PENN NATIONAL GAMING INC
Form 10-Q
November 10, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from to

Commission file number: 0-24206

PENN NATIONAL GAMING, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	**23-2234473**
(State or other jurisdiction of incorporation or organization)	(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 x No o

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 (Check one):

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

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

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

Title	**Outstanding as of November 1, 2008**
Common Stock, par value $.01 per share	78,123,682 (includes 380,000 shares of restricted stock)

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This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although Penn National Gaming, Inc. and its subsidiaries (collectively, the Company) believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors which could cause actual results to differ from expectations include, but are not limited to, risks related to the following: our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; the impact of market conditions or applicable legal restrictions on the Company s intention to repurchase shares of its common stock; the passage of state, federal or local legislation that would expand, restrict, further tax, prevent or negatively impact (such as a smoking ban at any of our facilities) operations in the jurisdictions in which we do business; the activities of our competitors and the emergence of new competitors; increases in the effective rate of taxation at any of our properties or at the corporate level; delays or changes to, or cancellations of, planned capital projects at our gaming and pari-mutuel facilities or an inability to achieve the expected returns from such projects; the existence of attractive acquisition candidates and development opportunities, the costs and risks involved in the pursuit of those acquisitions and development opportunities and our ability to integrate those acquisitions; the maintenance of agreements with our horsemen, pari-mutuel clerks and other organized labor groups; the effects of local and national economic, credit and capital market and energy conditions on the economy in general, and on the gaming and lodging industries in particular; construction factors, including delays, increased cost of labor and materials; the outcome of legal proceedings instituted against the Company in connection with the termination of the previously announced acquisition of the Company by certain affiliates of Fortress Investment Group LLC and Centerbridge Partners, L.P.; changes in accounting standards; third-party relations and approvals; our dependence on key personnel; the impact of terrorism and other international hostilities; the availability and cost of financing; and other factors as discussed in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 filed with the United States Securities and Exchange Commission. We do not intend to update publicly any forward-looking statements except as required by law.

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PENN NATIONAL GAMING, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Penn National Gaming, Inc. and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share and per share data)

	September 30, 2008 (unaudited)	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 125,656	$ 174,372
Receivables, net of allowance for doubtful accounts of $3,661 and $3,241 at September 30, 2008 and December 31, 2007, respectively	54,559	56,427
Prepaid expenses and other current assets	82,670	52,825
Deferred income taxes	21,715	19,079
Total current assets	284,600	302,703
Property and equipment, net	1,791,009	1,688,393
Other assets		
Investment in and advances to unconsolidated affiliate	14,945	15,548
Goodwill	2,013,284	2,013,139
Other intangible assets	769,771	777,441
Deferred financing costs, net of accumulated amortization of $36,104 and $27,680 at September 30, 2008 and December 31, 2007, respectively	37,720	46,144
Other assets	138,465	123,664
Total other assets	2,974,185	2,975,936
Total assets	$ 5,049,794	$ 4,967,032
Liabilities		
Current liabilities		
Current maturities of long-term debt	$ 105,774	$ 93,452
Accounts payable	26,753	28,581
Accrued expenses	101,293	163,579
Accrued interest	46,217	56,631
Accrued salaries and wages	60,688	54,149
Gaming, pari-mutuel, property, and other taxes	60,919	43,621
Income taxes payable	38,149	3,642
Insurance financing	14,162	16,515
Other current liabilities	39,072	33,704
Total current liabilities	493,027	493,874
Long-term liabilities		
Long-term debt, net of current maturities	2,287,986	2,881,470
Deferred income taxes	377,989	385,089
Noncurrent tax liabilities	82,523	82,849
Other noncurrent liabilities	474,178	2,788

Total long-term liabilities		3,222,676		3,352,196
Shareholders equity				
Preferred stock ($.01 par value, 1,000,000 shares authorized, none issued and outstanding at September 30, 2008 and December 31, 2007)				
Common stock ($.01 par value, 200,000,000 shares authorized, 85,880,866 and 88,579,070 shares issued at September 30, 2008 and December 31, 2007, respectively)		859		887
Treasury stock (1,698,800 shares issued at December 31, 2007)				(2,379)
Additional paid-in capital		307,759		322,760
Retained earnings		1,040,928		815,678
Accumulated other comprehensive loss		(15,455)		(15,984)
Total shareholders equity		1,334,091		1,120,962
Total liabilities and shareholders equity	$	5,049,794	$	4,967,032

See accompanying notes to the consolidated financial statements.

