

PENN NATIONAL GAMING INC  
Form 10-Q  
May 03, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2013**

**OR**

**o** **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 ☐  
(Do not check if a smaller reporting company)

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 ☒

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

| <b>Title</b>                            | <b>Outstanding as of April 30, 2013</b>                  |
|-----------------------------------------|----------------------------------------------------------|
| Common Stock, par value \$.01 per share | 78,590,940 (includes 323,995 shares of restricted stock) |

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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: the proposed separation of a newly formed publicly traded real estate investment trust which will be named Gaming and Leisure Properties, Inc. ( GLPI ) from the Company (the Spin-Off ), including our ability to timely receive all necessary consents and approvals, the anticipated timing of the proposed separation, the expected tax treatment of the proposed transaction, the ability of each of the post-spin Company and GLPI to conduct and expand their respective businesses following the proposed Spin-Off, and the diversion of management's attention from traditional business concerns; our ability to raise the capital necessary to finance the Spin-Off, including the redemption of our existing debt and preferred stock obligations, the anticipated cash portion of our special earnings and profit dividend and transaction costs; our ability to obtain timely 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 ongoing appeal by the Ohio Roundtable addressing the legality of video lottery terminals in Ohio; 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 State of Ohio that memorialize our earlier Memorandum of Understanding; our ability to reach agreements with the thoroughbred and harness horseman in Ohio in connection with the proposed relocations and to otherwise maintain agreements with our horseman, pari-mutuel clerks and other organized labor groups; with respect to the proposed Jamul project, particular risks associated with securing financing, local opposition, and building a complex project on a relatively small parcel; 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 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 rapid emergence of new competitors (traditional, internet based and sweepstakes based); increases in the effective rate 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, 2012, 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.

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

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|                                                                                                                                     | <b>March 31,<br/>2013<br/>(unaudited)</b> | <b>December 31,<br/>2012</b> |
|-------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------|
| <b>Assets</b>                                                                                                                       |                                           |                              |
| <b>Current assets</b>                                                                                                               |                                           |                              |
| Cash and cash equivalents                                                                                                           | \$ 247,702                                | \$ 260,467                   |
| Receivables, net of allowance for doubtful accounts of \$3,909 and \$3,901 at March 31, 2013 and December 31, 2012, respectively    | 56,888                                    | 53,720                       |
| Prepaid expenses                                                                                                                    | 74,525                                    | 94,620                       |
| Deferred income taxes                                                                                                               | 36,863                                    | 39,793                       |
| Other current assets                                                                                                                | 11,480                                    | 38,540                       |
| Total current assets                                                                                                                | 427,458                                   | 487,140                      |
| <b>Property and equipment, net</b>                                                                                                  | <b>2,707,172</b>                          | <b>2,730,797</b>             |
| <b>Other assets</b>                                                                                                                 |                                           |                              |
| Investment in and advances to unconsolidated affiliates                                                                             | 201,727                                   | 204,506                      |
| Goodwill                                                                                                                            | 1,379,355                                 | 1,380,689                    |
| Other intangible assets                                                                                                             | 706,718                                   | 706,477                      |
| Debt issuance costs, net of accumulated amortization of \$13,548 and \$11,462 at March 31, 2013 and December 31, 2012, respectively | 33,959                                    | 35,999                       |
| Other assets                                                                                                                        | 109,187                                   | 98,449                       |
| Total other assets                                                                                                                  | 2,430,946                                 | 2,426,120                    |
| <b>Total assets</b>                                                                                                                 | <b>\$ 5,565,576</b>                       | <b>\$ 5,644,057</b>          |
| <b>Liabilities</b>                                                                                                                  |                                           |                              |
| <b>Current liabilities</b>                                                                                                          |                                           |                              |
| Current maturities of long-term debt                                                                                                | \$ 88,368                                 | \$ 81,497                    |
| Accounts payable                                                                                                                    | 37,198                                    | 38,268                       |
| Accrued expenses                                                                                                                    | 103,308                                   | 133,316                      |
| Accrued interest                                                                                                                    | 14,882                                    | 21,872                       |
| Accrued salaries and wages                                                                                                          | 78,076                                    | 96,426                       |
| Gaming, pari-mutuel, property, and other taxes                                                                                      | 61,313                                    | 55,610                       |
| Insurance financing                                                                                                                 | 13,456                                    | 3,856                        |
| Other current liabilities                                                                                                           | 75,114                                    | 68,774                       |
| Total current liabilities                                                                                                           | 471,715                                   | 499,619                      |
| <b>Long-term liabilities</b>                                                                                                        |                                           |                              |
| Long-term debt, net of current maturities                                                                                           | 2,525,316                                 | 2,649,073                    |
| Deferred income taxes                                                                                                               | 221,124                                   | 216,357                      |
| Noncurrent tax liabilities                                                                                                          | 21,757                                    | 20,393                       |
| Other noncurrent liabilities                                                                                                        | 7,050                                     | 7,686                        |
| Total long-term liabilities                                                                                                         | 2,775,247                                 | 2,893,509                    |

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**Shareholders' equity**

Preferred stock (\$.01 par value, 1,000,000 shares authorized, 12,050 and 12,275 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively)

Common stock (\$.01 par value, 200,000,000 shares authorized, 78,175,181 and 77,446,601 shares issued at March 31, 2013 and December 31, 2012, respectively)

|                                                   |                     |                     |
|---------------------------------------------------|---------------------|---------------------|
|                                                   | 774                 | 769                 |
| Additional paid-in capital                        | 1,454,864           | 1,451,965           |
| Retained earnings                                 | 860,444             | 795,173             |
| Accumulated other comprehensive income            | 2,532               | 3,022               |
| Total shareholders' equity                        | 2,318,614           | 2,250,929           |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 5,565,576</b> | <b>\$ 5,644,057</b> |

See accompanying notes to the condensed consolidated financial statements.

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

**Condensed Consolidated Statements of Income**

**(in thousands, except per share data)**

**(unaudited)**

|                                                   | <b>Three Months Ended March 31,</b> |             |
|---------------------------------------------------|-------------------------------------|-------------|
|                                                   | <b>2013</b>                         | <b>2012</b> |
| <b>Revenues</b>                                   |                                     |             |
| Gaming                                            | \$ 717,925                          | \$ 656,077  |
| Food, beverage and other                          | 121,860                             | 112,908     |
| Management service fee                            | 3,047                               | 3,443       |
| Revenues                                          | 842,832                             | 772,428     |
| Less promotional allowances                       | (44,586)                            | (36,369)    |
| Net revenues                                      | 798,246                             | 736,059     |
| <b>Operating expenses</b>                         |                                     |             |
| Gaming                                            | 362,018                             | 340,169     |
| Food, beverage and other                          | 90,265                              | 87,804      |
| General and administrative                        | 135,577                             | 115,997     |
| Depreciation and amortization                     | 77,071                              | 53,337      |
| Insurance recoveries, net of deductible charges   |                                     | (3,863)     |
| Total operating expenses                          | 664,931                             | 593,444     |
| Income from operations                            | 133,315                             | 142,615     |
| <b>Other income (expenses)</b>                    |                                     |             |
| Interest expense                                  | (27,924)                            | (18,043)    |
| Interest income                                   | 262                                 | 219         |
| Gain from unconsolidated affiliates               | 1,721                               | 1,685       |
| Other                                             | 664                                 | (1,003)     |
| Total other expenses                              | (25,277)                            | (17,142)    |
| <b>Income from operations before income taxes</b> | 108,038                             | 125,473     |
| Taxes on income                                   | 42,767                              | 46,854      |
| <b>Net income</b>                                 | \$ 65,271                           | \$ 78,619   |
| <b>Earnings per common share:</b>                 |                                     |             |
| Basic earnings per common share                   | \$ 0.68                             | \$ 0.83     |
| Diluted earnings per common share                 | \$ 0.63                             | \$ 0.74     |

See accompanying notes to the condensed consolidated financial statements.

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

**Condensed Consolidated Statements of Comprehensive Income**

**(in thousands) (unaudited)**

|                                                                                  | <b>Three Months Ended March 31,</b> |             |
|----------------------------------------------------------------------------------|-------------------------------------|-------------|
|                                                                                  | <b>2013</b>                         | <b>2012</b> |
| Net income                                                                       | \$ 65,271                           | \$ 78,619   |
| Other comprehensive (loss) income, net of tax:                                   |                                     |             |
| Foreign currency translation adjustment during the period                        | (391)                               | 288         |
| Unrealized holding losses on corporate debt securities arising during the period | (99)                                | (70)        |
| Other comprehensive (loss) income                                                | (490)                               | 218         |
| Comprehensive income                                                             | \$ 64,781                           | \$ 78,837   |

See accompanying notes to the condensed consolidated financial statements.

