

PENN NATIONAL GAMING INC
Form 10-Q
August 02, 2013
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from to

Commission file number: 0-24206

PENN NATIONAL GAMING, INC.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

(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

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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

| Title | Outstanding as of July 26, 2013 |
|---|--|
| Common Stock, par value \$.01 per share | 78,892,597 (includes 381,245 shares of restricted stock) |

Table of Contents

This document 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 GLPI's 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 and the exemption of casinos from the commercial activity tax 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 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, CA project, particular risks associated with securing financing, local opposition, and building a complex project on a relatively small parcel; with respect to the Tewksbury, MA project, particular risks associated with local opposition and local permitting, surrounding community agreements and a local ballot measure; 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.

Table of Contents

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

| | | |
|----------------------|---|----|
| <u>PART I.</u> | <u>FINANCIAL INFORMATION</u> | 4 |
| <u>ITEM 1.</u> | <u>FINANCIAL STATEMENTS (Unaudited)</u> | 4 |
| | <u>Condensed Consolidated Balance Sheets June 30, 2013 and December 31, 2012</u> | 4 |
| | <u>Condensed Consolidated Statements of Operations Three and Six Months Ended June 30, 2013 and 2012</u> | 5 |
| | <u>Condensed Consolidated Statements of Comprehensive Income Three and Six Months Ended June 30, 2013 and 2012</u> | 6 |
| | <u>Condensed Consolidated Statements of Changes in Shareholders' Equity Six Months Ended June 30, 2013 and 2012</u> | 7 |
| | <u>Condensed Consolidated Statements of Cash Flows Six Months Ended June 30, 2013 and 2012</u> | 8 |
| | <u>Notes to the Condensed Consolidated Financial Statements</u> | 9 |
| <u>ITEM 2.</u> | <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | 22 |
| <u>ITEM 3.</u> | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> | 38 |
| <u>ITEM 4.</u> | <u>CONTROLS AND PROCEDURES</u> | 38 |
| <u>PART II.</u> | <u>OTHER INFORMATION</u> | 39 |
| <u>ITEM 1.</u> | <u>LEGAL PROCEEDINGS</u> | 39 |
| <u>ITEM 1A.</u> | <u>RISK FACTORS</u> | 39 |
| <u>ITEM 2.</u> | <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u> | 39 |
| <u>ITEM 3.</u> | <u>DEFAULTS UPON SENIOR SECURITIES</u> | 39 |
| <u>ITEM 4.</u> | <u>MINE SAFETY DISCLOSURES</u> | 39 |
| <u>ITEM 5.</u> | <u>OTHER INFORMATION</u> | 39 |
| <u>ITEM 6.</u> | <u>EXHIBITS</u> | 39 |
| <u>SIGNATURES</u> | | 40 |
| <u>EXHIBIT INDEX</u> | | 41 |

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Penn National Gaming, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets**

(in thousands, except share and per share data)

| | June 30, 2013 (unaudited) | December 31, 2012 |
|--|---------------------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 235,135 | \$ 260,467 |
| Receivables, net of allowance for doubtful accounts of \$4,272 and \$3,901 at June 30, 2013 and December 31, 2012, respectively | 52,135 | 53,720 |
| Insurance receivable | 210 | |
| Prepaid expenses | 65,482 | 94,620 |
| Deferred income taxes | 36,674 | 39,793 |
| Other current assets | 11,646 | 38,540 |
| Total current assets | 401,282 | 487,140 |
| Property and equipment, net | 2,678,003 | 2,730,797 |
| Other assets | | |
| Investment in and advances to unconsolidated affiliates | 201,547 | 204,506 |
| Goodwill | 1,309,413 | 1,380,689 |
| Other intangible assets, net | 698,467 | 706,477 |
| Debt issuance costs, net of accumulated amortization of \$15,636 and \$11,462 at June 30, 2013 and December 31, 2012, respectively | 31,761 | 35,999 |
| Other assets | 112,897 | 98,449 |
| Total other assets | 2,354,085 | 2,426,120 |
| Total assets | \$ 5,433,370 | \$ 5,644,057 |
| Liabilities | | |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 82,594 | \$ 81,497 |
| Accounts payable | 25,256 | 38,268 |
| Accrued expenses | 102,821 | 133,316 |
| Accrued interest | 19,831 | 21,872 |
| Accrued salaries and wages | 80,567 | 96,426 |
| Gaming, pari-mutuel, property, and other taxes | 65,857 | 55,610 |
| Insurance financing | 8,125 | 3,856 |
| Other current liabilities | 71,997 | 68,774 |
| Total current liabilities | 457,048 | 499,619 |
| Long-term liabilities | | |
| Long-term debt, net of current maturities | 2,393,606 | 2,649,073 |
| Deferred income taxes | 223,004 | 216,357 |
| Noncurrent tax liabilities | 23,044 | 20,393 |
| Other noncurrent liabilities | 7,050 | 7,686 |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

| | | |
|--|--------------|--------------|
| Total long-term liabilities | 2,646,704 | 2,893,509 |
| Shareholders equity | | |
| Preferred stock (\$.01 par value, 1,000,000 shares authorized, 12,050 and 12,275 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively) | | |
| Common stock (\$.01 par value, 200,000,000 shares authorized, 78,854,790 and 77,446,601 shares issued at June 30, 2013 and December 31, 2012, respectively) | 780 | 769 |
| Additional paid-in capital | 1,479,945 | 1,451,965 |
| Retained earnings | 848,264 | 795,173 |
| Accumulated other comprehensive income | 629 | 3,022 |
| Total shareholders equity | 2,329,618 | 2,250,929 |
| Total liabilities and shareholders equity | \$ 5,433,370 | \$ 5,644,057 |

See accompanying notes to the condensed consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|------------------|----------------------------------|-------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues | | | | |
| Gaming | \$ 679,829 | \$ 634,846 | \$ 1,397,754 | \$ 1,290,923 |
| Food, beverage and other | 121,044 | 109,955 | 242,904 | 222,863 |
| Management service fee | 3,667 | 3,614 | 6,714 | 7,057 |
| Revenues | 804,540 | 748,415 | 1,647,372 | 1,520,843 |
| Less promotional allowances | (43,169) | (35,864) | (87,755) | (72,233) |
| Net revenues | 761,371 | 712,551 | 1,559,617 | 1,448,610 |
| Operating expenses | | | | |
| Gaming | 341,889 | 330,875 | 703,907 | 671,044 |
| Food, beverage and other | 88,910 | 84,985 | 179,175 | 172,789 |
| General and administrative | 128,730 | 115,251 | 264,307 | 231,248 |
| Depreciation and amortization | 80,615 | 56,791 | 157,686 | 110,128 |
| Impairment losses | 71,846 | | 71,846 | |
| Insurance deductible charges, net of recoveries | 2,500 | (3,366) | 2,500 | (7,229) |
| Total operating expenses | 714,490 | 584,536 | 1,379,421 | 1,177,980 |
| Income from operations | 46,881 | 128,015 | 180,196 | 270,630 |
| Other income (expenses) | | | | |
| Interest expense | (27,060) | (17,823) | (54,984) | (35,866) |
| Interest income | 343 | 246 | 605 | 465 |
| Gain from unconsolidated affiliates | 3,821 | 1,054 | 5,542 | 2,739 |
| Other | 2,402 | 1,474 | 3,066 | 471 |
| Total other expenses | (20,494) | (15,049) | (45,771) | (32,191) |
| Income from operations before income taxes | 26,387 | 112,966 | 134,425 | 238,439 |
| Taxes on income | 38,567 | 46,299 | 81,334 | 93,153 |
| Net (loss) income | \$ (12,180) | \$ 66,667 | \$ 53,091 | \$ 145,286 |
| (Loss) earnings per common share: | | | | |
| Basic (loss) earnings per common share | \$ (0.16) | \$ 0.70 | \$ 0.55 | \$ 1.54 |
| Diluted (loss) earnings per common share | \$ (0.16) | \$ 0.63 | \$ 0.51 | \$ 1.37 |

See accompanying notes to the condensed consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|-------------|----------------------------------|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income | \$ (12,180) | \$ 66,667 | \$ 53,091 | \$ 145,286 |
| Other comprehensive (loss) income, net of tax: | | | | |
| Foreign currency translation adjustment during the period | (608) | (455) | (999) | (167) |
| Change in fair value of corporate debt securities | | | | |
| Unrealized holding gains (losses) on corporate debt securities arising during the period | | 155 | (98) | 85 |
| Less: Reclassification adjustments for gains included in net income | (1,296) | | (1,296) | |
| Change in fair value of corporate debt securities, net | (1,296) | 155 | (1,394) | 85 |
| Other comprehensive loss | (1,904) | (300) | (2,393) | (82) |
| Comprehensive (loss) income | \$ (14,084) | \$ 66,367 | \$ 50,698 | \$ 145,204 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**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 | Earnings | Comprehensive | Shareholders | | | | | |
| | | | | | Capital | | Income | 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 \$2,096 | | | 380,576 | | 4 | | 24,085 | | | | | | 24,089 |
| Restricted stock activity, including tax benefit of \$382 | | | (4,076) | | | | 2,230 | | | | | | 2,230 |
| Change in fair value of corporate debt securities | | | | | | | | | | | 85 | | 85 |
| Foreign currency translation adjustment | | | | | | | | | | | (167) | | (167) |
| Net income | | | | | | | | | | | 145,286 | | 145,286 |
| Balance, June 30, 2012 | 12,275 | \$ | 76,589,626 | \$ | 760 | \$ | 1,411,670 | \$ | 728,488 | \$ | 2,236 | \$ | 2,143,154 |
| 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 \$4,920 | | | 1,159,426 | | 11 | | 48,563 | | | | | | 48,574 |
| Restricted stock activity, including tax benefit of \$840 | | | 248,763 | | | | 1,692 | | | | | | 1,692 |
| Change in fair value of corporate debt securities | | | | | | | | | | | (1,394) | | (1,394) |
| Foreign currency translation adjustment | | | | | | | | | | | (999) | | (999) |
| Net income | | | | | | | | | | | 53,091 | | 53,091 |
| Balance, June 30, 2013 | 12,050 | \$ | 78,854,790 | \$ | 780 | \$ | 1,479,945 | \$ | 848,264 | \$ | 629 | \$ | 2,329,618 |

