**

On November 1, 2012, the Company raised \$915 million of additional funds through an add-on to its existing senior secured credit facility at the same terms and conditions as its existing facility. The Company issued \$515 million in variable rate Term Loan B due in July 2018 and \$400 million in variable rate Term Loan A due July 2016. Additionally, the Company increased its revolving borrowing capacity to \$785 million from \$700 million. The proceeds from the issuance 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.

[Table of Contents](#)

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Our Operations**

We are a leading, diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of September 30, 2012, we own, manage, or have ownership interests in twenty-seven 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. On October 8, 2012, we opened our twenty-eighth facility with Hollywood Casino Columbus in Ohio. We believe that our portfolio of assets provides us with diversified cash flow from operations.

We have made significant acquisitions in the past, and expect to continue to pursue additional acquisition and development opportunities in the future. In 1997, we began our 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, we have continued to expand our 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") in June 2011), 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, we, along with our joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012 and in Ohio, we opened our Hollywood Casino Toledo facility on May 29, 2012 and our Hollywood Casino Columbus facility on October 8, 2012. Finally, on May 7, 2012, we announced a definitive agreement to acquire Harrah's St. Louis facility, which closed on November 2, 2012.

The vast majority of our revenue is gaming revenue, derived primarily from gaming on slot machines (which represented approximately 88% and 93% of our gaming revenue in 2011 and 2010, respectively) and to a lesser extent, table games, which is highly dependent upon the volume and spending levels of customers at our properties. Other revenues are derived from our management service fee from Casino Rama, our hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities, and our racing operations. Our racing revenue includes our share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, our share of wagering from import and export simulcasting, and our share of wagering from our off-track wagering facilities.

Key performance indicators related to gaming revenue are slot handle and table game drop (volume indicators) and “win” or “hold” percentage. Our typical property slot hold percentage is in the range of 6% to 10% of slot handle, and our typical table game win percentage is in the range of 12% to 25% of table game drop.

Slot handle is the gross amount wagered for the period cited. The win or hold percentage is the net amount of gaming wins and losses, with liabilities recognized for accruals related to the anticipated payout of progressive jackpots. Our slot hold percentages have consistently been in the 6% to 10% range over the past several years. Given the stability in our slot hold percentages, we have not experienced significant impacts to earnings from changes in these percentages.

For table games, customers usually purchase cash chips at the gaming tables. The cash and markers (extensions of credit granted to certain credit worthy customers) are deposited in the gaming table’s drop box. Table game win is the amount of drop that is retained and recorded as casino gaming revenue, with liabilities recognized for funds deposited by customers before gaming play occurs and for unredeemed gaming chips. As we are focused on regional gaming markets, our table win percentages are fairly stable as the majority of these markets do not regularly experience high-end play which can lead to volatility in win percentages. Therefore, changes in table game win percentages do not typically have a material impact to our earnings. However, as discussed in our analysis of gaming revenues in a later section of this management’s discussion and analysis, the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and in March 2012 at Hollywood Casino Bangor has led to an increase in our gaming revenues and earnings in our East/West segment for the nine months ended September 30, 2012.

Our properties generate significant operating cash flow, since most of our revenue is cash-based from slot machines, table games, and pari-mutuel wagering. Our business is capital intensive, and we rely on cash flow from our properties to generate operating cash to repay debt, fund capital maintenance expenditures, fund new capital projects at existing properties and provide excess cash for future development and acquisitions.

We continue to expand our gaming operations through the implementation and execution of a disciplined capital expenditure program at our existing properties, the pursuit of strategic acquisitions and the development of new gaming properties, particularly in

---

## [Table of Contents](#)

attractive regional markets. Current capital projects are ongoing at several of our properties. Additional information regarding our capital projects is discussed in detail in the section entitled “Liquidity and Capital Resources—Capital Expenditures” below.

## **Segment Information**

We have aggregated our properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how our Chief Operating Decision Maker reviews and assesses our 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 our Casino Rama management service contract and the Mahoning Valley and Dayton Raceway projects which we anticipate 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 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, and includes our 50% investment in Kansas Entertainment, LLC (“Kansas Entertainment”), which owns the Hollywood Casino at Kansas Speedway. Additionally, Hollywood Casino St. Louis (formerly Harrah’s St. Louis which was acquired from Caesars Entertainment on November 2, 2012) is included in this segment beginning with acquisition related costs in the third quarter of 2012.

The Other category consists of our standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and our joint venture interests in Sam Houston Race Park, Valley Race Park and Freehold Raceway. It also included our joint venture interest in the Maryland Jockey Club which was sold in July 2011. If we are successful in obtaining gaming operations at these locations, they would be assigned to one of our regional executives and reported in their respective reportable segment. The Other category also includes our corporate overhead operations which does not meet the definition of an operating segment under Accounting Standards Codification 280, “Segment Reporting,” and our Bullwhackers property.

## **Executive Summary**

Economic conditions continue to impact the overall domestic gaming industry as well as operating results. We believe that current economic conditions, including, but not limited to, high unemployment levels, low levels of consumer confidence, and increased stock market volatility, have resulted in reduced levels of discretionary consumer spending compared to historical levels.

We believe our strengths include our relatively low leverage ratios compared to the regional casino companies that we directly compete against and the ability of our operations to generate positive cash flow. These two factors have allowed us to develop what we believe to be attractive future growth opportunities. We have also made investments in joint ventures and certain racetrack operations that we believe may allow us to capitalize on additional gaming opportunities in certain states if legislation or referenda are passed that permit and/or expand gaming in these jurisdictions.



## Financial Highlights:

We reported net revenues and income from operations of \$707.0 million and \$98.7 million, respectively, for the three months ended September 30, 2012 compared to \$710.9 million and \$130.3 million, respectively, for the corresponding period in the prior year and net revenues and income from operations of \$2,155.7 million and \$369.3 million, respectively, for the nine months ended September 30, 2012 compared to \$2,065.8 million and \$393.7 million, respectively, for the corresponding period in the prior year. The major factors affecting our results for the three and nine months ended September 30, 2012, as compared to the three and nine months ended September 30, 2011, were:

- The acquisition of the M Resort on June 1, 2011.
- An increase in gaming revenue at Hollywood Casino at Charles Town Races primarily due to the continued impact from the introduction of table games in July 2010 coupled with mild weather in the first quarter of 2012.
- The partial opening of a casino complex at the Arundel Mills mall in Maryland in June 2012 and its second phase opening in mid-September 2012, which negatively impacted Hollywood Casino at Charles Town Races and Hollywood Casino Perryville.