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

(in thousands, except share data) (unaudited)

|                                                           | Preferred Stock |        | Common Stock |        | Additional      | Retained   | Accumulated Other    | Total                |
|-----------------------------------------------------------|-----------------|--------|--------------|--------|-----------------|------------|----------------------|----------------------|
|                                                           | Shares          | Amount | Shares       | Amount | Paid-In Capital | Earnings   | Comprehensive Income | Shareholders' Equity |
| 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 \$1,126   |                 |        | 214,632      | 2      | 12,919          |            |                      | 12,921               |
| Restricted stock activity, including tax benefit of \$353 |                 |        | (4,076)      |        | 1,109           |            |                      | 1,109                |
| Change in fair value of corporate debt securities         |                 |        |              |        |                 |            | (70)                 | (70)                 |
| Foreign currency translation adjustment                   |                 |        |              |        |                 |            | 288                  | 288                  |
| Net income                                                |                 |        |              |        |                 | 78,619     |                      | 78,619               |
| Balance, March 31, 2012                                   | 12,275          | \$     | 76,423,682   | \$ 758 | \$ 1,399,383    | \$ 661,821 | \$ 2,536             | \$ 2,064,498         |
| Balance, December 31, 2012                                | 12,275          | \$     | 77,446,601   | \$ 769 | \$ 1,451,965    | \$ 795,173 | \$ 3,022             | \$ 2,250,929         |
| Repurchase of preferred stock                             | (225)           |        |              |        | (22,275)        |            |                      | (22,275)             |
| Stock option activity, including tax benefit of \$2,717   |                 |        | 540,567      | 5      | 24,732          |            |                      | 24,737               |
| Restricted stock activity, including tax benefit of \$749 |                 |        | 188,013      |        | 442             |            |                      | 442                  |
| Change in fair value of corporate debt securities         |                 |        |              |        |                 |            | (99)                 | (99)                 |
| Foreign currency translation adjustment                   |                 |        |              |        |                 |            | (391)                | (391)                |
| Net income                                                |                 |        |              |        |                 | 65,271     |                      | 65,271               |
| Balance, March 31, 2013                                   | 12,050          | \$     | 78,175,181   | \$ 774 | \$ 1,454,864    | \$ 860,444 | \$ 2,532             | \$ 2,318,614         |

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)**

| <b>Three Months Ended March 31,</b>                                               | <b>2013</b>     | <b>2012</b>     |
|-----------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Operating activities</b>                                                       |                 |                 |
| Net income                                                                        | \$ 65,271       | \$ 78,619       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                 |                 |
| Depreciation and amortization                                                     | 77,071          | 53,337          |
| Amortization of items charged to interest expense                                 | 2,149           | 1,649           |
| Loss (gain) on sale of fixed assets                                               | 2,390           | (945)           |
| Gain from unconsolidated affiliates                                               | (1,721)         | (1,685)         |
| Distributions of earnings from unconsolidated affiliates                          | 5,000           |                 |
| Deferred income taxes                                                             | 8,174           | (3,143)         |
| Charge for stock-based compensation                                               | 6,251           | 7,911           |
| (Increase) decrease, net of businesses acquired                                   |                 |                 |
| Accounts receivable                                                               | (3,807)         | (114)           |
| Insurance receivable                                                              |                 | 1,072           |
| Prepaid expenses and other current assets                                         | 21,878          | 3,459           |
| Other assets                                                                      | (11,544)        | (2,328)         |
| Increase (decrease), net of businesses acquired                                   |                 |                 |
| Accounts payable                                                                  | 3,922           | 197             |
| Accrued expenses                                                                  | (30,503)        | (23,897)        |
| Accrued interest                                                                  | (6,990)         | (7,711)         |
| Accrued salaries and wages                                                        | (18,096)        | (22,201)        |
| Gaming, pari-mutuel, property and other taxes                                     | 5,703           | (219)           |
| Income taxes                                                                      |                 | 31,434          |
| Other current and noncurrent liabilities                                          | 6,669           | 5,465           |
| Other noncurrent tax liabilities                                                  | 1,971           | 1,724           |
| Net cash provided by operating activities                                         | 133,788         | 122,624         |
| <b>Investing activities</b>                                                       |                 |                 |
| Expenditures for property and equipment, net of reimbursements                    | (62,703)        | (119,659)       |
| Proceeds from sale of property and equipment                                      | 2,517           | 1,283           |
| Investment in joint ventures                                                      | (500)           | (39,600)        |
| Decrease in cash in escrow                                                        | 26,000          | 25,650          |
| Acquisition of gaming licenses                                                    | (1,125)         |                 |
| Net cash used in investing activities                                             | (35,811)        | (132,326)       |
| <b>Financing activities</b>                                                       |                 |                 |
| Proceeds from exercise of options                                                 | 15,461          | 4,640           |
| Repurchase of preferred stock                                                     | (22,275)        |                 |
| Proceeds from issuance of long-term debt, net of issuance costs                   | 19,954          | 47,932          |
| Principal payments on long-term debt                                              | (136,949)       | (60,656)        |
| Proceeds from insurance financing                                                 | 15,306          |                 |
| Payments on insurance financing                                                   | (5,706)         | (4,682)         |
| Tax benefit from stock options exercised                                          | 3,467           | 1,479           |
| Net cash used in financing activities                                             | (110,742)       | (11,287)        |
| <b>Net decrease in cash and cash equivalents</b>                                  | <b>(12,765)</b> | <b>(20,989)</b> |
| Cash and cash equivalents at beginning of year                                    | 260,467         | 238,440         |
| Cash and cash equivalents at end of period                                        | \$ 247,702      | \$ 217,451      |

**Supplemental disclosure**

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|                                                   |    |        |    |        |
|---------------------------------------------------|----|--------|----|--------|
| Interest expense paid, net of amounts capitalized | \$ | 32,673 | \$ | 24,007 |
| Income taxes paid                                 | \$ | 1,124  | \$ | 15,353 |

See accompanying notes to the condensed consolidated financial statements.

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**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 March 31, 2013, the Company owned, managed, or had ownership interests in twenty-nine facilities in the following nineteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

The 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 three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2012 should be read in conjunction with these condensed consolidated financial statements. The December 31, 2012 financial information has been derived from the Company's audited consolidated financial statements.

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

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

A REIT is not permitted to retain earnings and profits ( E&P ) accumulated during the years when the company or its predecessor was taxed as a regular C corporation. For GLPI to elect REIT status, GLPI must distribute to its shareholders its undistributed E&P attributable to taxable periods prior to its REIT election. The Company currently estimates that, if GLPI were to elect REIT status as of January 1, 2014, the aggregate amount of the special E&P taxable dividend would be approximately \$1.1 billion. The dividend will be paid in a combination of cash and GLPI common stock, which will consist of at least 20% in cash with the remainder in GLPI common stock.

As a result of the proposed Spin-Off, GLPI will initially own substantially all of the real property assets and will lease back most of those assets to PNG for use by its subsidiaries, under a triple net 15 year Master Lease agreement (excluding four 5 year renewals, which are at PNG 's option) as well as own and operate Hollywood Casino Perryville and Hollywood Casino Baton Rouge through a taxable REIT subsidiary. PNG would hold the gaming licenses, operate the leased gaming facilities and own and operate other assets, including the Casino Rama casino management contract, the 50% joint venture interest in Hollywood Casino at Kansas Speedway, seven non-casino racetracks and gaming equipment.

The Company has received a private letter ruling from the Internal Revenue Service relating to the tax treatment of the separation and the qualification of GLPI as a REIT. The private letter ruling is subject to certain qualifications and based on certain representations and statements made by the Company. If such representations and statements are untrue or incomplete in any material

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respect (including as a result of a material change in the proposed transaction or other relevant facts), the Company may not be able to rely on the private letter ruling.