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)**

| Six Months Ended June 30, | 2013 | 2012 |
|---|-----------|------------|
| Operating activities | | |
| Net income | \$ 53,091 | \$ 145,286 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 157,686 | 110,128 |
| Amortization of items charged to interest expense | 4,300 | 3,290 |
| Accretion of settlement value on long term obligation | 1,217 | |
| Loss (gain) on sale of fixed assets | 2,675 | (1,037) |
| Hollywood St. Louis tornado deductible charges | 2,500 | |
| Gain from unconsolidated affiliates | (5,542) | (2,739) |
| Distributions of earnings from unconsolidated affiliates | 9,000 | |
| Deferred income taxes | 10,720 | (14,383) |
| Charge for stock-based compensation | 11,701 | 15,307 |
| Impairment losses | 71,846 | |
| Gain on investment in corporate debt securities | (1,325) | |
| (Increase) decrease, net of businesses acquired | | |
| Accounts receivable | (188) | (505) |
| Insurance receivable | (510) | 1,072 |
| Prepaid expenses and other current assets | 31,614 | 11,316 |
| Other assets | (23,330) | (5,191) |
| (Decrease) increase, net of businesses acquired | | |
| Accounts payable | (3,272) | (2,647) |
| Accrued expenses | (30,990) | (7,026) |
| Accrued interest | (2,041) | (646) |
| Accrued salaries and wages | (15,605) | (9,895) |
| Gaming, pari-mutuel, property and other taxes | 10,247 | (4,008) |
| Income taxes | | (15,278) |
| Other current and noncurrent liabilities | 3,552 | 4,506 |
| Other noncurrent tax liabilities | 4,084 | 3,336 |
| Net cash provided by operating activities | 291,430 | 230,886 |
| Investing activities | | |
| Capital project expenditures, net of reimbursements | (70,771) | (201,948) |
| Capital maintenance expenditures | (45,846) | (52,230) |
| Proceeds from sale of property and equipment | 2,818 | 2,803 |
| Proceeds from investment in corporate debt securities | 6,679 | |
| Investment in joint ventures | (500) | (39,600) |
| Decrease in cash in escrow | 26,000 | 15,500 |
| Acquisition of gaming licenses, net of acquisition of businesses | (52) | (50,000) |
| Net cash used in investing activities | (81,672) | (325,475) |
| Financing activities | | |
| Proceeds from exercise of options | 32,805 | 8,534 |
| Repurchase of preferred stock | (22,275) | |
| Proceeds from issuance of long-term debt, net of issuance costs | 20,064 | 151,932 |
| Principal payments on long-term debt | (275,713) | (93,305) |
| Proceeds from insurance financing | 15,306 | |
| Payments on insurance financing | (11,037) | (9,364) |
| Tax benefit from stock options exercised | 5,760 | 2,478 |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

| | | | | |
|---|----|-----------|----|----------|
| Net cash (used in) provided by financing activities | | (235,090) | | 60,275 |
| Net decrease in cash and cash equivalents | | (25,332) | | (34,314) |
| Cash and cash equivalents at beginning of year | | 260,467 | | 238,440 |
| Cash and cash equivalents at end of period | \$ | 235,135 | \$ | 204,126 |
| Supplemental disclosure | | | | |
| Interest expense paid, net of amounts capitalized | \$ | 52,020 | \$ | 33,035 |
| Income taxes paid | \$ | 28,248 | \$ | 115,054 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Penn National Gaming, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Organization and Basis of Presentation

Penn National Gaming, Inc. (Penn) and subsidiaries (collectively, the Company) is a diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of June 30, 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. However, on July 1, 2013, the Company sold its Bullwhackers property located in Colorado and no longer has any operations in the state.

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 six months ended June 30, 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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

On November 15, 2012, the Company announced that it intends to pursue a plan to separate the majority of its 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) 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 \$1.05 billion. The dividend will be paid in a combination of cash and GLPI common stock, with at least 20% being paid in cash and the remainder in GLPI common stock.

Upon satisfaction or waiver of conditions to the Spin-Off, Penn will effect the Spin-Off by distributing one share of common stock of GLPI to the holders of Penn common stock and Series C Convertible Preferred Stock (Series C) for every share of Penn common stock and every 1/1000th of a share of Series C that they hold at the close of business on the record date for the Spin-Off. See Note 11 for further information on the Series C. Additionally, certain members of the Carlino Group, which consists of Peter M. Carlino and the Carlino Family Trust and the beneficiaries thereof, will receive (i) additional shares of GLPI common stock, in exchange for shares of Penn common stock that they will transfer to Penn immediately prior to the Spin-Off and/or (ii) options to acquire GLPI common stock, in exchange for options to acquire Penn common stock, which options will be issued/tendered following

Table of Contents

the Spin-Off. Penn will engage in either or both of these exchanges with the Carlino Group to ensure that they collectively own less than 10%, as required for GLPI to qualify as a REIT, of the outstanding shares of Penn 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 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. In addition, although the Carlino Group has agreed in principle to effect the exchanges mentioned above at a specified valuation, neither the Carlino Group nor the independent directors of Penn, on behalf of Penn, have entered into definitive documentation regarding the exchanges and no assurance can be made that such definitive documentation will be executed and delivered. 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.

GLPI has filed a preliminary registration statement on Form S-11 (File No. 333-188608) with the Securities and Exchange Commission for the proposed transaction. Investors are encouraged to read the registration statement because it contains more complete information about GLPI and its separation from the Company including financial information and disclosures regarding GLPI's capital structure, senior management and relationship with the Company as well as a detailed description of the conditions that must be satisfied in order to proceed with the proposed transaction, including, without limitation, the continuing validity of the factual representations underlying the private letter ruling, the completion of the financings needed to fund each of the public companies and the successful completion of the gaming and racing regulatory approval process. Subject to satisfaction of the applicable conditions, the Company is planning to consummate the separation in the fourth quarter of 2013.

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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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 and six months ended June 30, 2013 and 2012 are as follows:

Table of Contents

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------|-----------------------------|-----------|---------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Rooms | \$ 8,993 | \$ 6,265 | \$ 18,312 | \$ 12,559 |
| Food and beverage | 31,232 | 27,236 | 63,722 | 54,715 |
| Other | 2,944 | 2,363 | 5,721 | 4,959 |
| Total promotional allowances | \$ 43,169 | \$ 35,864 | \$ 87,755 | \$ 72,233 |

The estimated cost of providing such complimentary services for the three and six months ended June 30, 2013 and 2012 are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------------------|-----------------------------|-----------|---------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Rooms | \$ 3,121 | \$ 2,307 | \$ 6,360 | \$ 4,663 |
| Food and beverage | 21,119 | 18,175 | 43,098 | 36,655 |
| Other | 1,383 | 1,429 | 3,027 | 2,951 |
| Total cost of complimentary services | \$ 25,623 | \$ 21,911 | \$ 52,485 | \$ 44,269 |

Gaming and Racing Taxes

The Company is subject to gaming and pari-mutuel taxes based on gross gaming revenue and pari-mutuel revenue in the jurisdictions in which it operates. The Company primarily recognizes gaming and pari-mutuel tax expense based on the statutorily required percentage of revenue that is required to be paid to state and local jurisdictions in the states where or in which wagering occurs. In certain states in which the Company operates, gaming taxes are based on graduated rates. The Company records gaming tax expense at the Company's estimated effective gaming tax rate for the year, considering estimated taxable gaming revenue and the applicable rates. Such estimates are adjusted each interim period. If gaming tax rates change during the year, such changes are applied prospectively in the determination of gaming tax expense in future interim periods. Finally, the Company recognizes purse expense based on the statutorily required percentage of revenue that is required to be paid out in the form of purses to the winning owners of horseraces run at the Company's racetracks in the period in which wagering occurs. For the three and six months ended June 30, 2013, these expenses, which are recorded primarily within gaming expense in the condensed consolidated statements of operations, were \$267.0 million and \$549.0 million, respectively, as compared to \$266.6 million and \$543.5 million for the three and six months ended June 30, 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 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 June 30, 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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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.

Since the Company reported a net loss for the three months ended June 30, 2013, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS for the three months ended June 30, 2013. In addition, since the Company reported a loss from operations for the three months ended June 30, 2013, the Preferred Stock was not deemed to be a participating security for the three months ended June 30,

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

2013, pursuant to ASC 260 as the Preferred Stock is not obligated to participate in the losses of the Company. The basic weighted-average common shares outstanding for the three months ended June 30, 2013 were 78,306,436.