23

## [Table of Contents](#)

- The introduction of table games at Hollywood Casino Bangor on March 16, 2012, which was partially offset by the opening of a new casino in Oxford, Maine in June 2012.
- An increase in gaming revenue at Zia Park Casino due to strengthening regional economic conditions.
- The opening of Hollywood Casino Toledo on May 29, 2012, which generated \$57.5 million and \$82.8 million of net revenues for the three and nine months ended September 30, 2012, respectively.
- New competition in our Midwest segment, namely a new casino opening in July 2011 near Hollywood Casino Aurora and Hollywood Casino Joliet, as well as a recent opening on June 1, 2012 of a new racino in Columbus, Ohio, which has negatively impacted Hollywood Casino Lawrenceburg. This impact was partially mitigated by the expiration of the 3% surcharge in July 2011 for Hollywood Casino Aurora and Hollywood Casino Joliet, as well as decreased marketing and payroll costs at these three properties due to a realignment of costs with business demand.
- Pre-tax insurance gain of \$18.5 million at Hollywood Casino Joliet during the nine months ended September 30, 2011.
- The February 3, 2012 opening of our joint venture, Hollywood Casino at Kansas Speedway, which negatively impacted the results at our Argosy Riverside property in our Southern Plains segment.
- The opening of a new casino in Biloxi, Mississippi in late May 2012, which impacted Boomtown Biloxi, and the opening of a new riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012, which impacted Hollywood Casino Baton Rouge.
- A pre-tax insurance gain of \$7.2 million at Hollywood Casino Tunica during the nine months ended September 30, 2012, compared to insurance deductible charges due to a flood at Hollywood Casino Tunica of \$5.2 million for the nine months ended September 30, 2011.
- Management's continued focus on cost management that has resulted in improved operating margins at 9 of our 16 gaming facilities that we operated in both periods, for the nine months ended September 30, 2012 compared to the corresponding period in the prior year.
- Lobbying efforts in Maryland related to our opposition to the November 2012 gaming referendum for \$19.2 million for the three months ended September 30, 2012, which is included in Other.
- Other also included a gain of \$20.2 million on the sale of our interest in the Maryland Jockey Club in July 2011, as well as a loss on the early extinguishment of debt for \$17.8 million related to debt issuance costs write-offs and the call premium on the \$250 million senior subordinated notes for the three months ended September 30, 2011.
- Net income decreased by \$24.4 million for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to the variances explained above, as well as increased depreciation expense, decreased interest expense, foreign currency translation losses and a decrease in income taxes.
- Net income decreased by \$6.6 million for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the variances explained above, as well as increased depreciation expense, decreased interest expense, and an increase in income taxes.

## Segment Developments:

The following are recent developments that have had or will have an impact on us by segment:

### Midwest

- Hollywood Casino Columbus, a \$400 million Hollywood-themed casino in Columbus, Ohio, inclusive of \$50 million in licensing fees, opened on October 8, 2012 and features approximately 3,000 slot machines, 78 table games and 30 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo, a \$320 million Hollywood-themed casino in Toledo, Ohio, inclusive of \$50 million in licensing fees, opened on May 29, 2012 and features 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. Additionally, in June 2011, we preliminarily agreed to pay an additional \$110 million over ten years to the

24

## [Table of Contents](#)

State of Ohio in return for certain clarifications from the State of Ohio with respect to various financial matters and limits on competition within the ten year time period.

- In March 2012, we announced that we had entered into a non-binding memorandum of understanding (“MOU”) with the State of Ohio that establishes a framework for relocating our existing racetracks in Toledo and Grove City to Dayton and Austintown (located in the Mahoning Valley), respectively, where we intend to develop new integrated racing and gaming facilities, each budgeted at approximately \$275 million inclusive of \$50 million in license fees and \$75 million in relocation fees but excluding potential credits of up to \$25 million per facility for qualifying costs incurred at our Raceway Park and Beulah Park racetracks. Pursuant to this arrangement, we would pay the State of Ohio the relocation fee per facility and the Ohio Lottery Commission would retain 33.5% of video lottery terminal revenues. In addition, the MOU restricts any other gaming facility from being located within 50 miles of our Columbus and Toledo casinos, as well as our relocated racetracks, with certain exceptions. In June 2012, we announced that we had formally filed applications with the Ohio Lottery Commission for Video Lottery Sales Agent Licenses for our Ohio racetracks, and with the Ohio State Racing Commission for permission to relocate the racetracks. The new Austintown facility, which will be a thoroughbred track, will be located on 184 acres in Austintown’s Centrepointe Business Park near the intersection of Interstate 80 and Ohio Route 46. The Dayton facility, a standardbred track, will be located on 125 acres on the site of an abandoned Delphi Automotive plant near Wagner Ford and Needmore roads in North Dayton. Both of the new racetrack facilities will each feature up to 1,500 video lottery terminals, as well as various restaurants, bars and other amenities. The opening of our Dayton facility will have an adverse impact on our Hollywood Casino Columbus facility.
- On October 21, 2011, The Ohio Roundtable filed a complaint in the Court of Common Pleas in Franklin County, Ohio against a number of defendants, including the Governor, the Ohio Lottery Commission and the Ohio Casino Control Commission. The complaint alleges a variety of substantive and procedural defects relative to the approval and implementation of video lottery terminals as well as several counts dealing with the taxation of standalone casinos. We, along with the other two casinos in Ohio, have filed motions for judgment on the pleadings. In May 2012, the complaint was dismissed; however, the plaintiffs have now filed an appeal.
- On June 1, 2012, a new racino at Scioto Downs in Columbus, Ohio opened, which has had a negative impact on Hollywood Casino Lawrenceburg’s financial results. In addition, a proposed casino in Cincinnati, Ohio is anticipated to open in 2013. This new facility will have a significant adverse impact on Hollywood Casino Lawrenceburg. Additionally, new racinos in Ohio are planned at Lebanon Raceway and River Downs. Lebanon Raceway and River Downs both hope to begin construction in 2012 with a late 2013 completion date. Both Lebanon Raceway and River Downs have filed applications for a license and can seek to each install up to 2,500 video lottery terminals. We anticipate the opening of these new racinos will have a further adverse impact on Hollywood Casino Lawrenceburg.
- In July 2011, we entered into a new interim agreement with the Ontario Lottery and Gaming Corporation (“OLGC”) for the operation of the Casino Rama facility through March 31, 2012, which was subsequently extended in January 2012 for an additional six months through September 30, 2012 and extended in August 2012 on a month-to-month basis going forward with a 60 days notice period. In March 2012, the OLGC canceled its process of evaluating bids for a new five year operating contract for the facility (which included a limit on operating fees exceeding \$5 million per year). Although the bid process has been canceled, there can be no assurance how long the OLGC will continue to engage us to manage the property.
- On July 18, 2011, the tenth licensed casino in Illinois opened in the city of Des Plaines. This facility is a new source of competition for Hollywood Casino Aurora and Hollywood Casino Joliet and has had a negative impact on these properties’ financial results. However, the 3% surcharge Hollywood Casino Aurora and Hollywood Casino Joliet paid to subsidize local horse racing interests is no longer required with the opening of the Des Plaines facility.