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

### **3. 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.

The amounts included in promotional allowances for the three months ended March 31, 2013 and 2012 are as follows:

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|                              | Three Months Ended March 31, |           |
|------------------------------|------------------------------|-----------|
|                              | 2013                         | 2012      |
|                              | (in thousands)               |           |
| Rooms                        | \$ 9,319                     | \$ 6,294  |
| Food and beverage            | 32,490                       | 27,479    |
| Other                        | 2,777                        | 2,596     |
| Total promotional allowances | \$ 44,586                    | \$ 36,369 |

The estimated cost of providing such complimentary services for the three months ended March 31, 2013 and 2012 are as follows:

|                                      | Three Months Ended March 31, |           |
|--------------------------------------|------------------------------|-----------|
|                                      | 2013                         | 2012      |
|                                      | (in thousands)               |           |
| Rooms                                | \$ 3,239                     | \$ 2,356  |
| Food and beverage                    | 21,979                       | 18,480    |
| Other                                | 1,644                        | 1,522     |
| Total cost of complimentary services | \$ 26,862                    | \$ 22,358 |

Table of Contents**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 months ended March 31, 2013, these expenses, which are recorded primarily within gaming expense in the condensed consolidated statements of income, were \$282.0 million, as compared to \$276.9 million for the three months ended March 31, 2012.

**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 March 31, 2013, the Company had outstanding 12,050 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.

The following table sets forth the allocation of net income for the three months ended March 31, 2013 and 2012 under the two-class method:

|                                          | Three Months Ended March 31, |        |      |        |
|------------------------------------------|------------------------------|--------|------|--------|
|                                          | 2013                         |        | 2012 |        |
|                                          | (in thousands)               |        |      |        |
| Net income                               | \$                           | 65,271 | \$   | 78,619 |
| Net income applicable to preferred stock |                              | 12,358 |      | 15,272 |
| Net income applicable to common stock    | \$                           | 52,913 | \$   | 63,347 |

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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 months ended March 31, 2013 and 2012:

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|                                                            | Three Months Ended March 31, |         |
|------------------------------------------------------------|------------------------------|---------|
|                                                            | 2013                         | 2012    |
|                                                            | (in thousands)               |         |
| Determination of shares:                                   |                              |         |
| Weighted-average common shares outstanding                 | 77,553                       | 75,994  |
| Assumed conversion of dilutive employee stock-based awards | 2,940                        | 2,222   |
| Assumed conversion of restricted stock                     | 99                           | 138     |
| Assumed conversion of preferred stock                      | 22,295                       | 27,278  |
| Diluted weighted-average common shares outstanding         | 102,887                      | 105,632 |

The Company is required to adjust its diluted weighted-average common shares outstanding for the purpose of calculating diluted EPS as follows: 1) when the average price of the Company's common stock at the end of the reporting period is less than \$45, the diluted weighted-average common shares outstanding is increased by 26,777,778 shares (regardless of how much the stock price is below \$45); 2) when the average price of the Company's common stock at the end of the reporting period is between \$45 and \$67, the diluted weighted-average common shares outstanding is increased by an amount which can be calculated by dividing \$1.205 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 17,985,075 shares and 26,777,778 shares; and 3) when the average price of the Company's common stock at the end of the reporting period is above \$67, the diluted weighted-average common shares outstanding is increased by 17,985,075 shares (regardless of how much the stock price exceeds \$67). See Note 9 for discussion of the proposed Spin-Off's potential future impact on the calculation of diluted weighted-average common shares outstanding.

Options to purchase 235,125 shares and 3,122,903 shares were outstanding during the three months ended March 31, 2013 and 2012, 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 March 31,          |         |    |         |
|----------------------------------------------------|---------------------------------------|---------|----|---------|
|                                                    | 2013                                  | 2012    |    |         |
|                                                    | (in thousands, except per share data) |         |    |         |
| <b>Calculation of basic EPS:</b>                   |                                       |         |    |         |
| Net income applicable to common stock              | \$                                    | 52,913  | \$ | 63,347  |
| Weighted-average common shares outstanding         |                                       | 77,553  |    | 75,994  |
| Basic EPS                                          | \$                                    | 0.68    | \$ | 0.83    |
|                                                    |                                       |         |    |         |
| <b>Calculation of diluted EPS:</b>                 |                                       |         |    |         |
| Net income                                         | \$                                    | 65,271  | \$ | 78,619  |
| Diluted weighted-average common shares outstanding |                                       | 102,887 |    | 105,632 |
| Diluted EPS                                        | \$                                    | 0.63    | \$ | 0.74    |

## 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 months ended March 31, 2013 was \$6.3 million, as compared to \$7.9 million for the three months

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ended March 31, 2012. 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 6.57 years, in order to match the expected life of the options at the grant date. Historically, at the grant date, there has been no expected dividend yield assumption since the Company has not paid any cash dividends on its common stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the

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Company's employees. Forfeitures are estimated at the date of grant based on historical experience. No stock options were granted by the Company during the three months ended March 31, 2013.

The Company has also issued 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 March 31, 2013, there was \$27.6 million of total unrecognized compensation cost that will be recognized over the grants remaining weighted average vesting period of 3.29 years. For the three months ended March 31, 2013, the Company recognized \$2.8 million of compensation expense associated with these awards, as compared to \$1.2 million for the three months ended March 31, 2012.

Additionally, 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 below. As of March 31, 2013, there was \$12.1 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period of 2.51 years. For the three months ended March 31, 2013, the Company recognized \$2.8 million of compensation expense associated with these awards, as compared to \$1.4 million for the three months ended March 31, 2012.

The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at March 31, 2013 and 2012:

|                                        | 2013   | 2012   |
|----------------------------------------|--------|--------|
| Risk-free interest rate                | 1.08%  | 1.04%  |
| Expected volatility                    | 46.27% | 47.60% |
| Dividend yield                         |        |        |
| Weighted-average expected life (years) | 6.57   | 5.82   |
| Forfeiture rate                        | 5.00%  | 5.00%  |

#### 4. New Accounting Pronouncements

In February 2013, the FASB finalized the disclosure requirements on how entities should present financial information about reclassification adjustments from accumulated other comprehensive income. The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, companies would instead cross reference to the related footnote for additional information. The disclosures required by this amendment are effective for public entities for annual and interim reporting periods beginning after December 15, 2012. The Company adopted the guidance as of January 1, 2013. Other than the additional disclosure requirements shown below, the adoption of this guidance did not have an impact on the Company's financial statements.



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The net of tax changes in accumulated other comprehensive income by component were as follows:

|                                                        | Foreign Currency | Available for<br>sale securities | Total    |
|--------------------------------------------------------|------------------|----------------------------------|----------|
| Balance at December 31, 2011                           | \$ 1,202         | \$ 1,116                         | \$ 2,318 |
| Other comprehensive (loss) income:                     |                  |                                  |          |
| Foreign currency translation adjustment                | 288              |                                  | 288      |
| Unrealized holding losses on corporate debt securities |                  | (70)                             | (70)     |
| Ending balance at March 31, 2012                       | \$ 1,490         | \$ 1,046                         | \$ 2,536 |
| Balance at December 31, 2012                           | \$ 1,628         | \$ 1,394                         | \$ 3,022 |
| Other comprehensive (loss) income:                     |                  |                                  |          |
| Foreign currency translation adjustment                | (391)            |                                  | (391)    |
| Unrealized holding losses on corporate debt securities |                  | (99)                             | (99)     |
| Ending balance at March 31, 2013                       | \$ 1,237         | \$ 1,295                         | \$ 2,532 |

## 5. Property and Equipment

Property and equipment, net, consists of the following:

|                                    | March 31,<br>2013 | December 31,<br>2012 |
|------------------------------------|-------------------|----------------------|
|                                    | (in thousands)    |                      |
| Land and improvements              | \$ 438,378        | \$ 442,882           |
| Building and improvements          | 2,295,878         | 2,283,230            |
| Furniture, fixtures, and equipment | 1,275,140         | 1,240,898            |
| Leasehold improvements             | 17,188            | 17,229               |
| Construction in progress           | 37,267            | 30,531               |
| Total property and equipment       | 4,063,851         | 4,014,770            |
| Less accumulated depreciation      | (1,356,679)       | (1,283,973)          |
| Property and equipment, net        | \$ 2,707,172      | \$ 2,730,797         |

Depreciation expense, for property and equipment, totaled \$76.2 million for the three months ended March 31, 2013, as compared to \$53.2 million for the three months ended March 31, 2012. Interest capitalized in connection with major construction projects was \$0.1 million for the three months ended March 31, 2013, as compared to \$2.9 million for the three months ended March 31, 2012.