The following table sets forth the allocation of net income for the three months ended June 30, 2012 and six months ended June 30, 2013 and 2012 under the two-class method:

| | Three Months Ended June 30, 2012 | | Six Months Ended June 30, 2013 (in thousands) | | Six Months Ended June 30, 2012 | |
|--|--|--------|---|--------|-----------------------------------|---------|
| | Net income | \$ | 66,667 | \$ | 53,091 | \$ |
| Net income applicable to preferred stock | | 12,914 | | 9,983 | | 28,183 |
| Net income applicable to common stock | \$ | 53,753 | \$ | 43,108 | \$ | 117,103 |

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 June 30, 2012 and six months ended June 30, 2013 and 2012:

| | Three Months Ended June 30, 2012 | | Six Months Ended June 30, 2013 (in thousands) | | Six Months Ended June 30, 2012 | |
|--|--|---------|---|---------|-----------------------------------|---------|
| | Determination of shares: | | | | | |
| Weighted-average common shares outstanding | | 76,257 | | 77,932 | | 76,126 |
| Assumed conversion of dilutive employee stock-based awards | | 2,453 | | 3,058 | | 2,325 |
| Assumed conversion of restricted stock | | 142 | | 92 | | 146 |
| Assumed conversion of preferred stock | | 27,278 | | 22,850 | | 27,278 |
| Diluted weighted-average common shares outstanding | | 106,130 | | 103,932 | | 105,875 |

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 11 for discussion of the proposed Spin-Off's potential future impact on the calculation of diluted weighted-average common shares outstanding.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Options to purchase 10,638,637 shares were outstanding during the three months ended June 30, 2013, but were not included in the computation of diluted EPS because they are antidilutive since the Company reported a loss from operations for the three months ended June 30, 2013. Options to purchase 99,625 shares were outstanding during the six months ended June 30, 2013, but were not included in the computation of diluted EPS because they were antidilutive. Options to purchase 1,700,528 shares and 3,125,403 shares were outstanding during the three and six months ended June 30, 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:

Table of Contents

Three Months
Ended June 30,
2012

Six Months Ended June 30,
2013

2012
 (in thousands, except per share data)

Calculation of basic EPS:

| | | | | | | |
|--|----|--------|----|--------|----|---------|
| Net income applicable to common stock | \$ | 53,753 | \$ | 43,108 | \$ | 117,103 |
| Weighted-average common shares outstanding | | 76,257 | | 77,932 | | 76,126 |
| Basic EPS | \$ | 0.70 | \$ | 0.55 | \$ | 1.54 |

Calculation of diluted EPS:

| | | | | | | |
|--|----|---------|----|---------|----|---------|
| Net income | \$ | 66,667 | \$ | 53,091 | \$ | 145,286 |
| Diluted weighted-average common shares outstanding | | 106,130 | | 103,932 | | 105,875 |
| Diluted EPS | \$ | 0.63 | \$ | 0.51 | \$ | 1.37 |

Stock-Based Compensation

The Company accounts for stock compensation under ASC 718, Compensation-Stock Compensation, which requires the Company to expense the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Stock based compensation expense for the three and six months ended June 30, 2013 was \$5.4 million and \$11.7 million, respectively, as compared to \$7.4 million and \$15.3 million for the three and six months ended June 30, 2012, respectively. This expense is recognized ratably over the requisite service period following the date of grant.

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the U.S. Treasury spot rate with a term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 6.57 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 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 six months ended June 30, 2013, however, the Company granted 256,500 shares of restricted stock during this same time period.

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 June 30, 2013, there was \$27.6 million of total unrecognized compensation cost that will be recognized over the grants remaining weighted average vesting period of 3.08 years. For the three and six months ended June 30, 2013, the Company recognized \$2.2 million and \$5.0 million of compensation expense associated with these awards, respectively, as compared to \$1.3 million and \$2.5 million for the three and six months ended June 30, 2012, respectively.

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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

during each reporting period and estimated using the Black-Scholes option pricing model based on the various inputs discussed below. As of June 30, 2013, there was \$11.2 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period of 2.28 years. For the three and six months ended June 30, 2013, the Company recognized \$0.9 million and \$3.7 million of compensation expense associated with these awards, respectively, as compared to \$1.1 million and \$2.5 million for the three and six months ended June 30, 2012, respectively.

The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at June 30, 2013 and 2012:

Table of Contents

| | 2013 | 2012 |
|--|--------|--------|
| Risk-free interest rate | 1.08% | 0.84% |
| Expected volatility | 46.27% | 45.78% |
| Dividend yield | | |
| Weighted-average expected life (years) | 6.57 | 6.64 |
| 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 condensed consolidated financial statements.

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

| | Foreign Currency | Available for sale securities | Total |
|--|------------------|----------------------------------|----------|
| Balance at December 31, 2011 | \$ 1,203 | \$ 1,115 | \$ 2,318 |
| Other comprehensive (loss) income: | | | |
| Foreign currency translation adjustment | (167) | | (167) |
| Unrealized holding gains on corporate debt securities | | 85 | 85 |
| Ending balance at June 30, 2012 | \$ 1,036 | \$ 1,200 | \$ 2,236 |
| Balance at December 31, 2012 | \$ 1,628 | \$ 1,394 | \$ 3,022 |
| Other comprehensive (loss) income: | | | |
| Foreign currency translation adjustment | (999) | | (999) |
| Unrealized holding losses on corporate debt securities | | (98) | (98) |
| Realized gain on redemption of corporate debt securities | | (1,296) | (1,296) |
| Ending balance at June 30, 2013 | \$ 629 | \$ | \$ 629 |

5. Property and Equipment

Property and equipment, net, consists of the following:

June 30,

December 31,

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

| | 2013 | | 2012 |
|------------------------------------|----------------|-------------|--------------|
| | (in thousands) | | |
| Land and improvements | \$ | 438,648 | \$ 442,882 |
| Building and improvements | | 2,312,637 | 2,283,230 |
| Furniture, fixtures, and equipment | | 1,290,690 | 1,240,898 |
| Leasehold improvements | | 17,188 | 17,229 |
| Construction in progress | | 44,988 | 30,531 |
| Total property and equipment | | 4,104,151 | 4,014,770 |
| Less accumulated depreciation | | (1,426,148) | (1,283,973) |
| Property and equipment, net | \$ | 2,678,003 | \$ 2,730,797 |

Table of Contents

Depreciation expense, for property and equipment, totaled \$75.5 million and \$151.7 million for the three and six months ended June 30, 2013, respectively, as compared to \$56.7 million and \$109.9 million for the three and six months ended June 30, 2012, respectively. Interest capitalized in connection with major construction projects was \$0.3 million and \$0.4 million for the three and six months ended June 30, 2013, respectively, as compared to \$3.0 million and \$5.9 million for the three and six months ended June 30, 2012, respectively.

6. Goodwill and Other Intangible Assets

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

| | |
|--|--------------|
| Balance at December 31, 2012: | |
| Goodwill | \$ 2,214,546 |
| Accumulated goodwill impairment losses | (833,857) |
| Goodwill, net | \$ 1,380,689 |
| Goodwill impairment losses | (68,727) |
| Other | (2,549) |
| Balance at June 30, 2013: | |
| Goodwill | \$ 2,211,997 |
| Accumulated goodwill impairment losses | (902,584) |
| Goodwill, net | \$ 1,309,413 |

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of other intangible assets at June 30, 2013 and December 31, 2012:

| | June 30, 2013 | | | December 31, 2012 | | |
|---|----------------------|--------------------------|----------------|----------------------|--------------------------|----------------|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| Indefinite-life intangible assets | \$ 676,968 | \$ | \$ 676,968 | \$ 675,901 | \$ | \$ 675,901 |
| Argosy Casino Sioux City gaming license | 20,949 | 4,190 | 16,759 | 24,068 | | 24,068 |
| Other intangible assets | 56,661 | 51,921 | 4,740 | 56,661 | 50,153 | 6,508 |
| Total | \$ 754,578 | \$ 56,111 | \$ 698,467 | \$ 756,630 | \$ 50,153 | \$ 706,477 |

As a result of a new gaming license being awarded for the development of a new casino in Sioux City, Iowa to another applicant in April 2013 (see Note 9 for further details), the Company recorded a pre-tax goodwill and other intangible asset impairment charge of \$68.7 million (\$68.6 million, net of taxes) and \$3.1 million (\$1.9 million, net of taxes), respectively, for Argosy Casino Sioux City during the three months ended June 30, 2013, as the Company determined that the fair value of its Sioux City reporting unit was less than its carrying amount based on the Company's analysis of the estimated future expected cash flows the Company anticipates receiving from the operations of the Sioux City facility. Furthermore, the remaining gaming license for Argosy Casino Sioux City of \$20.9 million at time of the impairment is now accounted for as a definite lived intangible asset and will be amortized on a straight line basis through June 2014, which is the anticipated opening date of the new facility.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

The Company's intangible asset amortization expense was \$5.1 million and \$6.0 million for the three and six months ended June 30, 2013, respectively, as compared to \$40 thousand and \$0.2 million for the three and six months ended June 30, 2012, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at June 30, 2013 (in thousands):

| | | |
|-------------------|----|--------|
| Remainder of 2013 | \$ | 10,148 |
| 2014 | | 11,332 |
| 2015 | | 19 |
| Total | \$ | 21,499 |

Table of Contents**7. Investment in Corporate Securities**

In 2008, the Company made an investment in the corporate debt securities of another gaming company which had a maturity date of November 1, 2012. This investment was accounted for as an available-for-sale investment and was included in other assets within the consolidated balance sheet. During 2010, the issuer of the security went into default on its obligations as it ceased making interest payments and the security was downgraded by certain rating agencies. As a result, in 2010, the Company wrote down the investment to its fair value, which was based on the transaction prices of the security subsequent to when the issuer defaulted on its obligations. In April 2011, the issuer of the security declared bankruptcy. In the second quarter of 2013, the Company received a distribution of \$6.7 million from the finalization of bankruptcy proceedings, which resulted in the recognition of a \$1.3 million realized gain included in other income (expenses) within the condensed consolidated statements of operations for the three and six months ended June 30, 2013.