### *East/West*

- In our East/West segment, Hollywood Casino at Charles Town Races and Hollywood Casino Perryville will face increased competition and their results have been and will continue to be negatively impacted by the opening of a casino complex at the Arundel Mills mall in Anne Arundel, Maryland. The casino opened on June 6, 2012 with approximately 3,200 slot machines and significantly increased its slot machine offerings by mid-September 2012 to approximately 4,750 slot machines.
- In August 2012, state lawmakers approved legislation authorizing a sixth casino in Prince George’s County and the ability to add table games to Maryland’s five existing and planned casinos, subject to voter approval that will be held on November 6, 2012. The new law also changes the tax rate casino operators pay the state, varying from casino to casino, allows all casinos in

## [Table of Contents](#)

Maryland to be open 24 hours per day for the entire year, and permits casinos to directly purchase slot machines in exchange for gaming tax reductions. If a sixth casino in Prince George’s County is approved (by the voters both statewide and in Prince George’s County), a bidding process for the new facility would be instituted, with the two principal bidders likely to be National Harbor and Rosecroft Raceway, which is owned by us. For our Hollywood Casino Perryville facility, the tax rate would decrease from 67 percent to 61 percent with an option for an additional 5 percent reduction if an independent commission agrees, and table games would be expected to be implemented at Perryville by early 2013. If the legislation is passed authorizing another gaming site in Prince George’s County in 2016 and Rosecroft Raceway is not selected, our results of operations would be adversely impacted as it would create increased competition for our Hollywood Casinos at Charles Town Races and Perryville facilities.

- Hollywood Casino Bangor introduced table games on March 16, 2012 with the addition of six blackjack tables, a roulette table and seven poker tables. However, on June 5, 2012, a new casino opened in Oxford, Maine, approximately 120 miles from our facility, which has and will continue to have a negative impact on Hollywood Casino Bangor.

### *Southern Plains*

- On May 7, 2012, we announced that we have entered into a definitive agreement to acquire 100% of the equity of Harrah’s St. Louis gaming and lodging facility from Caesars Entertainment for a purchase price of approximately \$610 million. While the acquisition is a stock transaction, it will be treated as

an asset transaction for tax purposes. This will enable us 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. Upon closing, we will re-brand Harrah's St. Louis with our Hollywood-themed brand. The purchase price of the transaction, which closed on November 2, 2012, was funded through an add-on to our senior secured credit facility. Harrah's St. Louis 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 over 294 acres along the Missouri River and features approximately 109,000 square feet of gaming space with approximately 2,100 slot machines, 59 table games, 21 poker tables, a 500 guestroom hotel, nine dining and entertainment venues and structured and surface parking.

- Kansas Entertainment opened its \$391 million facility, inclusive of licensing fees, 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. We and International Speedway Corporation shared equally in the cost of developing and constructing Hollywood Casino at Kansas Speedway. The opening of this casino has and will continue to negatively impact the financial results of our Argosy Riverside property due to their close proximity to one another.
- 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, we 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. We have received \$15.4 million in insurance proceeds related to the flood at Hollywood Casino Tunica, with \$8.4 million received during the nine months ended September 30, 2012. 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, we recorded a pre-tax gain of \$7.2 million during the nine months ended September 30, 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.
- Gaming licenses in Iowa are typically issued jointly to a gaming operator and a local charitable organization known as a Qualified Sponsoring Organization ("QSO"). The agreement between the Company's gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the "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 will be 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-

---

## [Table of Contents](#)

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. Further, the Belle's ability to continue its operations may also be impacted by its ability to renew or extend its existing docking lease, which expires in January 2013, or to locate a suitable site to construct a land-based facility and the results of the request for proposal process initiated by the IRGC (with submissions due November 5, 2012). Subsequent to September 30, 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. Argosy Casino Sioux City has goodwill and other intangible assets of \$92.8 million at September 30, 2012. Additionally, this facility had net revenues and income from operations of \$43.4 million and \$13.4 million, respectively, for the nine months ended September 30, 2012, which represented 2.0% and 3.6% of the Company's consolidated results. Any disruptions in Argosy Casino Sioux City's operations related to the items described above could result in a significant non-cash impairment charge in future periods as well as the loss of future earnings associated from this property.

- A new riverboat casino and hotel in Baton Rouge, Louisiana opened on September 1, 2012. The opening of this riverboat casino has and will continue to have an adverse effect on the financial results of Hollywood Casino Baton Rouge. In addition, a casino in Biloxi opened in late May 2012, which has and will continue to have an adverse effect on the financial results of our Boomtown Biloxi property.

## *Other*

- In Maryland we are currently lobbying to defeat the November referendum as we believe it is a flawed process that handicaps competition for a potential sixth casino license in Prince George's County for National Harbor. See discussion on Maryland in East/West section. For the three months ended September 30, 2012, we have spent \$19.2 million in lobbying which is included in general and administrative expense within the condensed consolidated statement of income. We will incur additional lobbying expenses related to this matter in the fourth quarter of 2012.

## **Critical Accounting Estimates**

We make certain judgments and use certain estimates and assumptions when applying accounting principles in the preparation of our consolidated financial statements. The nature of the estimates and assumptions are material due to the levels of subjectivity and judgment necessary to account for highly uncertain factors or the susceptibility of such factors to change. We have identified the accounting for long-lived assets, goodwill and other intangible assets, income taxes and litigation, claims and assessments as critical accounting estimates, as they are the most important to our financial statement presentation and require difficult, subjective and complex judgments.

We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations and, in certain situations, could have a material adverse effect on our financial condition.

For further information on our critical accounting estimates, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. There has been no material change to these estimates for the nine months ended September 30, 2012.

## Results of Operations

The following are the most important factors and trends that contribute to our operating performance:

- The fact that most of our properties operate in mature competitive markets. As a result, we expect a majority of our future growth to come from prudent acquisitions of gaming properties (such as our recent acquisition of Harrah's St. Louis gaming and lodging facility from Caesars Entertainment which closed on November 2, 2012), jurisdictional expansions (such as the February 2012 opening of a casino through a joint venture in Kansas, the May 2012 opening of Hollywood Casino Toledo, the October 2012 opening of Hollywood Casino Columbus, and the opening of video lottery terminal facilities at two racetracks in Ohio which are expected to commence operations in 2014), expansions of gaming in existing jurisdictions (such as the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and Hollywood Casino at Penn National Race Course, and more recently at Hollywood Casino Bangor in March 2012) and expansions/improvements of existing properties.