## 6. Long-term Debt

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

|                                                             | March 31,<br>2013 | December 31,<br>2012 |
|-------------------------------------------------------------|-------------------|----------------------|
|                                                             | (in thousands)    |                      |
| Senior secured credit facility                              | \$ 2,278,050      | \$ 2,394,963         |
| 325 million 8 ¾% senior subordinated                        |                   |                      |
| \$ notes due August 2019                                    | 325,000           | 325,000              |
| Other long-term obligations                                 | 10,000            | 10,000               |
| Capital leases                                              | 2,076             | 2,111                |
|                                                             | 2,615,126         | 2,732,074            |
| Less current maturities of long-term debt                   | (88,368)          | (81,497)             |
| Less discount on senior secured credit facility Term Loan B | (1,442)           | (1,504)              |
|                                                             | \$ 2,525,316      | \$ 2,649,073         |

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The following is a schedule of future minimum repayments of long-term debt as of March 31, 2013 (in thousands) (which does not contemplate the redemption of debt obligations that are anticipated to occur in connection with the proposed Spin-Off):

|                        |    |           |
|------------------------|----|-----------|
| Within one year        | \$ | 88,368    |
| 1-3 years              |    | 238,633   |
| 3-5 years              |    | 775,543   |
| Over 5 years           |    | 1,512,582 |
| Total minimum payments | \$ | 2,615,126 |

## **Senior Secured Credit Facility**

The Company's senior secured credit facility had a gross outstanding balance of \$2,278.1 million at March 31, 2013, consisting of a \$1,028.8 million Term Loan A facility and a \$1,249.3 million Term Loan B facility. No balances were outstanding on the revolving credit facility at March 31, 2013. Additionally, at March 31, 2013, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$73.2 million, resulting in \$711.8 million of available borrowing capacity as of March 31, 2013 under the revolving credit facility.

## **Covenants**

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

At March 31, 2013, the Company was in compliance with all required financial covenants.

## **7. 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

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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 QSO. The agreement between the Company's gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. ( "Belle"), and its QSO, Missouri River Historical Development, Inc. ( "MRHD"), expired in early July 2012. On July 12, 2012, when presented with an extension of the Company's QSO/operating agreement for the Sioux City facility through March 2015, the Iowa Racing and Gaming Commission ( "IRGC") failed to approve the extension and urged a shorter extension. In mid-August 2012, MRHD offered a revised contract to the Company that would require a yearly renewal from the IRGC and stated that MRHD would be able to continue searching for an operator for a new land-based casino. The Company rejected this contract offer and at the August 23, 2012 IRGC meeting urged the IRGC to reconsider the original extension offer through March 2015. The IRGC did not act on this request and, concluded that the casino can continue to operate without an effective operating agreement. The IRGC also announced at the July 12, 2012 meeting the schedule for requests for proposals for a new land-based Woodbury County casino. Applications and financing proposals were due by November 5, 2012. The Company submitted two proposals for a new gaming and entertainment destination in Woodbury County for the IRGC's consideration. On April 18, 2013, the IRGC awarded the license to another gaming operator. The IRGC has indicated that it intends to permit the Company to continue operations at its Sioux City facility until such time as the new

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casino opens to the public, but not beyond. The Company is currently reviewing all of its options and will maintain an open dialogue with members of the IRGC, Sioux City officials, and its employees regarding the IRGC's decision. However, in light of this decision, the Company believes that the fair value of its Sioux City reporting unit will be less than its carrying amount and expects to record a goodwill and other intangible impairment charge of between \$65 million and \$80 million in its results in the second quarter of 2013. The exact amount of the charge will be determined after the Company completes its analysis of the estimated future expected cash flows it anticipates receiving from the operations of its Sioux City facility. Argosy Casino Sioux City had remaining goodwill and other intangible assets of \$92.8 million at March 31, 2013, and had net revenues and income from operations of \$14.0 million and \$3.7 million, respectively, for the three months ended March 31, 2013, which represented 1.8% and 2.8% of the Company's consolidated results. 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. A trial has been scheduled to begin in April 2014.

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 alleged 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 sought 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 was included in current assets at December 31, 2012) paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants filed motions to dissolve and reduce the attachment. Those motions were denied. Following discovery, both parties filed dispositive motions and the motions were argued on April 20, 2012. In September 2012, the judge ruled in favor of the County on its motion for summary judgment. At December 31, 2012, the Company accrued \$6.4 million which was included in accrued expenses within the consolidated balance sheet, based on settlement discussions that took place in January 2013. In February 2013, the Company finalized the settlement with the County and the \$25 million privilege fee was returned to the Company, net of the amount previously accrued.

**8. Income Taxes**

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

|                                           | <b>Noncurrent<br/>tax liabilities<br/>(in thousands)</b> |
|-------------------------------------------|----------------------------------------------------------|
| Balance at January 1, 2013                | \$ 20,393                                                |
| Additions based on current year positions | 280                                                      |
| Additions based on prior year positions   | 1,691                                                    |
| Currency translation adjustments          | (607)                                                    |
| Balance at March 31, 2013                 | \$ 21,757                                                |

The increase in the Company's liability for unrecognized tax benefits during the three months ended March 31, 2013 was primarily due to recording interest expense accruals for previously recorded unrecognized tax benefits.

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The Company's effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 39.6% for the three months ended March 31, 2013, as compared to 37.3% for the three months ended March 31, 2012. During the three months ended March 31, 2013, the Company recorded a \$1.1 million valuation allowance against the tax benefit associated with capital losses incurred within the quarter that the Company does not believe it will be able to utilize prior to their expiration.

At March 31, 2013 and December 31, 2012, prepaid expenses within the condensed consolidated balance sheets include prepaid income taxes of \$33.6 million and \$68.4 million, respectively.

### **9. Shareholders' Equity**

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

As part of the proposed Spin-Off transaction described further in Note 2, the Company entered into an agreement (the "Exchange Agreement") with FIF V PFD LLC, an affiliate of Fortress Investment Group LLC ("Fortress"), providing for the potential

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exchange of shares of the Company's Preferred Stock for shares of a new class of preferred stock, Series C Convertible Preferred Stock (Series C), in contemplation of the potential Spin-Off.

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

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

The Company, Fortress and certain other holders of preferred stock are party to an Investor Rights Agreement, dated July 3, 2008 (the Investor Rights Agreement), that grants those holders certain rights with respect to the Company. In connection with the Exchange Agreement, Fortress and the Company entered into the Supplementary Investor Rights Agreement, which provides that, as between Fortress and the Company, the Series C shares will be governed by the Investor Rights Agreement, and modifies certain other existing arrangements between the Company and Fortress. The Supplementary Investor Rights Agreement provides Fortress with additional registration rights, beyond those currently set forth in the Investor Rights Agreement, including additional opportunities to sell shares of Series C stock in a registered offering, the right to select the managing underwriter in an underwritten offering prior to the Spin-Off and an increase in the registration expenses borne by the Company. The Supplementary Investor Rights Agreement also provides that, following the completion of the Spin-Off, the following rights and obligations under the Investor Rights Agreement would be eliminated: Fortress's right to nominate a director, the obligation of Fortress to vote its shares of common stock in accordance with the recommendations of the Company's Board of Directors, the restriction on hedging activities and certain information rights.

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

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

**10. Segment Information**

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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 in Ohio which the Company anticipates completing in 2014.

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

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, Boomtown Biloxi, Hollywood

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Casino St. Louis (formerly Harrah's St. Louis which was acquired from Caesars Entertainment on November 2, 2012), and includes the Company's 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway that opened on February 3, 2012.

The Other category consists of the Company's standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and the Company's joint venture interests in Sam Houston Race Park, Valley Race Park and Freehold Raceway. 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 the Bullwhackers property.