8. Long-term Debt

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

| | June 30, 2013 | December 31, 2012 |
|---|------------------|----------------------|
| | (in thousands) | |
| Senior secured credit facility | \$ 2,139,300 | \$ 2,394,963 |
| \$325 million 8 ³ / ₄ % senior subordinated notes due August 2019 | 325,000 | 325,000 |
| Other long-term obligations | 11,217 | 10,000 |
| Capital leases | 2,061 | 2,111 |
| | 2,477,578 | 2,732,074 |
| Less current maturities of long-term debt | (82,594) | (81,497) |
| Less discount on senior secured credit facility Term Loan B | (1,378) | (1,504) |
| | \$ 2,393,606 | \$ 2,649,073 |

The following is a schedule of future minimum repayments of long-term debt as of June 30, 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 | \$ 82,594 |
| 1-3 years | 192,711 |
| 3-5 years | 751,463 |
| Over 5 years | 1,450,810 |
| Total minimum payments | \$ 2,477,578 |

Senior Secured Credit Facility

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

The Company's senior secured credit facility had a gross outstanding balance of \$2,139.3 million at June 30, 2013, consisting of a \$1,015.0 million Term Loan A facility and a \$1,124.3 million Term Loan B facility. No balances were outstanding on the revolving credit facility at June 30, 2013. Additionally, at June 30, 2013, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$73.3 million, resulting in \$711.7 million of available borrowing capacity as of June 30, 2013 under the revolving credit facility. The Company made payments of \$128.2 million against its Term Loan B facility during 2013.

Other Long-Term Obligations

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

Table of Contents

settlement value, if any, will be accreted to interest expense through the maturity date of the instrument. During the six months ended June 30, 2013, the Company recorded \$1.2 million in accretion on this instrument.

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 June 30, 2013, the Company was in compliance with all required covenants.

9. Commitments and Contingencies

Litigation

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

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

Gaming licenses in Iowa are typically issued jointly to a gaming operator and a local charitable organization known as a 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 MHRD would be able to continue searching for an operator for a new land-based casino. The Company rejected this contract offer and at the August 23, 2012 IRGC meeting urged the IRGC to reconsider the original extension offer through March 2015. The IRGC did not act on this request and, concluded that the casino can continue to operate without an effective operating agreement. The IRGC also

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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 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. The Belle has filed four 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, announcing a process would be instituted to revoke the Belle's license, and its selection of another gaming operator. 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. Additionally, in June 2013, the Company filed a petition to request the appointment of a third party to receive and hold or distribute the funds to be paid to MRHD (for which oral argument was held in July 2013).

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

Table of Contents

\$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.

On June 13, 2013, the Company finalized an agreement to the terms of its previous non-binding memorandum of understanding with the State of Ohio. The Company has agreed to pay \$110 million over a ten year period commencing in July 2013 for certain clarifications from the State of Ohio with respect to various financial matters and limits on competition within the ten year time period. Additionally, in return for being able to relocate its existing racetracks in Toledo and Grove City to Dayton and Austintown (located in the Mahoning Valley), respectively, the Company agreed to pay the state \$7.5 million upon the opening of each facility, as well as eighteen semi-annual installment payments of \$4.8 million beginning one year after the opening of each facility.

10. Income Taxes

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

| | Noncurrent tax liabilities (in thousands) |
|---|--|
| Balance at January 1, 2013 | \$ 20,393 |
| Additions based on current year positions | 2,194 |
| Additions based on prior year positions | 1,916 |
| Currency translation adjustments | (1,459) |
| Balance at June 30, 2013 | \$ 23,044 |

The increase in the Company's liability for unrecognized tax benefits during the six months ended June 30, 2013 was primarily due to recording additional tax reserves and interest expense accruals for previously recorded unrecognized tax benefits.

The Company's effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 146.2% and 60.5% for the three and six months ended June 30, 2013, respectively, as compared to 41.0% and 39.1% for the three and six months ended June 30, 2012, respectively, primarily due to the non-deductible portion of the Company's goodwill impairment charge related to Argosy Casino Sioux City.

At June 30, 2013 and December 31, 2012, prepaid expenses within the condensed consolidated balance sheets included prepaid income taxes of \$30.0 million and \$68.4 million, respectively.

11. 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 exchange of shares of the Company's Preferred Stock for shares of a new class of 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 Preferred Stock 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

Table of Contents

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 shares of 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 shares 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 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 Capital 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.

12. Segment Information

The Company has aggregated its properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how the Company's Chief Operating Decision Maker reviews and assesses the Company's financial performance.

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

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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

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

The Other category consists of the Company's standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and the Company's joint venture interests in Sam Houston Race Park, Valley Race Park and Freehold Raceway. 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 (which was sold on July 1, 2013).

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

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

| | Midwest | East/West | Southern Plains (in thousands) | Other | Total |
|---|------------|------------|-----------------------------------|-----------|------------|
| Three months ended June 30, 2013 | | | | | |
| Net revenues | \$ 258,178 | \$ 317,071 | \$ 175,897 | \$ 10,225 | \$ 761,371 |
| Income (loss) from operations | 53,069 | 75,955 | (47,564) | (34,579) | 46,881 |
| Depreciation and amortization | 32,573 | 19,292 | 24,655 | 4,095 | 80,615 |
| Gain (loss) from unconsolidated affiliates | | | 4,047 | (226) | 3,821 |
| Impairment losses | | | 71,846 | | 71,846 |
| Capital expenditures | 27,416 | 6,989 | 17,755 | 1,754 | 53,914 |
| Three months ended June 30, 2012 | | | | | |
| Net revenues | 217,975 | 348,652 | 137,405 | 8,519 | 712,551 |
| Income (loss) from operations | 47,139 | 76,732 | 37,532 | (33,388) | 128,015 |
| Depreciation and amortization | 19,645 | 21,784 | 11,212 | 4,150 | 56,791 |
| Gain (loss) from unconsolidated affiliates | | | 1,276 | (222) | 1,054 |
| Capital expenditures | 109,079 | 15,882 | 8,881 | 677 | 134,519 |
| Six months ended June 30, 2013 | | | | | |
| Net revenues | 545,491 | 634,119 | 360,581 | 19,426 | 1,559,617 |
| Income (loss) from operations | 116,865 | 145,062 | (10,555) | (71,176) | 180,196 |
| Depreciation and amortization | 64,830 | 40,125 | 44,543 | 8,188 | 157,686 |
| Gain (loss) from unconsolidated affiliates | | | 5,784 | (242) | 5,542 |
| Impairment losses | | | 71,846 | | 71,846 |
| Capital expenditures | 61,246 | 14,060 | 36,782 | 4,529 | 116,617 |
| Six months ended June 30, 2012 | | | | | |
| Net revenues | 423,086 | 719,281 | 287,125 | 19,118 | 1,448,610 |
| Income (loss) from operations | 93,422 | 160,622 | 82,243 | (65,657) | 270,630 |
| Depreciation and amortization | 37,197 | 44,026 | 22,600 | 6,305 | 110,128 |
| Gain (loss) from unconsolidated affiliates | | | 2,954 | (215) | 2,739 |
| Capital expenditures | 210,959 | 26,541 | 12,813 | 3,865 | 254,178 |
| Balance sheet at June 30, 2013 | | | | | |
| Total assets | 2,277,845 | 1,169,482 | 1,588,279 | 397,764 | 5,433,370 |
| Investment in and advances to unconsolidated affiliates | | 86 | 135,298 | 66,163 | 201,547 |
| Goodwill and other intangible assets, net | 1,023,904 | 226,047 | 702,121 | 55,808 | 2,007,880 |
| Balance sheet at December 31, 2012 | | | | | |
| 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 |

13. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

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

Investment in Corporate Debt Securities

The fair value of the investment in corporate debt securities was estimated based on a third party broker quote and as such was a Level 2 measurement as defined under ASC 820, Fair Value Measurements and Disclosures. The investment in corporate debt securities was measured at fair value on a recurring basis using the market approach. As described in Note 7, a distribution for the redemption of the investment in corporate debt securities was received in the second quarter of 2013.

Table of Contents*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. The fair value of the remainder of the Company's senior secured credit facility approximates its carrying value as it is variable rate debt. The fair value of the Company's other long-term obligations approximates its carrying value.

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

| | June 30, 2013 | | December 31, 2012 | |
|---|-----------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$ 235,135 | \$ 235,135 | \$ 260,467 | \$ 260,467 |
| Investment in corporate debt securities | | | 6,790 | 6,790 |
| Financial liabilities: | | | | |
| Long-term debt | | | | |
| Senior secured credit facility | 2,137,922 | 2,140,762 | 2,393,459 | 2,401,225 |
| Senior subordinated notes | 325,000 | 355,875 | 325,000 | 368,875 |
| Other long-term obligations | 11,217 | 11,217 | 10,000 | 10,000 |

14. Insurance Deductibles*Hollywood Casino St. Louis Tornado*

On May 31, 2013, Hollywood Casino St. Louis sustained minor damage as a result of a tornado and was forced to close for approximately fourteen hours. At the time of the tornado, the Company carried property insurance coverage with a limit of \$600 million for both property damage and business interruption applicable to this event. This coverage included a \$2.5 million property damage deductible and two days of business interruption deductible for the peril of a tornado. During the three months ended June 30, 2013, the Company recorded a \$2.5 million pre-tax loss for the property damage insurance deductible.