27

## Table of Contents

- The fact that a number of states are currently considering or implementing legislation to legalize or expand gaming. Such legislation presents both potential opportunities to establish new properties (for example, in Kansas where we opened a casino through a joint venture in February 2012, in Ohio where we opened a casino in Toledo in May 2012 and in Columbus in October 2012, and in Maryland where we opened Hollywood Casino Perryville on September 27, 2010) and increased competitive threats to business at our existing properties (such as the introduction/expansion of commercial casinos in Kansas, Maryland, Ohio, and potentially Kentucky, an additional casino in Illinois which opened on July 18, 2011, a new riverboat casino and hotel in Baton Rouge, Louisiana which opened on September 1, 2012, and the introduction of tavern licenses in several states).
- The actions of government bodies can affect our operations in a variety of ways. For instance, the continued pressure on governments to balance their budgets could intensify the efforts of state and local governments to raise revenues through increases in gaming taxes or via an expansion of gaming. In addition, government bodies may restrict, prevent or negatively impact operations in the jurisdictions in which we do business (such as the implementation of smoking bans).
- The continued demand for, and our emphasis on, slot wagering entertainment at our properties.
- The successful execution of the development and construction activities currently underway at a number of our facilities, as well as the risks associated with the costs, regulatory approval and the timing of these activities.
- The risks related to economic conditions and the effect of such conditions on consumer spending for leisure and gaming activities, which may negatively impact our operating results and our ability to continue to access financing at favorable terms.

The results of operations for the three and nine months ended September 30, 2012 and 2011 are summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
<b>Revenues:</b>				
Gaming	\$ 633,836	\$ 636,389	\$ 1,924,759	\$ 1,868,373
Food, beverage and other	103,735	109,681	326,598	289,361
Management service fee	4,347	4,476	11,404	11,830
Revenues	741,918	750,546	2,262,761	2,169,564
Less promotional allowances	(34,874)	(39,641)	(107,107)	(103,757)
Net revenues	707,044	710,905	2,155,654	2,065,807
<b>Operating expenses:</b>				
Gaming	327,489	331,496	998,533	979,285
Food, beverage and other	80,875	87,952	253,664	231,801
General and administrative	137,615	108,897	368,863	314,695
Depreciation and amortization	62,399	52,195	172,527	159,583
Insurance recoveries, net of deductible charges	—	30	(7,229)	(13,219)
Total operating expenses	608,378	580,570	1,786,358	1,672,145
Income from operations	\$ 98,666	\$ 130,335	\$ 369,296	\$ 393,662

Certain information regarding our results of operations by segment for the three and nine months ended September 30, 2012 and 2011 is summarized below:

28

## Table of Contents

Three Months Ended September 30,	Net Revenues		Income (loss) from Operations	
	2012	2011	2012	2011
	(in thousands)			
Midwest	\$ 247,287	\$ 205,333	\$ 55,088	\$ 49,167
East/West	324,603	350,278	68,078	72,276
Southern Plains	128,604	148,722	26,496	36,604
Other	6,550	6,572	(50,996)	(27,712)
<b>Total</b>	<b>\$ 707,044</b>	<b>\$ 710,905</b>	<b>\$ 98,666</b>	<b>\$ 130,335</b>

Nine Months Ended September 30,	Net Revenues		Income (loss) from Operations	
	2012	2011	2012	2011
	(in thousands)			
Midwest	\$ 670,373	\$ 633,547	\$ 148,509	\$ 171,651
East/West	1,043,884	957,275	228,700	201,500
Southern Plains	415,729	450,322	108,739	105,397
Other	25,668	24,663	(116,652)	(84,886)
<b>Total</b>	<b>\$ 2,155,654</b>	<b>\$ 2,065,807</b>	<b>\$ 369,296</b>	<b>\$ 393,662</b>

### Revenues

Revenues for the three and nine months ended September 30, 2012 and 2011 were as follows (in thousands):

Three Months Ended September 30,	2012	2011	Variance	Percentage Variance
Gaming	\$ 633,836	\$ 636,389	\$ (2,553)	(0.4)%
Food, beverage and other	103,735	109,681	(5,946)	(5.4)%
Management service fee	4,347	4,476	(129)	(2.9)%
Revenues	741,918	750,546	(8,628)	(1.1)%
Less promotional allowances	(34,874)	(39,641)	4,767	12.0%
Net revenues	<u>\$ 707,044</u>	<u>\$ 710,905</u>	<u>\$ (3,861)</u>	(0.5)%

  

Nine Months Ended September 30,	2012	2011	Variance	Percentage Variance
Gaming	\$ 1,924,759	\$ 1,868,373	\$ 56,386	3.0%
Food, beverage and other	326,598	289,361	37,237	12.9%
Management service fee	11,404	11,830	(426)	(3.6)%
Revenues	2,262,761	2,169,564	93,197	4.3%
Less promotional allowances	(107,107)	(103,757)	(3,350)	(3.2)%
Net revenues	<u>\$ 2,155,654</u>	<u>\$ 2,065,807</u>	<u>\$ 89,847</u>	4.3%

In our business, revenue is driven by discretionary consumer spending, which has been impacted by weakened general economic conditions such as, but not limited to, high unemployment levels, low levels of consumer confidence, and increased stock market volatility.

We have no certain mechanism for determining why consumers choose to spend more or less money at our properties from period to period and as such cannot quantify a dollar amount for each factor that impacts our customers' spending behaviors. However, based on our experience, we can generally offer some insight into the factors that we believe were likely to account for such changes. In instances where we believe one factor may have had a significantly greater impact than the other factors, we have noted that as well. However, in all instances, such insights are based only on our reasonable judgment and professional experience, and no assurance can be given as to the accuracy of our judgments.

### [Table of Contents](#)

#### Gaming revenue

Gaming revenue decreased by \$2.6 million, or 0.4%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, and increased by \$56.4 million, or 3.0%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the variances explained below.

Gaming revenue for our East/West segment decreased by \$19.7 million, or 6.5%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to a decrease in gaming revenue at Hollywood Casino at Charles Town Races of \$9.2 million and Hollywood Casino Perryville of \$8.5 million due to the impact from the partial opening of a casino complex at the Arundel Mills mall in Maryland in June 2012 and its second phase opening in mid-September 2012.

Gaming revenue for our East/West segment increased by \$62.9 million, or 7.4%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to full year impact of the M Resort which was acquired on June 1, 2011, and an increase in gaming revenue at Hollywood Casino at Charles Town Races primarily due to the continued impact from the introduction of table games in July 2010 coupled with mild weather in the first quarter of 2012 partially offset by the impact from the partial opening of a casino complex at the Arundel Mills mall in Maryland in June 2012 and its second phase opening in mid-September 2012. We also experienced growth at Zia Park Casino due to strengthening regional economic conditions and at Hollywood Casino Bangor for the introduction of table games on March 16, 2012, partially offset by the opening of a new casino in Oxford, Maine in June 2012.