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

|                                                         | Midwest    | East/West  | Southern Plains<br>(in thousands) | Other    | Total      |
|---------------------------------------------------------|------------|------------|-----------------------------------|----------|------------|
| <b>Three months ended March 31, 2013</b>                |            |            |                                   |          |            |
| Net revenues                                            | \$ 287,312 | \$ 317,048 | \$ 184,684                        | \$ 9,202 | \$ 798,246 |
| Income (loss) from operations                           | 63,796     | 69,107     | 37,009                            | (36,597) | 133,315    |
| Depreciation and amortization                           | 32,257     | 20,833     | 19,888                            | 4,093    | 77,071     |
| Gain (loss) from unconsolidated affiliates              |            |            | 1,737                             | (16)     | 1,721      |
| Capital expenditures                                    | 33,830     | 7,071      | 19,027                            | 2,775    | 62,703     |
| <b>Three months ended March 31, 2012</b>                |            |            |                                   |          |            |
| Net revenues                                            | 205,110    | 370,629    | 149,720                           | 10,600   | 736,059    |
| Income (loss) from operations                           | 46,281     | 83,891     | 44,712                            | (32,269) | 142,615    |
| Depreciation and amortization                           | 17,552     | 22,241     | 11,388                            | 2,156    | 53,337     |
| Gain from unconsolidated affiliates                     |            |            | 1,678                             | 7        | 1,685      |
| Capital expenditures                                    | 101,880    | 10,659     | 3,932                             | 3,188    | 119,659    |
| <b>Balance sheet at March 31, 2013</b>                  |            |            |                                   |          |            |
| Total assets                                            | 2,300,768  | 1,188,482  | 1,673,197                         | 403,129  | 5,565,576  |
| Investment in and advances to unconsolidated affiliates |            | 87         | 135,251                           | 66,389   | 201,727    |
| Goodwill and other intangible assets, net               | 1,025,295  | 226,047    | 778,913                           | 55,818   | 2,086,073  |
| <b>Balance sheet at December 31, 2012</b>               |            |            |                                   |          |            |
| Total assets                                            | 2,318,283  | 1,198,391  | 1,680,773                         | 446,610  | 5,644,057  |
| Investment in and advances to unconsolidated affiliates |            | 87         | 138,514                           | 65,905   | 204,506    |
| Goodwill and other intangible assets, net               | 1,025,505  | 226,047    | 779,787                           | 55,827   | 2,087,166  |

## 11. Fair Value of Financial Instruments

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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 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.

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

|                                         | March 31, 2013  |            | December 31, 2012 |            |
|-----------------------------------------|-----------------|------------|-------------------|------------|
|                                         | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| <b>Financial assets:</b>                |                 |            |                   |            |
| Cash and cash equivalents               | \$ 247,702      | \$ 247,702 | \$ 260,467        | \$ 260,467 |
| Investment in corporate debt securities | 6,650           | 6,650      | 6,790             | 6,790      |
| <b>Financial liabilities:</b>           |                 |            |                   |            |
| Long-term debt                          |                 |            |                   |            |
| Senior secured credit facility          | 2,276,608       | 2,289,044  | 2,393,459         | 2,401,225  |
| Senior subordinated notes               | 325,000         | 368,063    | 325,000           | 368,875    |
| Other long-term obligations             | 10,000          | 10,000     | 10,000            | 10,000     |

## 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 March 31, 2013 and December 31, 2012 (in thousands):

| Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | March 31, 2013 Total |
|------------------------|---------------------------------------------------------|-----------------------------------------------|-------------------------------------------|----------------------|
|------------------------|---------------------------------------------------------|-----------------------------------------------|-------------------------------------------|----------------------|

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## Liabilities (Level 1)

### Assets:

|                                         |              |    |    |       |    |    |       |
|-----------------------------------------|--------------|----|----|-------|----|----|-------|
| Investment in corporate debt securities | Other assets | \$ | \$ | 6,650 | \$ | \$ | 6,650 |
|-----------------------------------------|--------------|----|----|-------|----|----|-------|

| 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, 2012 Total |
|------------------------|-------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|-------------------------|
|------------------------|-------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|-------------------------|

### Assets:

|                                         |              |    |    |       |    |    |       |
|-----------------------------------------|--------------|----|----|-------|----|----|-------|
| 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 three months ended March 31, 2013.

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**13. Subsequent Event**

On April 18, 2013, in connection with a request for proposal it issued in 2012, the IRGC awarded a new gaming license (with certain conditions) for the development of an additional casino in Sioux City, Iowa to another applicant. The IRGC has indicated that it intends to permit the Company to continue operations at its Sioux City facility until such time as the new casino opens to the public, but not beyond. The Company, which already has several legal actions pending that relate to this issue, is currently reviewing all of its options and will maintain an open dialogue with members of the IRGC, Sioux City officials, and its employees regarding the IRGC's decision. However, in light of this decision, the Company believes that the fair value of its Sioux City reporting unit will be less than its carrying amount and expects to record a goodwill and other intangible asset impairment charge of between \$65 million and \$80 million in its results for the second quarter of 2013. The exact amount of the charge will be determined after the Company completes its analysis of the estimated future expected cash flows it anticipates receiving from the operations of its Sioux City facility. This facility has goodwill and other intangible assets of \$92.8 million at March 31, 2013 and had net revenues and income from operations of \$14.0 million and \$3.7 million, respectively, for the three months ended March 31, 2013, which represented 1.8% and 2.8% of the Company's consolidated results.

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**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 March 31, 2013, we owned, managed, or had ownership interests in twenty-nine facilities in the following nineteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

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 M Resorts), greenfield projects (such as 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 November 2, 2012, we acquired Harrah's St. Louis facility, which we are in the process of rebranding to Hollywood Casino St. Louis.

The vast majority of our revenue is gaming revenue, derived primarily from gaming on slot machines (which represented approximately 84% and 88% of our gaming revenue in 2012 and 2011, 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

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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.

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 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.

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

On November 15, 2012, we announced that we intend to pursue a plan to separate the majority of our gaming operating assets and real property assets into two publicly traded companies, including an operating entity, PNG, and, through a tax-free Spin-Off of our real estate assets to holders of our common and preferred stock, a newly formed publicly traded REIT, GLPI, subject to required gaming regulatory body approvals and other contingencies noted below. As a result of the proposed Spin-Off, GLPI will initially own substantially all of the real property assets and will lease back most of those assets to PNG for use by its subsidiaries, under a triple net 15 year Master Lease agreement (excluding four 5 year renewal options, which are at PNG's option). PNG would hold the gaming licenses, operate the leased gaming facilities and own and operate other assets, including the Casino Rama casino management contract, the 50% joint venture interest in Hollywood Casino at Kansas Speedway, seven non-casino racetracks and gaming equipment.

Based on the Company's current real estate portfolio, GLPI is expected to initially own the real estate for 17 casino facilities. Through its rent structure, which is partially based on the performance of the facilities, GLPI would expect to grow organically by participating in PNG's growing revenue base. In addition, GLPI would focus on expanding its gaming and leisure sector real estate portfolio through acquisitions, and thereby diversify its asset base and tenant base over time. GLPI will also own and operate Hollywood Casino Perryville and Hollywood Casino Baton Rouge through its taxable REIT subsidiary.

After the proposed Spin-Off of GLPI shares to the Company's shareholders, GLPI will declare a dividend to its shareholders to distribute any accumulated earnings and profits attributable to any pre-REIT years to comply with certain REIT qualification requirements. We currently estimate that, if GLPI were to elect REIT status as of January 1, 2014, the aggregate amount of the taxable dividend would be approximately \$1.1 billion. The dividend will be paid in a combination of cash and GLPI common stock, which will consist of at least 20% in cash with the remainder in GLPI common stock. In addition, going forward, the Company expects that GLPI will distribute at least 90% of its annual taxable income as dividends.

Prior to the Spin-Off, the Company anticipates refinancing its existing debt obligations and PNG and GLPI are expected to enter into new credit facilities.

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

The completion of the proposed transaction is contingent on receipt of regulatory approvals, which the Company anticipates could occur in the second half of 2013, the receipt of final approval by the Penn National Gaming Board of Directors, the receipt of legal and accounting opinions, and other customary conditions. The Company may, at any time and for any reason until the proposed Spin-Off is complete, abandon the Spin-Off or modify or change the terms of the Spin-Off.

**Segment Information**

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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 in Ohio 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 the M Resort.

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

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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. 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, increased stock market volatility, and higher taxes, 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 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 and we are selected as a licensee.

*Financial Highlights:*

We reported net revenues and income from operations of \$798.2 million and \$133.3 million, respectively, for the three months ended March 31, 2013 compared to \$736.1 million and \$142.6 million, respectively, for the corresponding period in the prior year. The major factors affecting our results for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, were:

- 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.
- The opening of Hollywood Casino Toledo on May 29, 2012, which generated \$51.1 million of net revenues for the three months ended March 31, 2013.
- The opening of Hollywood Casino Columbus on October 8, 2012, which generated \$63.6 million of net revenues for the three months ended March 31, 2013.
- New competition in our Midwest segment for Hollywood Casino Lawrenceburg, namely the opening on June 1, 2012 of a new racino in Columbus, Ohio, the March 4, 2013 opening of a casino in Cincinnati, Ohio, as well as our Columbus casino.