Table of Contents

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

Our Operations

We are a leading, diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of June 30, 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. However, on July 1, 2013, we sold our Bullwhackers property located in Colorado and no longer have any operations in the state.

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 renovating and rebranding to Hollywood Casino St. Louis.

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

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

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

For table games, customers usually purchase cash chips at the gaming tables. The cash and markers (extensions of credit granted to certain credit worthy customers) are deposited in the gaming table's drop box. Table game win is the amount of drop that is retained and recorded as casino gaming revenue, with liabilities recognized for funds deposited by customers before gaming play occurs and for unredeemed gaming chips. As we are focused on regional gaming markets, our table win percentages are fairly stable as the majority of these markets do not

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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.

Table of Contents

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 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 \$1.05 billion. The dividend will be paid in a combination of cash and GLPI common stock, with at least 20% being paid in cash and 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 Company's 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.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

GLPI has filed a preliminary registration statement on Form S-11 (File No. 333-188608) with the Securities and Exchange Commission for the proposed transaction. Investors are encouraged to read the registration statement because it contains more complete information about GLPI and its separation from the Company including financial information and disclosures regarding GLPI's capital structure, senior management and relationship with the Company as well as a detailed description of the conditions that must be satisfied in order to proceed with the proposed transaction, including, without limitation, the continuing validity of the factual representations underlying the private letter ruling, the completion of the financings needed to fund each of the public companies and the successful completion of the gaming and racing regulatory approval process. Subject to satisfaction of the applicable conditions, the Company is planning to consummate the separation in the fourth quarter of 2013.

Segment Information

We have aggregated our properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how our Chief Operating Decision Maker reviews and assesses our financial performance.

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

Table of Contents

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.

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 (which was sold on July 1, 2013).

Executive Summary

Economic conditions and the expansion of newly constructed gaming facilities continue to impact the overall domestic gaming industry as well as our operating results. We believe that current economic conditions, including, but not limited to, high unemployment levels, low levels of consumer confidence, and higher taxes, have resulted in reduced levels of discretionary consumer spending compared to historical levels. Additionally, the expansion of newly constructed gaming facilities has increased competition in many of our regional markets.

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 \$761.4 million and \$46.9 million, respectively, for the three months ended June 30, 2013 compared to \$712.6 million and \$128.0 million, respectively, for the corresponding period in the prior year and net revenues and income from operations of \$1,559.6 million and \$180.2 million, respectively, for the six months ended June 30, 2013 compared to \$1,448.6 million and \$270.6 million, respectively, for the corresponding period in the prior year. The major factors affecting our results for the three and six months ended June 30, 2013, as compared to the three and six months ended June 30, 2012, were:

- A pre-tax goodwill and other intangible asset impairment charge of \$71.8 million for Argosy Casino Sioux City in our Southern Plains segment during the three and six months ended June 30, 2013.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

- 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 and \$102.2 million of net revenues for the three and six months ended June 30, 2013, respectively, as compared to \$25.3 million for the corresponding periods in the prior year.
- The opening of Hollywood Casino Columbus on October 8, 2012, which generated \$55.3 million and \$118.9 million of net revenues for the three and six months ended June 30, 2013, respectively.
- New competition in our Midwest segment for Hollywood Casino Lawrenceburg, namely the March 4, 2013 opening of a casino in Cincinnati, Ohio, the opening on June 1, 2012 of a new racino in Columbus, Ohio, as well as our Columbus casino.
- The acquisition of Harrah's St. Louis facility, now known as Hollywood Casino St. Louis, on November 2, 2012, which contributed \$54.1 million and \$111.9 million of net revenues for the three and six months ended June 30, 2013, respectively.

Table of Contents

- The opening of a new riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012, which negatively impacted Hollywood Casino Baton Rouge in our Southern Plains segment.
- 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.
- A pre-tax insurance loss of \$2.5 million at Hollywood Casino St. Louis during the three and six months ended June 30, 2013, as compared to a pre-tax insurance gain of \$3.4 million and \$7.2 million at Hollywood Casino Tunica during the three and six months ended June 30, 2012, respectively.
- Net income decreased by \$78.8 million and \$92.2 million for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained above, as well as increased interest expense offset by decreased income taxes.

Segment Developments:

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

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 \$254 million and \$261 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. In mid-June 2013, the definitive agreement between the Company and the State of Ohio was signed. 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 up to 1,000 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 up to 1,500 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 video lottery terminal facility and expects both to open in the second half of 2014. The opening of our Dayton facility may have an adverse impact on our Hollywood Casino Columbus facility.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

- 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 and the Ohio Supreme Court has elected to accept 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 and 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 are anticipated to be completed in early 2014. We anticipate the opening of these new racinos will have a further adverse impact on Hollywood Casino Lawrenceburg and we anticipate that the Lebanon Raceway facility will have a negative impact on Hollywood Casino Columbus.

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 negatively impacted by the opening of a casino complex, Maryland Live!, at the Arundel Mills mall in Anne Arundel, Maryland. The casino opened on June 6, 2012 with approximately 3,200 slot machines and

Table of Contents

significantly increased its slot machine offerings by mid-September 2012 to approximately 4,750 slot machines. In addition, the Anne Arundel facility opened table games on April 11, 2013 which has negatively impacted Hollywood Casino at Charles Town Races. Additionally, in late August 2013, Maryland Live! plans to open a 52 table poker room, which we anticipate 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 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. In May 2013, three different bidders, including the Company, submitted proposals for a Prince George casino. Our proposal includes a \$700 million casino resort, which would be constructed at our Rosecroft Raceway facility, with 3,000 video lottery terminals, 100 table games and 40 poker tables, as well as a hotel, variety of food and beverage options, an entertainment and multi-purpose event center, a new grandstand facility, and structured and surface parking. Though we are participating 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.

- 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.

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 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. The Belle has filed four 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, announcing a process would be instituted to revoke the Belle's license, and its selection of another gaming operator. 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. Additionally, in June 2013, the Company filed a petition to request the appointment of a third party to receive and hold or distribute the funds to be paid to MRHD

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

(for which oral argument was held in July 2013).

- 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.

Table of Contents

Other

- On July 1, 2013, we sold our Bullwhackers property. The Bullwhackers casino, which is located in Black Hawk, Colorado, included 10,425 square feet of gaming space with approximately 280 slot machines. The property also included a gas station/convenience store located approximately 7 miles east of the Bullwhackers casino on Highway 119.

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.

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 six months ended June 30, 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 (such as Massachusetts) 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 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.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

- 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 and six months ended June 30, 2013 and 2012 are summarized below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------------|---------------------------|--------------|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Revenues: | | | | |
| Gaming | \$ 679,829 | \$ 634,846 | \$ 1,397,754 | \$ 1,290,923 |
| Food, beverage and other | 121,044 | 109,955 | 242,904 | 222,863 |
| Management service fee | 3,667 | 3,614 | 6,714 | 7,057 |
| Revenues | 804,540 | 748,415 | 1,647,372 | 1,520,843 |
| Less promotional allowances | (43,169) | (35,864) | (87,755) | (72,233) |
| Net revenues | 761,371 | 712,551 | 1,559,617 | 1,448,610 |
| Operating expenses: | | | | |
| Gaming | 341,889 | 330,875 | 703,907 | 671,044 |
| Food, beverage and other | 88,910 | 84,985 | 179,175 | 172,789 |
| General and administrative | 128,730 | 115,251 | 264,307 | 231,248 |
| Depreciation and amortization | 80,615 | 56,791 | 157,686 | 110,128 |
| Impairment losses | 71,846 | | 71,846 | |
| Insurance deductible charges, net of recoveries | 2,500 | (3,366) | 2,500 | (7,229) |
| Total operating expenses | 714,490 | 584,536 | 1,379,421 | 1,177,980 |
| Income from operations | \$ 46,881 | \$ 128,015 | \$ 180,196 | \$ 270,630 |

Certain information regarding our results of operations by segment for the three and six months ended June 30, 2013 and 2012 is summarized below:

| Three Months Ended June 30, | Net Revenues | | Income (loss) from Operations | |
|-----------------------------|----------------|------------|-------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Midwest | \$ 258,178 | \$ 217,975 | \$ 53,069 | \$ 47,139 |
| East/West | 317,071 | 348,652 | 75,955 | 76,732 |
| Southern Plains | 175,897 | 137,405 | (47,564) | 37,532 |
| Other | 10,225 | 8,519 | (34,579) | (33,388) |
| Total | \$ 761,371 | \$ 712,551 | \$ 46,881 | \$ 128,015 |

| Six Months Ended June 30, | Net Revenues | | Income (loss) from Operations | |
|---------------------------|----------------|------------|-------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Midwest | \$ 545,491 | \$ 423,086 | \$ 116,865 | \$ 93,422 |
| East/West | 634,119 | 719,281 | 145,062 | 160,622 |
| Southern Plains | 360,581 | 287,125 | (10,555) | 82,243 |

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

| | | | | | | | | |
|--------------|----|-----------|----|-----------|----|----------|----|----------|
| Other | | 19,426 | | 19,118 | | (71,176) | | (65,657) |
| Total | \$ | 1,559,617 | \$ | 1,448,610 | \$ | 180,196 | \$ | 270,630 |

Adjusted EBITDA

Adjusted EBITDA is used by management as the primary measure of the Company's operating performance. We define adjusted EBITDA as earnings before interest, taxes, stock compensation, impairment charges, insurance recoveries and deductible charges, depreciation and amortization, gain or loss on disposal of assets, and other income or expenses, and inclusive of gain or loss from unconsolidated affiliates. Adjusted EBITDA is not a measure of performance or liquidity calculated in accordance with GAAP. Adjusted EBITDA information is presented as a supplemental disclosure, as management believes that it is a widely used measure of