Gaming revenue for our Midwest segment increased by \$37.1 million, or 19.4%, and \$29.7 million, or 5.0%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino

Toledo on May 29, 2012, which generated \$52.4 million and \$75.1 million of gaming revenue for the three and nine months ended September 30, 2012, respectively. Our other properties in our Midwest segment had revenue declines primarily due to the impact of new competition, namely a new casino opening in July 2011 near Hollywood Casino Aurora and Hollywood Casino Joliet, as well as a recent opening on June 1, 2012 of a new racino in Columbus, Ohio, which has negatively impacted Hollywood Casino Lawrenceburg. However, in the third quarter of 2012, Hollywood Casino Joliet showed an increase in gaming revenue primarily due to higher than anticipated table hold which led to an increase of \$2.2 million in table game revenues for the three months ended September 30, 2012.

We expect a further increase in gaming revenue in our Midwest segment in the fourth quarter of 2012 due to the October 8, 2012 opening of Hollywood Casino Columbus.

Gaming revenue for our Southern Plains segment decreased by \$19.6 million, or 14.1%, and \$34.6 million, or 8.2%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to a decrease in gaming revenue at Argosy Casino Riverside of \$9.3 million and \$23.9 million for the three and nine months ended September 30, 2012, respectively, primarily due to the opening of our Hollywood Casino at Kansas Speedway joint venture in February 2012, as well as a decrease in gaming revenue at Boomtown Biloxi and Hollywood Casino Baton Rouge primarily due to new competition, namely the opening a new casino in Biloxi in late May 2012 and the opening of a new riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012.

We expect an increase in gaming revenue in our Southern Plains segment in the fourth quarter of 2012 due to the acquisition of Harrah's St. Louis which closed on November 2, 2012.

#### *Food, beverage and other revenue*

Food, beverage and other revenue decreased by \$5.9 million, or 5.4%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, and increased by \$37.2 million, or 12.9%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the variances explained below.

Food, beverage and other revenue for our East/West segment decreased by \$7.9 million, or 13.3%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to the sale of the on-site gas station in April 2012 as well as the closure of a dining outlet at the M Resort.

Food, beverage and other revenue for our East/West segment increased by \$32.6 million, or 24.3%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

#### [Table of Contents](#)

Food, beverage and other revenue for our Midwest segment increased by \$3.5 million, or 16.2%, and \$3.5 million, or 5.3%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012, which contributed \$5.4 million and \$8.3 million for the three and nine months ended September 30, 2012, respectively, partially offset by the recent opening on June 1, 2012 of a new racino in Columbus, Ohio which has negatively impacted Hollywood Casino Lawrenceburg.

#### *Promotional allowances*

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." Our promotional allowance levels are determined based on various factors such as our marketing plans, competitive factors, economic conditions, and regulations.

Promotional allowances decreased by \$4.8 million, or 12.0%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to a rationalization of marketing efforts at both the M Resort and Hollywood Casino Lawrenceburg.

Promotional allowances increased by \$3.4 million, or 3.2%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011, partially offset by rationalization efforts in the third quarter of 2012 mentioned above.

#### Operating Expenses

Operating expenses for the three and nine months ended September 30, 2012 and 2011 were as follows (in thousands):

<b>Three Months Ended September 30,</b>	<b>2012</b>	<b>2011</b>	<b>Variance</b>	<b>Percentage Variance</b>
Gaming	\$ 327,489	\$ 331,496	\$ (4,007)	(1.2)%
Food, beverage and other	80,875	87,952	(7,077)	(8.0)%
General and administrative	137,615	108,897	28,718	26.4%
Depreciation and amortization	62,399	52,195	10,204	19.5%
Insurance deductible charges	—	30	(30)	(100.0)%
Total operating expenses	<u>\$ 608,378</u>	<u>\$ 580,570</u>	<u>\$ 27,808</u>	4.8%

<b>Nine Months Ended September 30,</b>	<b>2012</b>	<b>2011</b>	<b>Variance</b>	<b>Percentage Variance</b>
Gaming	\$ 998,533	\$ 979,285	\$ 19,248	2.0%
Food, beverage and other	253,664	231,801	21,863	9.4%
General and administrative	368,863	314,695	54,168	17.2%
Depreciation and amortization	172,527	159,583	12,944	8.1%

Insurance recoveries, net of deductible charges	(7,229)	(13,219)	5,990	45.3%
Total operating expenses	<u>\$ 1,786,358</u>	<u>\$ 1,672,145</u>	<u>\$ 114,213</u>	6.8%

#### *Gaming expense*

Gaming expense decreased by \$4.0 million, or 1.2%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, and increased by \$19.2 million, or 2.0%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the variances explained below.

Gaming expense for our East/West segment decreased by \$12.5 million, or 7.1%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to a decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above at Hollywood Casinos at Charles Town Races and Perryville.

Gaming expense for our East/West segment increased by \$25.2 million, or 5.0%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011 and an overall increase in gaming taxes resulting from increased taxable gaming revenue mentioned above at Hollywood Casino at Charles Town Races, as well as to a lesser extent at Zia Park Casino.

#### [Table of Contents](#)

Gaming expense for our Midwest segment increased by \$15.2 million, or 15.0%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012. This increase was partially offset by decreased gaming taxes from lower levels of taxable gaming revenue for Hollywood Casino Aurora and Hollywood Casino Lawrenceburg primarily due to previously mentioned new competition, as well as decreased payroll and marketing costs at Hollywood Casino Lawrenceburg.

Gaming expense for our Midwest segment increased by \$7.1 million, or 2.3%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012. This increase was partially offset by an overall decrease in gaming taxes resulting from decreased taxable gaming revenue for Hollywood Casino Joliet, Hollywood Casino Aurora and Hollywood Casino Lawrenceburg primarily due to previously mentioned new competition, as well as the expiration of the 3% surcharge in July 2011 in connection with the opening of a new competing casino for Hollywood Casino Joliet and Hollywood Casino Aurora which had been required to subsidize local horse racing interests. These properties also had decreased marketing and payroll costs for the nine months ended September 30, 2012 compared to the corresponding period in the prior year due to realignment of costs with decreased business demand resulting from the new competition.

Gaming expense for our Southern Plains segment decreased by \$6.6 million, or 12.6%, and \$12.7 million, or 8.1%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for Argosy Casino Riverside, as well as decreased payroll costs at this property due to realignment of costs associated with lower business demand subsequent to the opening of our joint venture at Hollywood Casino at Kansas Speedway.

#### *Food, beverage and other expense*

Food, beverage and other expense decreased by \$7.1 million, or 8.0%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, and increased by \$21.9 million, or 9.4%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the variances explained below.

Food, beverage and other expense for our East/West segment decreased by \$7.9 million, or 17.1%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to the sale of the on-site gas station in April 2012 as well as the closure of a dining outlet at the M Resort.

Food, beverage and other expense for our East/West segment increased by \$21.5 million, or 20.9%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

Food, beverage and other expense for our Midwest segment increased by \$3.2 million, or 18.5%, and \$4.3 million, or 8.3%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012, partially offset by the recent opening on June 1, 2012 of a new racino in Columbus, Ohio which has negatively impacted Hollywood Casino Lawrenceburg.