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- The acquisition of Harrah's St. Louis facility, now known as Hollywood Casino St. Louis, on November 2, 2012, which contributed \$57.8 million of net revenues for the three months ended March 31, 2013.
- 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 riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012, which impacted Hollywood Casino Baton Rouge.
- A pre-tax insurance gain of \$3.9 million at Hollywood Casino Tunica during the three months ended March 31, 2012.
- Net income decreased by \$13.3 million for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained above, as well as increased depreciation and amortization expense of \$23.7 million and interest expense of \$9.9 million as well as decreased income taxes for \$4.1 million.

### *Segment Developments:*

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

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*Midwest*

- 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, budgeted at approximately \$257 million and \$265 million, inclusive of \$50 million in license fees and \$75 million in relocation fees, respectively. Pursuant to this arrangement, the Ohio Lottery Commission would retain 33.5% of video lottery terminal revenues (exclusive of the horsemen's share). 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. The definitive documentation of the MOU is not yet complete. In June 2012, we announced that we had 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 and feature 1,000 or up to 1,500 video lottery terminals, 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, which will be a standardbred track and feature 1,500 or up to 1,800 video lottery terminals, will be located on 125 acres on the site of an abandoned Delphi Automotive plant near Wagner Ford and Needmore roads in North Dayton. On May 1, 2013, the Company received approval from the Ohio Racing Commission for our relocation plans for each new racetrack and VLT facility and expects both to open in 2014. The opening of our Dayton facility may 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, filed motions for judgment on the pleadings. In May 2012, the complaint was dismissed; however, the plaintiffs filed an appeal and oral arguments were held on January 17, 2013. In March 2013, the Ohio appeals court upheld the ruling. The decision of the appeals court was appealed to the Ohio Supreme Court by the plaintiffs on April 30, 2013. The Ohio Supreme Court has the discretion to accept or reject the appeal.

- On March 4, 2013, a new casino in Cincinnati, Ohio opened, which has had and will continue to have a negative impact on Hollywood Casino Lawrenceburg's financial results. In addition, on June 1, 2012, a new racino at Scioto Downs in Columbus, Ohio opened, which has also negatively impacted Hollywood Casino Lawrenceburg and competes in the same market as Hollywood Casino Columbus. Additionally, new racinos in Ohio are planned at Lebanon Raceway and River Downs, both of which hope to finish in early 2014. We anticipate the opening of these new racinos will have a further adverse impact on Hollywood Casino Lawrenceburg.

*East/West*

- In our East/West segment, Hollywood Casino at Charles Town Races and Hollywood Casino Perryville faced 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 addition, the Anne Arundel facility introduced table games on April 11, 2013, which will further negatively impact our Hollywood Casino at Charles Town Races facility.

- In November 2012, voters 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. On March 5, 2013, table games were opened at Hollywood Casino Perryville. The new

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law also changes the tax rate casino operators pay the state, varying from casino to casino, allows all casinos in 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. For our Hollywood Casino Perryville facility, the tax rate would decrease upon the opening of the Prince George casino from 67 percent to 61 percent with an option for an additional 5 percent reduction if an independent commission agrees. A separate state commission is expected to take bids for the Prince George's casino on May 10, 2013. Though we intend to participate in the bidding process, we believe another operator could be selected, and as a result our financial results would be adversely impacted as it would create additional competition for Hollywood Casino at Charles Town Races and Hollywood Casino Perryville.

### *Southern Plains*

- Gaming licenses in Iowa are typically issued jointly to a gaming operator and a local charitable organization known as a QSO. The agreement between the Company's gaming operator subsidiary in Iowa, Belle, and its QSO, MRHD, expired in early July

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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 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. The IRGC also announced at the July 12, 2012 meeting the schedule for requests for proposals for a new land-based Woodbury County casino. Applications and financing proposals were due by November 5, 2012. We submitted two proposals for a new gaming and entertainment destination in Woodbury County for the IRGC's consideration. On April 18, 2013, the IRGC awarded the license to another gaming operator. The IRGC has indicated that it intends to permit the Company to continue operations at its Sioux City facility until such time as the new casino opens to the public, but not beyond. We are currently reviewing all of our options and will maintain an open dialogue with members of the IRGC, Sioux City officials, and our employees regarding the IRGC's decision. However, in light of this decision, we believe the fair value of our Sioux City reporting unit will be less than its carrying amount and expect to record a goodwill and other intangible asset impairment charge of between \$65 million and \$80 million in our results for the second quarter of 2013. The exact amount of the charge will be determined after we complete our analysis of the estimated future expected cash flows we anticipate receiving from the operations of our Sioux City facility. Argosy Casino Sioux City had remaining goodwill and other intangible assets of \$92.8 million at March 31, 2013, and had net revenues and income from operations of \$14.0 million and \$3.7 million, respectively, for the three months ended March 31, 2013, which represented 1.8% and 2.8% of the Company's consolidated results. 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. A trial has been scheduled to begin in April 2014.

- On April 5, 2013, we announced that we and the Jamul Indian Village (the Tribe) have entered into definitive agreements to jointly develop a Hollywood-branded casino and resort on the Tribe's trust land in San Diego County, California. The proposed facility is located approximately 20 miles east of downtown San Diego. The proposed \$360 million development will include a three-story gaming and entertainment facility of approximately 200,000 square feet featuring at least 1,700 slot machines, 50 live table games including poker, multiple restaurants, bars and lounges and a partially enclosed parking structure with over 1,900 spaces. It is anticipated that construction could commence late this year with an expected construction period of approximately 24 months. We may, under certain circumstances, provide backstop financing to the Tribe in connection with the project and, upon opening, we will manage the casino and resort.

- 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 February 2013, we entered into a definitive agreement to sell our Bullwhackers property, including the gas station/convenience store located approximately 7 miles east of the Bullwhackers casino. We anticipate the sale will close in the second quarter of 2013 following the receipt of gaming regulatory approvals.

**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 consolidated financial condition.

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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, 2012. There has been no material change to these estimates for the three months ended March 31, 2013.

**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, Hollywood Casino Bangor in March 2012, and more recently at Hollywood Casino Perryville in March 2013) and expansions/improvements of existing properties.
- 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, a new riverboat casino and hotel in Baton Rouge, Louisiana which opened on September 1, 2012, a new casino in Biloxi, Mississippi which opened in late May 2012, a new casino that opened in Oxford, Maine on June 5, 2012, and the introduction of tavern licenses and sweepstakes machines 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 and/or property 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.

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- 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 consolidated results of operations for the three months ended March 31, 2013 and 2012 are summarized below:

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|                                                 | Three Months Ended March 31, |            |
|-------------------------------------------------|------------------------------|------------|
|                                                 | 2013                         | 2012       |
|                                                 | (in thousands)               |            |
| <b>Revenues:</b>                                |                              |            |
| Gaming                                          | \$ 717,925                   | \$ 656,077 |
| Food, beverage and other                        | 121,860                      | 112,908    |
| Management service fee                          | 3,047                        | 3,443      |
| Revenues                                        | 842,832                      | 772,428    |
| Less promotional allowances                     | (44,586)                     | (36,369)   |
| Net revenues                                    | 798,246                      | 736,059    |
| <b>Operating expenses:</b>                      |                              |            |
| Gaming                                          | 362,018                      | 340,169    |
| Food, beverage and other                        | 90,265                       | 87,804     |
| General and administrative                      | 135,577                      | 115,997    |
| Depreciation and amortization                   | 77,071                       | 53,337     |
| Insurance recoveries, net of deductible charges |                              | (3,863)    |
| Total operating expenses                        | 664,931                      | 593,444    |
| Income from operations                          | \$ 133,315                   | \$ 142,615 |

Certain information regarding our results of operations by segment for the three months ended March 31, 2013 and 2012 is summarized below:

| Three Months Ended March 31, | Net Revenues      |                   | Income (loss) from Operations |                   |
|------------------------------|-------------------|-------------------|-------------------------------|-------------------|
|                              | 2013              | 2012              | 2013                          | 2012              |
|                              | (in thousands)    |                   |                               |                   |
| Midwest                      | \$ 287,312        | \$ 205,110        | \$ 63,796                     | \$ 46,281         |
| East/West                    | 317,048           | 370,629           | 69,107                        | 83,891            |
| Southern Plains              | 184,684           | 149,720           | 37,009                        | 44,712            |
| Other                        | 9,202             | 10,600            | (36,597)                      | (32,269)          |
| <b>Total</b>                 | <b>\$ 798,246</b> | <b>\$ 736,059</b> | <b>\$ 133,315</b>             | <b>\$ 142,615</b> |

# Revenues

Revenues for the three months ended March 31, 2013 and 2012 were as follows (in thousands):

| Three Months Ended March 31, | 2013       | 2012       | Variance  | Percentage Variance |
|------------------------------|------------|------------|-----------|---------------------|
| Gaming                       | \$ 717,925 | \$ 656,077 | \$ 61,848 | 9.4%                |
| Food, beverage and other     | 121,860    | 112,908    | 8,952     | 7.9%                |
| Management service fee       | 3,047      | 3,443      | (396)     | (11.5)%             |
| Revenues                     | 842,832    | 772,428    | 70,404    | 9.1%                |
| Less promotional allowances  | (44,586)   | (36,369)   | (8,217)   | (22.6)%             |
| Net revenues                 | \$ 798,246 | \$ 736,059 | \$ 62,187 | 8.4%                |

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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, higher taxes, 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

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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.