Table of Contents

performance in the gaming industry. In addition, management uses adjusted EBITDA as the primary measure of the operating performance of its segments, including the evaluation of operating personnel. Adjusted EBITDA should not be construed as an alternative to operating income, as an indicator of the Company's operating performance, as an alternative to cash flows from operating activities, as a measure of liquidity, or as any other measure of performance determined in accordance with GAAP. The Company has significant uses of cash flows, including capital expenditures, interest payments, taxes and debt principal repayments, which are not reflected in adjusted EBITDA. It should also be noted that other gaming companies that report adjusted EBITDA information may calculate adjusted EBITDA in a different manner than the Company and therefore, comparability may be limited. Adjusted EBITDA is presented as a supplemental disclosure, as management believes that it is a principal basis for the valuation of gaming companies, as this measure is considered by many to be a better indicator of the Company's operating results than diluted net income (loss) per GAAP. A reconciliation of the Company's adjusted EBITDA to net income (loss) per GAAP, as well as the Company's adjusted EBITDA to income (loss) from operations per GAAP, is included below. Additionally, a reconciliation of each segment's adjusted EBITDA to income (loss) from operations is also included below. On a segment level, adjusted EBITDA is reconciled to income (loss) from operations per GAAP, rather than net income (loss) per GAAP due to, among other things, the impracticability of allocating interest expense, interest income, income taxes and certain other items to the Company's segments on a segment by segment basis. Management believes that this presentation is more meaningful to investors in evaluating the performance of the Company's segments and is consistent with the reporting of other gaming companies.

The reconciliation of the Company's adjusted EBITDA to income (loss) from operations per GAAP, as well as the Company's adjusted EBITDA to net income (loss) per GAAP, for the three and six months ended June 30, 2013 and 2012 was as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------------|------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income | \$ (12,180) | \$ 66,667 | \$ 53,091 | \$ 145,286 |
| Taxes on income | 38,567 | 46,299 | 81,334 | 93,153 |
| Other | (2,402) | (1,474) | (3,066) | (471) |
| Gain from unconsolidated affiliates | (3,821) | (1,054) | (5,542) | (2,739) |
| Interest income | (343) | (246) | (605) | (465) |
| Interest expense | 27,060 | 17,823 | 54,984 | 35,866 |
| Income from operations | \$ 46,881 | \$ 128,015 | \$ 180,196 | \$ 270,630 |
| Loss (gain) on disposal of assets | 285 | (92) | 2,675 | (1,037) |
| Insurance deductible charges, net of recoveries | 2,500 | (3,366) | 2,500 | (7,229) |
| Impairment losses | 71,846 | | 71,846 | |
| Charge for stock compensation | 5,450 | 7,396 | 11,701 | 15,307 |
| Depreciation and amortization | 80,615 | 56,791 | 157,686 | 110,128 |
| Gain from unconsolidated affiliates | 3,821 | 1,054 | 5,542 | 2,739 |
| Adjusted EBITDA | \$ 211,398 | \$ 189,798 | \$ 432,146 | \$ 390,538 |

The reconciliations of each segment's adjusted EBITDA to income (loss) from operations for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

| Three months ended June 30, 2013 | Midwest | East/West | Southern Plains | Other | Total |
|--|------------------|------------------|------------------------|--------------------|-------------------|
| Income (loss) from operations | \$ 53,069 | \$ 75,955 | \$ (47,564) | \$ (34,579) | \$ 46,881 |
| Charge for stock compensation | | | | 5,450 | 5,450 |
| Impairment losses | | | 71,846 | | 71,846 |
| Insurance deductible charges | | | 2,500 | | 2,500 |
| Depreciation and amortization | 32,573 | 19,292 | 24,655 | 4,095 | 80,615 |
| Loss (gain) on disposal of assets | 239 | (128) | 185 | (11) | 285 |
| Gain (loss) from unconsolidated affiliates | | | 4,047 | (226) | 3,821 |
| Adjusted EBITDA | \$ 85,881 | \$ 95,119 | \$ 55,669 | \$ (25,271) | \$ 211,398 |

| Three months ended June 30, 2012 | Midwest | East/West | Southern Plains | Other | Total |
|---|------------------|------------------|------------------------|--------------------|-------------------|
| Income (loss) from operations | \$ 47,139 | \$ 76,732 | \$ 37,532 | \$ (33,388) | \$ 128,015 |
| Charge for stock compensation | | | | 7,396 | 7,396 |
| Insurance recoveries, net of deductible charges | | | (3,366) | | (3,366) |
| Depreciation and amortization | 19,645 | 21,784 | 11,212 | 4,150 | 56,791 |
| Loss (gain) on disposal of assets | 12 | (137) | 37 | (4) | (92) |
| Gain (loss) from unconsolidated affiliates | | | 1,276 | (222) | 1,054 |
| Adjusted EBITDA | \$ 66,796 | \$ 98,379 | \$ 46,691 | \$ (22,068) | \$ 189,798 |

| Six months ended June 30, 2013 | Midwest | East/West | Southern Plains | Other | Total |
|--|-------------------|-------------------|------------------------|--------------------|-------------------|
| Income (loss) from operations | \$ 116,865 | \$ 145,062 | \$ (10,555) | \$ (71,176) | \$ 180,196 |
| Charge for stock compensation | | | | 11,701 | 11,701 |
| Impairment losses | | | 71,846 | | 71,846 |
| Insurance deductible charges | | | 2,500 | | 2,500 |
| Depreciation and amortization | 64,830 | 40,125 | 44,543 | 8,188 | 157,686 |
| Loss (gain) on disposal of assets | 271 | 2,470 | 243 | (309) | 2,675 |
| Gain (loss) from unconsolidated affiliates | | | 5,784 | (242) | 5,542 |
| Adjusted EBITDA | \$ 181,966 | \$ 187,657 | \$ 114,361 | \$ (51,838) | \$ 432,146 |

| Six months ended June 30, 2012 | Midwest | East/West | Southern Plains | Other | Total |
|---|-------------------|-------------------|------------------------|--------------------|-------------------|
| Income (loss) from operations | \$ 93,422 | \$ 160,622 | \$ 82,243 | \$ (65,657) | \$ 270,630 |
| Charge for stock compensation | | | | 15,307 | 15,307 |
| Insurance recoveries, net of deductible charges | | | (7,229) | | (7,229) |
| Depreciation and amortization | 37,197 | 44,026 | 22,600 | 6,305 | 110,128 |
| (Gain) loss on disposal of assets | (784) | (257) | 8 | (4) | (1,037) |
| Gain (loss) from unconsolidated affiliates | | | 2,954 | (215) | 2,739 |
| Adjusted EBITDA | \$ 129,835 | \$ 204,391 | \$ 100,576 | \$ (44,264) | \$ 390,538 |

Adjusted EBITDA for our Midwest segment increased by \$19.1 million, or 28.6%, and \$52.1 million, or 40.2%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012, which were partially offset by a decline in adjusted EBITDA at Hollywood Casino Lawrenceburg due to new competition discussed further below.

Adjusted EBITDA for our East/West segment decreased by \$3.3 million, or 3.3%, and \$16.7 million, or 8.2%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to a decline in adjusted EBITDA at Hollywood Casino at Charles Town Races due to increased competition discussed further below, which was partially offset by higher earnings levels at the M Resort due to certain cost containment initiatives and improved slot revenues in the second quarter of 2013.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Adjusted EBITDA for our Southern Plains segment increased by \$9.0 million, or 19.2%, and \$13.8 million, or 13.7%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis on November 2, 2012, which was partially offset by reduced earnings at Hollywood Casino Baton Rouge due to increased competition discussed further below.

Adjusted EBITDA for Other changed by \$3.2 million, or 14.5%, and \$7.6 million, or 17.1%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to higher Spin-Off transaction costs as well as higher lobbying and developments costs. In addition, our liability based stock compensation charges increased for the six months ended June 30, 2013, compared to the corresponding period in the prior year, due to an increase in our common stock price.

Table of ContentsRevenues

Revenues for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

| Three Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|-----------------------------|------------|------------|-----------|---------------------|
| Gaming | \$ 679,829 | \$ 634,846 | \$ 44,983 | 7.1% |
| Food, beverage and other | 121,044 | 109,955 | 11,089 | 10.1% |
| Management service fee | 3,667 | 3,614 | 53 | 1.5% |
| Revenues | 804,540 | 748,415 | 56,125 | 7.5% |
| Less promotional allowances | (43,169) | (35,864) | (7,305) | (20.4)% |
| Net revenues | \$ 761,371 | \$ 712,551 | \$ 48,820 | 6.9% |

| Six Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|-----------------------------|--------------|--------------|------------|---------------------|
| Gaming | \$ 1,397,754 | \$ 1,290,923 | \$ 106,831 | 8.3% |
| Food, beverage and other | 242,904 | 222,863 | 20,041 | 9.0% |
| Management service fee | 6,714 | 7,057 | (343) | (4.9)% |
| Revenues | 1,647,372 | 1,520,843 | 126,529 | 8.3% |
| Less promotional allowances | (87,755) | (72,233) | (15,522) | (21.5)% |
| Net revenues | \$ 1,559,617 | \$ 1,448,610 | \$ 111,007 | 7.7% |

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

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

Gaming revenue

Gaming revenue increased by \$45.0 million, or 7.1%, and \$106.8 million, or 8.3%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

Gaming revenue for our Midwest segment increased by \$37.3 million, or 18.5%, and \$111.5 million, or 28.4%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012, which had increased gaming revenue of \$24.7 million and \$71.8 million for the three and six months ended June 30, 2013, respectively, as compared to the corresponding period in the prior year, and the opening of Hollywood Casino Columbus on

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

October 8, 2012, which generated \$51.3 million and \$109.2 million of gaming revenue for the three and six months ended June 30, 2013, respectively, which were 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 \$35.9 million, or 28.3%, and \$69.0 million, or 25.9%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012, which generated \$50.9 million and \$105.5 million of gaming revenue for the three and six months ended June 30, 2013, respectively, which was partially offset by decreased gaming revenue at Hollywood Casino Baton Rouge primarily due to the opening of a new riverboat casino and hotel in Baton Rouge, Louisiana on September 1, 2012. Additionally, gaming revenue decreased at Argosy Casino Riverside for the six months ended June 30, 2013, as compared to the corresponding period in the prior year, primarily due to the continued impact of the opening of our Hollywood Casino at Kansas Speedway joint venture in February 2012.