Food, beverage and other expense for our Southern Plains segment decreased by \$2.3 million, or 11.1%, and \$4.6 million, or 7.4%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to a reduction in costs at Argosy Casino Riverside to align results with lower business volumes that have been experienced since the opening of our Hollywood Casino at Kansas Speedway joint venture in February 2012.

#### *General and administrative expenses*

General and administrative expenses include expenses such as compliance, facility maintenance, utilities, property and liability insurance, surveillance and security, and certain housekeeping services, as well as all expenses for administrative departments such as accounting, purchasing, human resources, legal and internal audit. General and administrative expenses also include lobbying expenses.

General and administrative expenses increased by \$28.7 million, or 26.4%, and \$54.2 million, or 17.2%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the variances explained below.

General and administrative expenses for our East/West segment increased by \$9.5 million, or 11.1%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

General and administrative expenses for our Midwest segment increased by \$8.6 million, or 33.7%, and \$14.7 million, or 19.2%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012 and increased preopening costs at Hollywood Casino Columbus of \$3.4 million and \$6.6 million for the three and nine months ended September 30, 2012, respectively, as well as \$1.2 million in severance charges for the three months ended September 30, 2012 at Hollywood Casino Lawrenceburg. These increases were partially offset by declines at our other properties in the Midwest segment which had reduced costs in light of lower business volumes due to new competition.

General and administrative expenses for Other increased by \$21.5 million, or 91.9%, and \$29.5 million, or 39.9%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to lobbying efforts in Maryland related to our opposition to the November 2012 gaming referendum for \$19.2 million for the three and nine months ended September 30, 2012 and increased compensation costs to support our growing organization.

#### *Depreciation and amortization expense*

Depreciation and amortization expense increased by \$10.2 million, or 19.5%, and \$12.9 million, or 8.1%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the variances explained below.

Depreciation and amortization expense for our Midwest segment increased by \$9.1 million, or 57.6%, and \$15.0 million, or 31.9%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012.

Depreciation and amortization expense for our East/West segment increased by \$3.2 million, or 5.1%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

Depreciation and amortization expense for Other increased by \$2.0 million, or 91.0%, and \$3.3 million, or 46.8%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011. This was caused by our decision to relocate our Ohio racetrack licenses at Raceway Park and Beulah Park to Dayton and Austintown, respectively, which resulted in the shortening of the useful lives of our property and equipment at our existing racetracks in order to fully depreciate these assets to their net salvage value by the anticipated relocation date in 2014.

Depreciation and amortization expense for our Southern Plains segment decreased by \$1.7 million, or 13.4%, and \$8.6 million, or 20.4%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to decreased depreciation and amortization expense at Hollywood Casino Bay St. Louis primarily related to replacement assets that were purchased after Hurricane Katrina being fully depreciated in August 2011. In addition, depreciation and amortization expense for the nine months ended September 30, 2012 compared to the corresponding period in the prior year was impacted by replacement assets that were purchased after Hurricane Katrina being fully depreciated in June 2011 at Boomtown Biloxi.

#### *Insurance recoveries, net of deductible charges*

Insurance recoveries, net of deductible charges during the nine months ended September 30, 2012 were related to a pre-tax insurance gain of \$7.2 million, for the flood at Hollywood Casino Tunica. Insurance recoveries, net of deductible charges during the nine months ended September 30, 2011 were related to a pre-tax insurance gain of \$18.5 million for a fire at Hollywood Casino Joliet, partially offset by a pre-tax insurance loss of \$5.2 million for the flood at Hollywood Casino Tunica for the nine months ended September 30, 2011.

#### *Other income (expenses)*

Other income (expenses) for the three and nine months ended September 30, 2012 and 2011 were as follows (in thousands):

<b>Three Months Ended September 30,</b>	<b>2012</b>	<b>2011</b>	<b>Variance</b>	<b>Percentage Variance</b>
Interest expense	\$ (19,953)	\$ (23,514)	\$ 3,561	15.1%
Interest income	218	68	150	220.6%
Gain from unconsolidated affiliates	807	17,293	(16,486)	(95.3)%
Loss on early extinguishment of debt	—	(17,838)	17,838	100.0%
Other	(1,954)	2,737	(4,691)	(171.4)%
Total other expenses	<u>\$ (20,882)</u>	<u>\$ (21,254)</u>	<u>\$ 372</u>	1.8%
<b>Nine Months Ended September 30,</b>	<b>2012</b>	<b>2011</b>	<b>Variance</b>	<b>Percentage Variance</b>
Interest expense	\$ (55,819)	\$ (78,649)	\$ 22,830	29.0%
Interest income	683	217	466	214.7%
Gain from unconsolidated affiliates	3,546	15,370	(11,824)	(76.9)%
Loss on early extinguishment of debt	—	(17,838)	17,838	100.0%
Other	(1,483)	393	(1,876)	(477.4)%
Total other expenses	<u>\$ (53,073)</u>	<u>\$ (80,507)</u>	<u>\$ 27,434</u>	34.1%



### *Interest expense*

Interest expense decreased by \$3.6 million, or 15.1%, for the three months ended September 30, 2012, as compared to the three months ended September 30, 2011, primarily due to the expiration of interest rate swap contracts in 2011 and the redemption of our \$250 million 6 ¾% senior subordinated notes in August 2011, both of which were partially offset by higher interest on our senior secured credit facility primarily due to higher outstanding balances.

Interest expense decreased by \$22.8 million, or 29.0%, for the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, primarily due to the expiration of all interest rate swap contracts in 2011, redemption of our \$250 million 6 ¾% senior subordinated notes in August 2011 and higher capitalized interest for the nine months ended September 30, 2012 compared to the corresponding period in the prior year, all of which were partially offset by higher interest on our senior secured credit facility entered into in July 2011 primarily due to higher interest rates and higher outstanding balances. In 2011, we funded the redemption of our \$250 million 6 ¾% senior subordinated notes with our revolving credit facility under the 2011 senior secured credit facility.

### *Gain from unconsolidated affiliates*

Gain from unconsolidated affiliates decreased by \$16.5 million, or 95.3%, and \$11.8 million, or 76.9%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to a gain of \$20.2 million on the sale of our interest in the Maryland Jockey Club in July 2011, which was partially offset by the opening of our joint venture, Hollywood Casino at Kansas Speedway, in February 2012.

### *Loss on early extinguishment of debt*

During the three and nine months ended September 30, 2011, we recorded a \$17.8 million loss on the early extinguishment of debt related to debt issuance costs write-offs and the call premium on the \$250 million senior subordinated notes.

### *Other*

Other changed by \$4.7 million, or 171.4%, and \$1.9 million, or 477.4%, for the three and nine months ended September 30, 2012, respectively, as compared to the three and nine months ended September 30, 2011, primarily due to foreign currency translation losses of \$1.8 million and \$1.4 million for the three and nine months ended September 30, 2012, respectively, as compared to foreign currency translation gains of \$2.9 million and \$0.8 million for the three and nine months ended September 30, 2011, respectively.