*Gaming revenue*

Gaming revenue increased by \$61.8 million, or 9.4%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

Gaming revenue for our Midwest segment increased by \$74.2 million, or 38.9%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012, which generated \$47.1 million and \$57.9 million, respectively, of gaming revenue for the three months ended March 31, 2013, which was partially offset by a reduction in gaming revenue for Hollywood Casino Lawrenceburg due to new competition, namely the opening on June 1, 2012 of a new racino in Columbus, Ohio, our own Columbus casino, as well as a new casino that opened on March 4, 2013 in Cincinnati, Ohio.

Gaming revenue for our Southern Plains segment increased by \$33.1 million, or 23.8%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012, which generated \$54.6 million of gaming revenue for the three months ended March 31, 2013, which was partially offset by decreased gaming revenue at Hollywood Casino Baton Rouge and to a lesser extent Argosy Casino Riverside primarily due to the opening of a new riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012 and the continued impact of the opening of our Hollywood Casino at Kansas Speedway joint venture in February 2012, respectively.

Gaming revenue for our East/West segment decreased by \$45.0 million, or 13.9%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the opening of a casino complex at the Arundel Mills mall in Maryland in 2012 which impacted Hollywood Casino at Charles Town Races and Hollywood Casino Perryville, as well as to a lesser extent a more severe winter compared to the prior year. Additionally, we experienced decreased gaming revenue at Hollywood Casino at Penn National Race Course primarily due to adverse weather compared to the prior year.

*Food, beverage and other revenue*

Food, beverage and other revenue increased by \$9.0 million, or 7.9%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

Food, beverage and other revenue for our Midwest segment increased by \$10.3 million, or 48.5%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012, which generated \$4.9 million and \$6.9 million, respectively of food, beverage and other revenue for the three months ended March 31, 2013.

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Food, beverage and other revenue for our Southern Plains segment increased by \$9.1 million, or 38.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012, which contributed \$10.9 million of food, beverage and other revenue for the three months ended March 31, 2013.

Food, beverage and other revenue for our East/West segment decreased by \$9.5 million, or 16.2%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to decreased food, beverage and other revenue at the M Resort due to the sale of an on-site gas station in April 2012, which had sales of \$5.3 million for the three months ended March 31, 2012, and the closure of a dining outlet, which lowered food and beverage revenue by \$1.2 million for the three months ended March 31, 2013 compared to the corresponding period in the prior year.

### *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 increased by \$8.2 million, or 22.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012 in our Southern Plains segment and the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012 in our Midwest segment.

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### Operating Expenses

Operating expenses for the three months ended March 31, 2013 and 2012 were as follows (in thousands):

| Three Months Ended March 31,                    | 2013       | 2012       | Variance  | Percentage<br>Variance |
|-------------------------------------------------|------------|------------|-----------|------------------------|
| Gaming                                          | \$ 362,018 | \$ 340,169 | \$ 21,849 | 6.4%                   |
| Food, beverage and other                        | 90,265     | 87,804     | 2,461     | 2.8%                   |
| General and administrative                      | 135,577    | 115,997    | 19,580    | 16.9%                  |
| Depreciation and amortization                   | 77,071     | 53,337     | 23,734    | 44.5%                  |
| Insurance recoveries, net of deductible charges |            | (3,863)    | 3,863     | 100.0%                 |
| Total operating expenses                        | \$ 664,931 | \$ 593,444 | \$ 71,487 | 12.0%                  |

#### *Gaming expense*

Gaming expense increased by \$21.8 million, or 6.4%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

Gaming expense for our Midwest segment increased by \$34.0 million, or 34.3%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012. These increases were partially offset by an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for Hollywood Casino Lawrenceburg, as well as decreased payroll and marketing costs at this property due to increased cost management efforts.

Gaming expense for our Southern Plains segment increased by \$17.3 million, or 33.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012, which was partially offset by an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for Argosy Casino Riverside and Hollywood Casino Baton Rouge, as well as decreased payroll and marketing costs at these properties due to realignment of costs associated with lower business demand.

Gaming expense for our East/West segment decreased by \$29.1 million, or 15.5%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above at Hollywood Casino at Charles Town Races, Hollywood Casino Perryville and Hollywood Casino at Penn National Race Course.

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

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Food, beverage and other expense increased by \$2.5 million, or 2.8%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

Food, beverage and other expense for our Midwest segment increased by \$6.9 million, or 41.3%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012.

Food, beverage and other expense for our Southern Plains segment increased by \$5.2 million, or 26.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

Food, beverage and other expense for our East/West segment decreased by \$8.4 million, or 19.0%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the sale of an on-site gas station in April 2012 at the M Resort, which had expenses of \$5.5 million for the three months ended March 31, 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.

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General and administrative expenses increased by \$19.6 million, or 16.9%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

General and administrative expenses for our Midwest segment increased by \$8.7 million, or 31.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012.

General and administrative expenses for our Southern Plains segment increased by \$7.9 million, or 29.5%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

General and administrative expenses for Other increased by \$2.8 million, or 9.5%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to higher legal, consulting and other fees related to the pursuit of potential opportunities (primarily in the state of Massachusetts) and increased liability based stock compensation charges for the three months ended March 31, 2013 compared to the corresponding period in the prior year due to an increase in our common stock price.

### *Depreciation and amortization expense*

Depreciation and amortization expense increased by \$23.7 million, or 44.5%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the variances explained below.

Depreciation and amortization expense for our Midwest segment increased by \$14.7 million, or 83.8%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012.

Depreciation and amortization expense for our Southern Plains segment increased by \$8.5 million, or 74.6%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

Depreciation and amortization expense for Other increased by \$1.9 million, or 89.8%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012. This was caused by our decision in April 2012 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.

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## *Insurance recoveries, net of deductible charges*

Insurance recoveries, net of deductible charges during the three months ended March 31, 2012 were related to a pre-tax insurance gain of \$3.9 million for the flood at Hollywood Casino Tunica.

## Other income (expenses)

Other income (expenses) for the three months ended March 31, 2013 and 2012 were as follows (in thousands):

| Three Months Ended March 31,        | 2013        | 2012        | Variance   | Percentage<br>Variance |
|-------------------------------------|-------------|-------------|------------|------------------------|
| Interest expense                    | \$ (27,924) | \$ (18,043) | \$ (9,881) | (54.8)%                |
| Interest income                     | 262         | 219         | 43         | 19.6%                  |
| Gain from unconsolidated affiliates | 1,721       | 1,685       | 36         | 2.1%                   |
| Other                               | 664         | (1,003)     | 1,667      | 166.2%                 |
| Total other expenses                | \$ (25,277) | \$ (17,142) | \$ (8,135) | (47.5)%                |

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*Interest expense*

Interest expense increased by \$9.9 million, or 54.8%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to the higher outstanding borrowing on our senior secured credit facility from 2012 and lower capitalized interest for the three months ended March 31, 2013 compared to the corresponding period in the prior year.

*Other*

Other changed by \$1.7 million, or 166.2%, for the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, primarily due to foreign currency translation gains for the three months ended March 31, 2013 compared to foreign currency translation losses for the three months ended March 31, 2012.

*Taxes*

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 39.6% for the three months ended March 31, 2013, as compared to 37.3% for the three months ended March 31, 2012. During the three months ended March 31, 2013, the Company recorded a \$1.1 million valuation allowance against the tax benefit associated with capital losses incurred within the quarter that the Company does not believe it will be able to utilize prior to their expiration.