Table of Contents

Gaming revenue for our East/West segment decreased by \$28.2 million, or 9.2%, and \$73.2 million, or 11.6%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to decreased gaming revenue at Hollywood Casino at Charles Town Races for \$21.9 million and \$46.2 million, respectively, and Hollywood Casino Perryville for \$4.0 million and \$16.5 million, respectively, primarily due to the opening of a casino complex at the Arundel Mills mall in Maryland in 2012. However, the decrease at Hollywood Casino Perryville was partially offset by the introduction of table games at the property in March 2013. Additionally, these two casinos as well as Hollywood Casino at Penn National Race Course experienced a more severe winter in the first quarter of 2013 compared to the prior year.

Food, beverage and other revenue

Food, beverage and other revenue increased by \$11.1 million, or 10.1%, and \$20.0 million, or 9.0%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

Food, beverage and other revenue for our Southern Plains segment increased by \$8.0 million, or 34.2%, and \$17.2 million, or 36.4%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012, which contributed \$9.5 million and \$20.4 million of food, beverage and other revenue for the three and six months ended June 30, 2013, respectively, which was partially offset by decreased food, beverage and other revenue at Hollywood Casino Baton Rouge primarily due to the aforementioned new competition.

Food, beverage and other revenue for our Midwest segment increased by \$5.2 million, or 22.7%, and \$15.5 million, or 35.1%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the opening of Hollywood Casino Toledo on May 29, 2012, which had increased food, beverage and other revenue of \$2.0 million and \$7.0 million for the three and six months ended June 30, 2013, respectively, as compared to the corresponding period in the prior year, and the opening of Hollywood Casino Columbus on October 8, 2012, which generated \$5.5 million and \$12.4 million of food, beverage and other revenue for the three and six months ended June 30, 2013, respectively, both of which were partially offset by a reduction in food, beverage and other revenue for Hollywood Casino Lawrenceburg due to previously mentioned new competition.

Food, beverage and other revenue for our East/West segment decreased by \$3.9 million, or 6.9%, and \$13.4 million, or 11.6%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 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.

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.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Promotional allowances increased by \$7.3 million, or 20.4%, and \$15.5 million, or 21.5%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012 in our Southern Plains segment, as well as to a lesser extent the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012 in our Midwest segment.

Operating Expenses

Operating expenses for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

| Three Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|---|------------|------------|------------|---------------------|
| Gaming | \$ 341,889 | \$ 330,875 | \$ 11,014 | 3.3% |
| Food, beverage and other | 88,910 | 84,985 | 3,925 | 4.6% |
| General and administrative | 128,730 | 115,251 | 13,479 | 11.7% |
| Depreciation and amortization | 80,615 | 56,791 | 23,824 | 42.0% |
| Impairment losses | 71,846 | | 71,846 | N/M |
| Insurance deductible charges, net of recoveries | 2,500 | (3,366) | 5,866 | 174.3% |
| Total operating expenses | \$ 714,490 | \$ 584,536 | \$ 129,954 | 22.2% |

| Six Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|---|--------------|--------------|------------|---------------------|
| Gaming | \$ 703,907 | \$ 671,044 | \$ 32,863 | 4.9% |
| Food, beverage and other | 179,175 | 172,789 | 6,386 | 3.7% |
| General and administrative | 264,307 | 231,248 | 33,059 | 14.3% |
| Depreciation and amortization | 157,686 | 110,128 | 47,558 | 43.2% |
| Impairment losses | 71,846 | | 71,846 | N/M |
| Insurance deductible charges, net of recoveries | 2,500 | (7,229) | 9,729 | 134.6% |
| Total operating expenses | \$ 1,379,421 | \$ 1,177,980 | \$ 201,441 | 17.1% |

Gaming expense

Gaming expense increased by \$11.0 million, or 3.3%, and \$32.9 million, or 4.9%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

Gaming expense for our Midwest segment increased by \$13.8 million, or 13.1%, and \$47.8 million, or 23.4%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 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 to a lesser extent decreased payroll and marketing costs at this property due to increased cost management efforts.

Gaming expense for our Southern Plains segment increased by \$17.2 million, or 36.1%, and \$34.4 million, or 34.8%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 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 Hollywood Casino Baton Rouge, as well as to a lesser extent decreased payroll and marketing costs at this property due to realignment of costs associated with lower business demand.

Gaming expense for our East/West segment decreased by \$19.9 million, or 11.3%, and \$49.0 million, or 13.4%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 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 and Hollywood Casino Perryville. Additionally, Hollywood Casino at Penn National Race Course experienced an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Food, beverage and other expense

Food, beverage and other expense increased by \$3.9 million, or 4.6%, and \$6.4 million, or 3.7%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

Food, beverage and other expense for our Southern Plains segment increased by \$5.1 million, or 26.8%, and \$10.3 million, or 26.7%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

Food, beverage and other expense for our Midwest segment increased by \$2.6 million, or 14.2%, and \$9.6 million, or 27.1%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012.

Table of Contents

which were partially offset by decreased food, beverage and other expense at Hollywood Casino Lawrenceburg primarily due to lower food and beverage expense as well as decreased payroll costs due to increased cost management efforts.

Food, beverage and other expense for our East/West segment decreased by \$4.4 million, or 10.5%, and \$12.8 million, or 14.9%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the sale of an on-site gas station in April 2012 at the M Resort.

General and administrative expenses

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

General and administrative expenses increased by \$13.5 million, or 11.7%, and \$33.1 million, or 14.3%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

General and administrative expenses for our Southern Plains segment increased by \$10.2 million, or 40.0%, and \$18.0 million, or 34.7%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012.

General and administrative expenses for our Midwest segment increased by \$5.0 million, or 17.0%, and \$13.8 million, or 24.0%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the openings of Hollywood Casino Toledo on May 29, 2012 and Hollywood Casino Columbus on October 8, 2012.

General and administrative expenses for Other increased by \$2.3 million, or 8.0%, and \$5.1 million, or 8.8%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to higher legal, consulting and other fees related to the pursuit of potential opportunities, including the Spin-Off transaction, as well as higher lobbying costs, which was partially offset by lower stock compensation due to a lower number of equity grants awarded to employees in the current year compared to the prior year, for the three and six months ended June 30, 2013 compared to the corresponding period in the prior year. In addition, our liability based stock compensation charges increased for the six months ended June 30, 2013, compared to the corresponding period in the prior year, due to an increase in our common stock price.

Depreciation and amortization expense

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Depreciation and amortization expense increased by \$23.8 million, or 42.0%, and \$47.6 million, or 43.2%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the variances explained below.

Depreciation and amortization expense for our Midwest segment increased by \$12.9 million, or 65.8%, and \$27.6 million, or 74.3%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 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 \$13.4 million, or 119.9%, and \$21.9 million, or 97.1%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the acquisition of Harrah's St. Louis facility on November 2, 2012. Additionally, in April 2013, we began to amortize on a straight line basis through June 2014 our gaming license intangible asset at Argosy Casino Sioux City based on the IRGC awarding the gaming license to another gaming operator. See Note 9 for further details.

Depreciation and amortization expense for our East/West segment decreased by \$2.5 million, or 11.4%, and \$3.9 million, or 8.9%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to decreased depreciation expense at Hollywood Casino at Penn National Race Course primarily due to assets purchased when the casino was built that had a five year useful life reaching full amortization in February 2013.

Impairment losses

As a result of a new gaming license being awarded for the development of a new casino in Sioux City, Iowa to another applicant in April 2013, we recorded a pre-tax goodwill and other intangible asset impairment charge in our Southern Plains segment

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

Table of Contents

of \$71.8 million (\$70.5 million, net of taxes) for Argosy Casino Sioux City during the three months ended June 30, 2013, as we determined that the fair value of our Sioux City reporting unit was less than our carrying amount based on our analysis of the estimated future expected cash flows we anticipate receiving from the operations of our Sioux City facility.

Insurance deductible charges, net of recoveries

Insurance deductible charges during the three and six months ended June 30, 2013 were related to a pre-tax insurance loss of \$2.5 million for the three and six months ended June 30, 2013 for the tornado damage at Hollywood Casino St. Louis.

Insurance recoveries, net of deductible charges during the three and six months ended June 30, 2012 were related to a pre-tax insurance gain of \$3.4 million and \$7.2 million, respectively, for the flood at Hollywood Casino Tunica.