### *Taxes*

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 40.3% and 39.4% for the three and nine months ended September 30, 2012, respectively, as compared to 35.1% and 36.7% for the three and nine months ended September 30, 2011, respectively. The primary reason for the increase for the nine months ended September 30, 2012 is

---

### [Table of Contents](#)

due to the reversal of previously recorded unrecognized tax benefit reserves in the second quarter of 2011 as well as favorable state income tax benefits resulting from the impact of certain subsidiary restructurings completed in the third quarter of 2011. The increase in the effective tax rate for the three months ended September 30, 2012 compared to the corresponding period in the prior year is due to the previously mentioned lobbying expenses partially offset by unrecognized tax benefit reversals recorded during the three months ended September 30, 2012.

Our projected annual effective tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and the level of our tax credits. Certain of these and other factors, including our history of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets.

### **Liquidity and Capital Resources**

Historically, our primary sources of liquidity and capital resources have been cash flow from operations, borrowings from banks and proceeds from the issuance of debt and equity securities.

Net cash provided by operating activities totaled \$337.8 million and \$438.1 million for the nine months ended September 30, 2012 and 2011, respectively. The decrease in net cash provided by operating activities of \$100.3 million for the nine months ended September 30, 2012 compared to the corresponding period in the prior year is comprised primarily of an increase in income tax payments of \$116.1 million, cash paid to suppliers and vendors of \$40.3 million, and cash paid to employees of \$35.5 million, all of which were partially offset by an increase in cash receipts from customers of \$76.6 million and a decrease in interest payments of \$24.7 million. The increase in cash receipts collected from our customers and the increase in higher cash payments for operating expenses for the nine months ended September 30, 2012 compared to the prior year was primarily due to the previously discussed growth in our East/West segment as well as the opening of Hollywood Casino Toledo in late May 2012, partially offset by new competition for various properties. The increase in higher cash payments for operating expenses was also impacted by \$19.2 million of lobbying expenses incurred for our efforts in Maryland. The increase in cash paid to employees was primarily due to the acquisition of the M Resort on June 1, 2011 and the opening of Hollywood Casino Toledo in late May 2012 and Hollywood Casino Columbus in early October 2012. Additionally, the increase in income tax payments was primarily due to higher taxable income estimates as of September 30, 2012 which caused a \$45.2 million increase in our tax payments. A significant component driving our increase in estimated taxable income in 2012 compared to 2011 was due to legislation passed in the later part of 2010, "Tax Relief Act of 2010," that allowed 100 percent bonus depreciation for qualifying new assets acquired and placed in service through 2011 (compared to 50 percent bonus depreciation allowance for 2012). We also made payments in the current year of \$12.8 million on our liability for unrecognized tax benefits and also had a significant federal income tax overpayment from 2010 that was credited against our 2011 federal income tax liability.

Net cash used in investing activities totaled \$490.6 million and \$222.7 million for the nine months ended September 30, 2012 and 2011, respectively. Net cash used in investing activities for the nine months ended September 30, 2012 included expenditures for property and equipment, net of reimbursements totaling \$364.9 million, acquisition of gaming licenses for \$105.0 million for Hollywood Casino Toledo and Hollywood Casino Columbus, and investment in

joint ventures of \$39.6 million, all of which were partially offset by a decrease in cash in escrow of \$15.8 million and proceeds from the sale of property and equipment totaling \$3.1 million. The increase in net cash used in investing activities of \$267.9 million for the nine months ended September 30, 2012 compared to the corresponding period in the prior year was primarily due to increased expenditures for property and equipment of \$161.4 million as a result of increased expenditures at our two new facilities in Ohio and gaming license payments totaling \$105.0 million in connection with the May 29, 2012 opening of Hollywood Casino Toledo and the October 8, 2012 opening of Hollywood Casino Columbus.

Net cash provided by (used in) financing activities totaled \$131.9 million and \$(253.9) million for the nine months ended September 30, 2012 and 2011, respectively. The increase in net cash provided by financing activities for the nine months ended September 30, 2012 compared to the corresponding period in the prior year was primarily due to an increase in borrowings under our revolver in our senior secured credit facility primarily used for our increased expenditures in Ohio and income tax payments.

### Capital Expenditures

Capital expenditures are accounted for as either capital project or capital maintenance (replacement) expenditures. Capital project expenditures are for fixed asset additions that expand an existing facility or create a new facility. Capital maintenance expenditures are expenditures to replace existing fixed assets with a useful life greater than one year that are obsolete, worn out or no longer cost effective to repair.

The following table summarizes our expected capital project expenditures by segment for the fiscal year ending December 31, 2012, and actual expenditures for the nine months ended September 30, 2012 (excluding licensing fees). The table below should not be utilized to predict future expected capital project expenditures subsequent to 2012.

### Table of Contents

Property	Expected for Year Ending December 31, 2012	Expenditures for Nine Months Ended September 30, 2012 (in millions)	Balance to Expend in 2012
Midwest	\$ 376.9	\$ 287.0	\$ 89.9
East/West	12.9	8.6	4.3
Southern Plains	14.2	2.9	11.3
Other	0.2	0.1	0.1
<b>Total</b>	<b>\$ 404.2</b>	<b>\$ 298.6</b>	<b>\$ 105.6</b>

In November 2009, the “Ohio Jobs and Growth Plan,” a casino ballot proposal calling for an amendment to Ohio’s Constitution to authorize casinos in the state’s four largest cities, Cincinnati, Cleveland, Columbus and Toledo, was approved. Hollywood Casino Toledo, a \$320 million Hollywood-themed casino in Toledo, Ohio, inclusive of \$50 million in licensing fees, opened on May 29, 2012 and features 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Columbus, a \$400 million Hollywood-themed casino in Columbus, Ohio, inclusive of \$50 million in licensing fees, opened on October 8, 2012 and features approximately 3,000 slot machines, 78 table games and 30 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. As of September 30, 2012, we have incurred cumulative costs of \$310.2 million and \$320.8 million, which includes licensing fees, for Hollywood Casino Toledo and Hollywood Casino Columbus, respectively.

In June 2012, we announced that we had formally filed applications with the Ohio Lottery Commission for Video Lottery Sales Agent Licenses for our Ohio racetracks, Raceway Park and Beulah Park, and with the Ohio State Racing Commission for permission to relocate the racetracks to Dayton and Austintown, respectively. Full details and design of the project at Austintown are in the development stage for a new \$275 million Hollywood-themed facility, inclusive of a \$75 million relocation fee and \$50 million license fee, featuring a new thoroughbred racetrack and up to 1,500 video lottery terminals, as well as various restaurants, bars and other amenities. The new Austintown facility will be located on 184 acres in Austintown’s Centrepointe Business Park near the intersection of Interstate 80 and Ohio Route 46. The Dayton facility will be located on 125 acres on the site of an abandoned Delphi Automotive plant near Wagner Ford and Needmore roads in North Dayton. Full details and design of the Dayton project are in the development stage, with a new \$275 million Hollywood-themed facility, inclusive of a \$75 million relocation fee and \$50 million license fee, featuring a new standardbred racetrack and up to 1,500 video lottery terminals, as well as various restaurants, bars and other amenities. We have incurred cumulative costs of \$6.1 million and \$4.1 million as of September 30, 2012 for the Austintown facility and the Dayton facility, respectively.