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 \$133.8 million and \$122.6 million for the three months ended March 31, 2013 and 2012, respectively. The increase in net cash provided by operating activities of \$11.2 million for the three months ended March 31, 2013 compared to the corresponding period in the prior year comprised primarily of an increase in cash receipts from customers of \$59.2 million, decreased income tax payments of \$14.2 million, and receipt of cash from earnings of our joint venture in Kansas for \$5.0 million, all of which were partially offset by an increase in cash paid to suppliers and vendors of \$49.4 million, cash paid to employees of \$12.7 million, and interest payments of \$8.7 million. The increase in cash receipts collected from our customers and the increase in higher cash payments for operating

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expenses and to employees for the three months ended March 31, 2013 compared to the prior year was primarily due to the previously discussed openings of Hollywood Casino Toledo in late May 2012 and Hollywood Casino Columbus in early October 2012 and the acquisition of Harrah's St. Louis facility on November 2, 2012, partially offset by the impact of new competition on our operations for various properties.

Net cash used in investing activities totaled \$35.8 million and \$132.3 million for the three months ended March 31, 2013 and 2012, respectively. Net cash used in investing activities for the three months ended March 31, 2013 included expenditures for property and equipment, net of reimbursements totaling \$62.7 million, acquisition of gaming licenses for \$1.1 million for Hollywood Casino Toledo and Hollywood Casino Columbus, and investment in joint ventures of \$0.5 million, all of which were partially offset by a decrease in cash in escrow of \$26.0 million and proceeds from the sale of property and equipment totaling \$2.5 million. The decrease in net cash used in investing activities of \$96.5 million for the three months ended March 31, 2013 compared to the corresponding period in the prior year was primarily due to decreased expenditures for property and equipment of \$57.0 million primarily due to the opening of our two new facilities in Ohio in 2012 as well as decreased funding provided to our joint venture in Kansas.

Net cash used in financing activities totaled \$110.7 million and \$11.3 million for the three months ended March 31, 2013 and 2012, respectively. The increase in net cash used in financing activities for the three months ended March 31, 2013 compared to the corresponding period in the prior year was primarily due to higher net repayments to our senior secured credit facility and the repurchase of preferred stock for \$22.3 million, both of which were offset by increased insurance financing and proceeds from the exercise of options.

### *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.

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The following table summarizes our expected capital project expenditures by segment for the fiscal year ending December 31, 2013, and actual expenditures for the three months ended March 31, 2013 (excluding licensing fees and net of reimbursements). The table below should not be utilized to predict future expected capital project expenditures subsequent to 2013.

| Property        | Expected for Year<br>Ending December<br>31, 2013 | Expenditures for<br>Three Months Ended<br>March 31, 2013<br>(in millions) | Balance to Expend<br>in 2013 |
|-----------------|--------------------------------------------------|---------------------------------------------------------------------------|------------------------------|
| Midwest         | \$ 210.4                                         | \$ 27.8                                                                   | \$ 182.6                     |
| East/West       | 11.5                                             | 0.2                                                                       | 11.3                         |
| Southern Plains | 48.3                                             | 12.6                                                                      | 35.7                         |
| Other           | 2.8                                              | 0.2                                                                       | 2.6                          |
| Total           | \$ 273.0                                         | \$ 40.8                                                                   | \$ 232.2                     |

In June 2012, we announced that we had 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. On May 1, 2013, we received approval from the Ohio Racing Commission for our relocation plans. Full details and design of the project at Austintown are in the development stage for a new Hollywood-themed facility, with a \$265 million budget, 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 Centrepointhe 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 for a new Hollywood-themed facility, with a \$257 million budget, inclusive of a \$75 million relocation fee and \$50 million license fee, featuring a new standardbred racetrack and up to 1,800 video lottery terminals, as well as various restaurants, bars and other amenities. As of March 31, 2013, we have incurred cumulative costs of \$10.7 million and \$8.2 million for the Austintown facility and the Dayton facility, respectively.

During the three months ended March 31, 2013, we spent approximately \$21.9 million for capital maintenance expenditures, with \$6.0 million at our Midwest segment, \$6.9 million at our East/West segment, \$6.4 million at our Southern Plains segment, and \$2.6 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 2013 to date.

*Debt*

Our senior secured credit facility had a gross outstanding balance of \$2,278.1 million at March 31, 2013, consisting of a \$1,028.8 million Term Loan A facility and a \$1,249.3 million Term Loan B facility. No balances were outstanding on the revolving credit facility at March 31, 2013. Additionally, at March 31, 2013, we were contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$73.2 million, resulting in \$711.8 million of available borrowing capacity as of March 31, 2013 under the revolving credit facility.

*Covenants*

Our senior secured credit facility and \$325 million 83/4% 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 83/4% 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 March 31, 2013, 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, will be adequate to meet our anticipated debt

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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, 2012 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.

As discussed earlier in connection with our proposed Spin-Off, we will redeem our \$325 million 83/4% senior subordinated notes and refinance our existing remaining debt obligations at the time of the Spin-Off and both the surviving operating gaming company, PNG, and GLPI will enter into new credit facilities.

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

The table below provides information at March 31, 2013 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 March 31, 2013.

|                           | 04/01/13 -<br>03/31/14 | 04/01/14 -<br>03/31/15 | 04/01/15 -<br>03/31/16 | 04/01/16 -<br>03/31/17 | 04/01/17 -<br>03/31/18 | Thereafter   | Total        | Fair Value<br>03/31/13 |
|---------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|--------------|--------------|------------------------|
| (in thousands)            |                        |                        |                        |                        |                        |              |              |                        |
| <b>Long-term debt:</b>    |                        |                        |                        |                        |                        |              |              |                        |
| Fixed rate                | \$                     | \$                     | \$                     | \$                     | \$                     | \$ 325,000   | \$ 325,000   | \$ 368,063             |
| Average interest rate     |                        |                        |                        |                        |                        | 8.75%        |              |                        |
| Variable rate             | \$ 88,275              | \$ 115,775             | \$ 122,650             | \$ 752,650             | \$ 12,650              | \$ 1,186,050 | \$ 2,278,050 | \$ 2,289,044           |
| Average interest rate (1) | 2.75%                  | 2.95%                  | 3.22%                  | 3.38%                  | 4.58%                  | 4.77%        |              |                        |

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

**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 March 31, 2013, 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 March 31, 2013 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.

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### 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 7: 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, 2012.

### ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

|                                      | Total Number of<br>Shares Purchased | Average Price Paid<br>per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced<br>Program (1) | Maximum Dollar<br>Value of Shares that<br>May Yet Be<br>Purchased Under<br>the Program |
|--------------------------------------|-------------------------------------|---------------------------------|----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|
| January 1, 2013 - January 31, 2013   |                                     | N/A                             | N/A                                                                                    | \$ 160,158,751                                                                         |
| February 1, 2013 - February 28, 2013 | 7,737                               | 51.10                           | N/A                                                                                    | 160,158,751                                                                            |
| March 1, 2013 - March 31, 2013       |                                     | N/A                             | N/A                                                                                    | 160,158,751                                                                            |

(1) In July 2008, the Company announced the Board of Directors authorized the repurchase of up to \$200 million of the Company's common stock. This authorization has been increased and extended several times since 2008, and as of March 31, 2013, there remains available authorization of \$160.2 million, which will expire at the Annual Meeting of Shareholders in 2013, unless otherwise extended or shortened by the Board of Directors. The shares repurchased in the table above represent repurchases of shares from employees who surrendered a portion of their shares received through the Company's stock based compensation plans to cover their associated minimum income tax liabilities.

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### ITEM 3 Defaults upon Senior Securities

Not applicable.

### ITEM 4 Mine Safety Disclosures

Not applicable.

### ITEM 5 Other information

Not applicable.

### ITEM 6. EXHIBITS

| Exhibit | Description of Exhibit                                            |
|---------|-------------------------------------------------------------------|
| 10.1*   | Penn National Gaming, Inc. Deferred Compensation Plan as amended. |

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- 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 March 31, 2013 and December 31, 2012, (ii) the Condensed Consolidated Statements of Income for the three months ended March 31, 2013 and 2012, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2013 and 2012, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2013 and 2012, (v) the Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012 and (vi) the notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.

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\* 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.

May 3, 2013

By:

/s/ William J. Clifford  
William J. Clifford  
Senior Vice President Finance and Chief Financial  
Officer  
(Principal Financial Officer)

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**EXHIBIT INDEX**

| <b>Exhibit</b> | <b>Description of Exhibit</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1*          | Penn National Gaming, Inc. Deferred Compensation Plan as amended.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 31.1*          | CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
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