Other income (expenses)

Other income (expenses) for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

| Three Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|-------------------------------------|-------------|-------------|------------|------------------------|
| Interest expense | \$ (27,060) | \$ (17,823) | \$ (9,237) | (51.8)% |
| Interest income | 343 | 246 | 97 | 39.4% |
| Gain from unconsolidated affiliates | 3,821 | 1,054 | 2,767 | 262.5% |
| Other | 2,402 | 1,474 | 928 | 63.0% |
| Total other expenses | \$ (20,494) | \$ (15,049) | \$ (5,445) | (36.2)% |

| Six Months Ended June 30, | 2013 | 2012 | Variance | Percentage Variance |
|-------------------------------------|-------------|-------------|-------------|------------------------|
| Interest expense | \$ (54,984) | \$ (35,866) | \$ (19,118) | (53.3)% |
| Interest income | 605 | 465 | 140 | 30.1% |
| Gain from unconsolidated affiliates | 5,542 | 2,739 | 2,803 | 102.3% |
| Other | 3,066 | 471 | 2,595 | 551.0% |
| Total other expenses | \$ (45,771) | \$ (32,191) | \$ (13,580) | (42.2)% |

Interest expense

Interest expense increased by \$9.2 million, or 51.8%, and \$19.1 million, or 53.3%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to the higher outstanding borrowings on our senior secured credit facility from 2012, lower capitalized interest for the three and six months ended June 30, 2013 compared to the corresponding period in the prior year, and \$1.2 million and \$2.2 million of interest expense related to our other long-term obligation entered into in September 2012 for the three and six months ended June 30, 2013, respectively.

Gain from unconsolidated affiliates

Gain from unconsolidated affiliates increased by \$2.8 million, or 262.5%, and \$2.8 million, or 102.3%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to increased earnings related to our joint venture in Kansas Entertainment primarily due to a favorable property tax settlement of \$1.5 million in the second quarter of 2013 as well as growth in its market share.

Other

Other increased by \$0.9 million, or 63.0%, and \$2.6 million, or 551.0%, for the three and six months ended June 30, 2013, respectively, as compared to the three and six months ended June 30, 2012, primarily due to a gain on redemption of corporate debt securities of \$1.3 million for the three months ended June 30, 2013, as well as increased foreign currency translation gains for the six months ended June 30, 2013 compared to the corresponding period in the prior year.

Table of Contents

Taxes

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) increased to 146.2% and 60.5% for the three and six months ended June 30, 2013, respectively, as compared to 41.0% and 39.1% for the three and six months ended June 30, 2012, respectively, primarily due to the non-deductible portion of our goodwill impairment charge related to Argosy Casino Sioux City.

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 \$291.4 million and \$230.9 million for the six months ended June 30, 2013 and 2012, respectively. The increase in net cash provided by operating activities of \$60.5 million for the six months ended June 30, 2013 compared to the corresponding period in the prior year comprised primarily of an increase in cash receipts from customers of \$109.1 million, decreased income tax payments of \$86.8 million, and receipt of cash from earnings of our joint venture in Kansas for \$9.0 million, all of which were partially offset by an increase in cash paid to suppliers and vendors of \$96.2 million, cash paid to employees of \$30.0 million, and interest payments of \$19.0 million. The increase in cash receipts collected from our customers and the increase in higher cash payments for operating expenses and to employees for the six months ended June 30, 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. The decrease in income tax payments for the six months ended June 30, 2013 compared to the prior year was primarily due to a significant federal income tax overpayment from 2012 that was utilized in 2013.

Net cash used in investing activities totaled \$81.7 million and \$325.5 million for the six months ended June 30, 2013 and 2012, respectively. Net cash used in investing activities for the six months ended June 30, 2013 included expenditures for property and equipment, net of reimbursements totaling \$116.6 million, and investment in joint ventures of \$0.5 million, both of which were partially offset by a decrease in cash in escrow of \$26.0 million, proceeds from investment in corporate debt securities of \$6.7 million and proceeds from the sale of property and equipment totaling \$2.8 million. The decrease in net cash used in investing activities of \$243.8 million for the six months ended June 30, 2013 compared to the corresponding period in the prior year was primarily due to decreased expenditures for property and equipment of \$137.6 million primarily due to the opening of our two new facilities in Ohio in 2012, partially offset by increased expenditures for the rebranding of our St. Louis facility in 2013, as well as decreased funding provided to our joint venture in Kansas and a gaming license payment of \$50 million in 2012 for Hollywood Casino Toledo.

Net cash (used in) provided by financing activities totaled (\$235.1) million and \$60.3 million for the six months ended June 30, 2013 and 2012, respectively. The increase in net cash used in financing activities of \$295.4 million for the six months ended June 30, 2013 compared to the

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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.

The following table summarizes our expected capital project expenditures by segment for the fiscal year ending December 31, 2013, and actual expenditures for the six months ended June 30, 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.

Table of Contents

| Property | Expected for Year Ending December 31, 2013 | Expenditures for Six Months Ended June 30, 2013 (in millions) | Balance to Expend in 2013 |
|-----------------|--|--|------------------------------|
| Midwest | \$ 135.4 | \$ 47.7 | \$ 87.7 |
| East/West | 9.5 | 0.3 | 9.2 |
| Southern Plains | 46.8 | 22.3 | 24.5 |
| Other | 2.8 | 0.5 | 2.3 |
| Total | \$ 194.5 | \$ 70.8 | \$ 123.7 |

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. Construction started in late May 2013 for the new Hollywood-themed facility in Austintown, with a \$261 million budget, inclusive of a \$75 million relocation fee and \$50 million license fee, featuring a new thoroughbred racetrack and up to 1,000 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 Centrepoinette Business Park near the intersection of Interstate 80 and Ohio Route 46. For Dayton, construction started in late May 2013 for the new Hollywood-themed facility, with a \$254 million budget, inclusive of a \$75 million relocation fee and \$50 million license fee, featuring a new standardbred racetrack and up to 1,500 video lottery terminals, as well as various restaurants, bars and other amenities. 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. As of June 30, 2013, we have incurred cumulative costs of \$13.0 million and \$11.2 million for the Austintown facility and the Dayton facility, respectively.

During the six months ended June 30, 2013, we spent approximately \$45.8 million for capital maintenance expenditures, with \$13.6 million at our Midwest segment, \$13.7 million at our East/West segment, \$14.5 million at our Southern Plains segment, and \$4.0 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 \$2,139.3 million at June 30, 2013, consisting of a \$1,015.0 million Term Loan A facility and a \$1,124.3 million Term Loan B facility. No balances were outstanding on the revolving credit facility at June 30, 2013. Additionally, at June 30, 2013, we were contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$73.3 million, resulting in \$711.7 million of available borrowing capacity as of June 30, 2013 under the revolving credit facility. The Company made payments of \$128.2 million against its Term Loan B facility during 2013.

Covenants

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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 June 30, 2013, we were in compliance with all required 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 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

Table of Contents

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.

As discussed in Note 9, on June 13, 2013, the Company finalized an agreement with the state of Ohio and has agreed to pay \$110 million over a ten year period commencing in July 2013 for certain clarifications from the State of Ohio with respect to various financial matters and limits on competition within the ten year time period. Additionally, in return for being able to relocate its existing racetracks in Toledo and Grove City to Dayton and Austintown (located in Mahoning Valley), respectively, the Company agreed to pay the state \$7.5 million upon the opening of each facility, as well as eighteen semi-annual installment payments of \$4.8 million beginning one year after the opening of each facility.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information at June 30, 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 June 30, 2013.

| | 07/01/13 - 06/30/14 | 07/01/14 - 06/30/15 | 07/01/15 - 06/30/16 | 07/01/16 - 06/30/17 | 07/01/17 - 06/30/18 | Thereafter | Total | Fair Value 06/30/13 |
|------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|--------------|--------------|------------------------|
| | (in thousands) | | | | | | | |
| Long-term debt: | | | | | | | | |
| Fixed rate | \$ | \$ | \$ | \$ | \$ | \$ 325,000 | \$ 325,000 | \$ 355,875 |
| Average interest rate | | | | | | 8.75% | | |
| Variable rate | \$ 82,500 | \$ 110,000 | \$ 82,500 | \$ 740,000 | \$ | \$ 1,124,300 | \$ 2,139,300 | \$ 2,140,762 |
| Average interest rate | | | | | | | | |
| (1) | 3.22% | 3.62% | 3.94% | 4.21% | 0.00% | 5.59% | | |

(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 June 30, 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 June 30, 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

Table of Contents

Commission's rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1 Legal Proceedings

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

ITEM 1A Risk Factors

We are not aware of any material changes to the risk factors described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

The Company did not repurchase any shares of common stock during the three months ended June 30, 2013.

ITEM 3 Defaults upon Senior Securities

None.

Edgar Filing: PENN NATIONAL GAMING INC - Form 10-Q

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 (Incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q filed on May 3, 2013). |
| 10.2* | Amendment of Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan |
| 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 June 30, 2013 and December 31, 2012, (ii) the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012, (iv) the Condensed Consolidated Statements of Changes in Shareholders |

Table of Contents

Equity for the six months ended June 30, 2013 and 2012, (v) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 and (vi) the notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.

* Filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PENN NATIONAL GAMING, INC.

August 2, 2013

By:

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

Table of Contents

EXHIBIT INDEX

| Exhibit | Description of Exhibit |
|----------------|---|
| 10.1 | Penn National Gaming, Inc. Deferred Compensation Plan as amended (Incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q filed on May 3, 2013). |
| 10.2* | Amendment of Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan |
| 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 June 30, 2013 and December 31, 2012, (ii) the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2013 and 2012, (v) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 and (vi) the notes to the Condensed Consolidated Financial Statements, tagged as blocks of text. |

* Filed herewith.