During the nine months ended September 30, 2012, we spent approximately \$66.3 million for capital maintenance expenditures, with \$18.5 million at our Midwest segment, \$26.3 million at our East/West segment, \$16.7 million at our Southern Plains segment, and \$4.8 million for Other. The majority of the capital maintenance expenditures were for slot machines and slot machine equipment.

Cash generated from operations and cash available under the revolving credit facility portion of our senior secured credit facility have funded our capital project and capital maintenance expenditures in 2012 to date.

### Debt

Our senior secured credit facility had a gross outstanding balance of \$1,840.9 million at September 30, 2012, consisting of \$444.0 million drawn under the revolving credit facility, a \$656.3 million Term Loan A facility, and a \$740.6 million Term Loan B facility. Additionally, at September 30, 2012, we were contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$24.1 million, resulting in \$231.9 million of available borrowing capacity as of September 30, 2012 under the revolving credit facility. On November 1, 2012, we increased the size of our senior secured credit facility. See Note 14 to the condensed consolidated financial statements for further detail.

### Other long-term obligations

In September 2012, we 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 entitled A3 Gaming Investments to invest in a

[Table of Contents](#)

levels of the M Resort. In accordance with ASC 480, “Distinguishing Liabilities from Equity,” we 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.

*Covenants*

Our senior secured credit facility and \$325 million 8¾% senior subordinated notes require us, 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, our senior secured credit facility and \$325 million 8¾% senior subordinated notes restrict, among other things, our 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 September 30, 2012, we were in compliance with all required financial covenants.

*Outlook*

Based on our current level of operations and anticipated earnings growth, we believe that cash generated from operations and cash on hand, together with amounts available under our senior secured credit facility (including amounts that can be obtained for the Harrah’s St. Louis acquisition, see Note 4 for further details), will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. However, we cannot be certain that our business will generate sufficient cash flow from operations, that our anticipated earnings growth will be realized, or that future borrowings will be available under our senior secured credit facility or otherwise will be available to enable us to service our indebtedness, including the senior secured credit facility and the senior subordinated notes, to retire or redeem the senior subordinated notes when required or to make anticipated capital expenditures. In addition, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, greenfield projects, jurisdictional expansions and property expansion in under-penetrated markets. If we consummate significant acquisitions in the future or undertake any significant property expansions, our cash requirements may increase significantly and we may need to make additional borrowings or complete equity or debt financings to meet these requirements. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control. See “Risk Factors—Risks Related to Our Capital Structure” in our Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of the risk related to our capital structure.

We have historically maintained a capital structure comprising a mix of equity and debt financing. We vary our leverage to pursue opportunities in the marketplace and in an effort to maximize our enterprise value for our shareholders. We expect to meet our debt obligations as they come due through internally generated funds from operations and/or refinancing them through the debt or equity markets prior to their maturity.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The table below provides information at September 30, 2012 about our financial instruments that are sensitive to changes in interest rates. For debt obligations, the table presents notional amounts maturing during the period and the related weighted-average interest rates by maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged by maturity date and the weighted-average interest rates are based on implied forward LIBOR rates at September 30, 2012.

	10/01/12 - 09/30/13	10/01/13 - 09/30/14	10/01/14 - 09/30/15	10/01/15 - 09/30/16	10/01/16 - 09/30/17	Thereafter	Total	Fair Value 9/30/12
(in thousands)								
<b>Long-term debt:</b>								
Fixed rate	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 325,000	\$ 325,000	\$ 365,625
Average interest rate						8.75%		
Variable rate	\$ 46,875	\$ 64,375	\$ 77,500	\$ 941,500	\$ 7,500	\$ 703,125	\$ 1,840,875	\$ 1,842,727
Average interest rate (1)	2.41%	2.54%	2.73%	2.85%	4.29%	4.46%		

(1) Estimated rate, reflective of forward LIBOR plus the spread over LIBOR applicable to variable-rate borrowing.

[Table of Contents](#)

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of 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 September 30, 2012, which is the end of the period covered by this Quarterly Report on Form 10-Q. In designing and 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 September 30, 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 were no changes that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1 — Legal Proceedings**

Information in response to this Item is incorporated by reference to the information set forth in "Note 9: Commitments and Contingencies" in the Notes to the condensed consolidated financial statements in Part I of this Quarterly Report on Form 10-Q.

**ITEM 1A — Risk Factors**

We are not aware of any material changes to the risk factors described in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

**ITEM 2 — Unregistered Sales of Equity Securities and Use of Proceeds**

The Company did not repurchase any common equity securities during the three months ended September 30, 2012.

**ITEM 3 — Defaults upon Senior Securities**

Not applicable.

**ITEM 4 — Mine Safety Disclosures**

None.

**ITEM 5 — Other information**

Not applicable.

**ITEM 6. EXHIBITS**

<b>Exhibit</b>	<b>Description of Exhibit</b>
31.1*	CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
31.2*	CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
32.1*	CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of

[Table of Contents](#)

2002.

32.2\* CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011, (ii) the Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2012 and 2011, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2011, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2012 and 2011, (v) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 and (vi) the notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.

\* Filed herewith

**SIGNATURES**

Pursuant to the requirements 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/ William J. Clifford  
William J. Clifford

[Table of Contents](#)

**EXHIBIT INDEX**

<b>Exhibit</b>	<b>Description of Exhibit</b>
31.1*	CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
31.2*	CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
32.1*	CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011, (ii) the Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2012 and 2011, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2011, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2012 and 2011, (v) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 and (vi) the notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.

\* Filed herewith.

## CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES AND EXCHANGE ACT OF 1934

I, Peter M. Carlino, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn National Gaming, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2012

/s/ Peter M. Carlino

Peter M. Carlino

Chairman and Chief Executive Officer

---

## CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES AND EXCHANGE ACT OF 1934

I, William J. Clifford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn National Gaming, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2012

/s/ William J. Clifford

William J. Clifford

Senior Vice President Finance and Chief Financial Officer  
(Principal Financial Officer)

---

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter M. Carlino, Chief Executive Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Peter M. Carlino

Peter M. Carlino

Chairman and Chief Executive Officer

November 5, 2012

---



**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002,  
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Clifford, Chief Financial Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William J. Clifford

\_\_\_\_\_  
William J. Clifford

Senior Vice President Finance and Chief Financial Officer  
(Principal Financial Officer)

November 5, 2012

---