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Penn National Gaming, Inc. and Subsidiaries

Consolidated Statements of Income

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

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenues				
Gaming	$ 558,424	$ 574,717	$ 1,685,455	$ 1,694,091
Management service fee	4,898	5,217	13,577	13,032
Food, beverage and other	88,670	82,418	252,040	239,082
Gross revenues	651,992	662,352	1,951,072	1,946,205
Less promotional allowances	(34,105)	(32,902)	(99,105)	(95,253)
Net revenues	617,887	629,450	1,851,967	1,850,952
Operating expenses				
Gaming	298,202	296,919	887,644	878,296
Food, beverage and other	68,935	62,476	200,454	183,929
General and administrative	110,149	98,935	306,144	291,427
Depreciation and amortization	44,224	37,241	129,198	110,221
Total operating expenses	521,510	495,571	1,523,440	1,463,873
Income from operations	96,377	133,879	328,527	387,079
Other income (expenses)				
Interest expense	(37,880)	(50,203)	(129,631)	(149,852)
Interest income	720	1,020	1,956	3,185
(Loss) earnings from joint venture	(139)	(122)	(1,050)	243
Merger termination settlement fees, net of related expenses	195,471		195,471	
Other	636	(2,637)	1,520	(8,341)
Total other income (expenses)	158,808	(51,942)	68,266	(154,765)
Income from operations before income taxes	255,185	81,937	396,793	232,314
Taxes on income	107,694	35,347	171,543	104,484
Net income	$ 147,491	$ 46,590	$ 225,250	$ 127,830
Basic earnings per share	$ 1.72	$ 0.54	$ 2.61	$ 1.50
Diluted earnings per share	$ 1.69	$ 0.52	$ 2.55	$ 1.45

See accompanying notes to the consolidated financial statements.

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Penn National Gaming, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders Equity

(in thousands, except share data) (unaudited)

	Common Stock Shares	Common Stock Amount	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity	Comprehensive Income
Balance, December 31, 2006	86,814,999	$ 868	$ (2,379)	$ 251,943	$ 667,557	$ 3,174	$ 921,163	
Stock option activity, including tax benefit of $16,897	1,578,535	16		55,985			56,001	$
Restricted stock	(60,000)			1,470			1,470	
Change in fair value of interest rate swap contracts, net of income taxes of $4,324						(7,615)	(7,615)	(7,615)
Foreign currency translation adjustment						505	505	505
Cumulative effect of adoption of FIN 48					(11,932)		(11,932)	
Net income					127,830		127,830	127,830
Balance, September 30, 2007	88,333,534	$ 884	$ (2,379)	$ 309,398	$ 783,455	$ (3,936)	$ 1,087,422	$ 120,720
Balance, December 31, 2007	88,579,070	$ 887	$ (2,379)	$ 322,760	$ 815,678	$ (15,984)	$ 1,120,962	
Stock option activity, including tax benefit of $965	150,196	2		17,511			17,513	$
Share activity	(2,848,400)	(30)	2,379	(33,988)			(31,639)	
Restricted stock				1,476			1,476	
Change in fair value of interest rate swap contracts, net of income taxes of $801						1,410	1,410	1,410
Change in fair value of corporate debt securities						(420)	(420)	(420)
Foreign currency translation adjustment						(461)	(461)	(461)
Net income					225,250		225,250	225,250
Balance, September 30, 2008	85,880,866	$ 859	$	$ 307,759	$ 1,040,928	$ (15,455)	$ 1,334,091	$ 225,779

See accompanying notes to the consolidated financial statements.

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Penn National Gaming, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(in thousands) (unaudited)

Nine Months Ended September 30,	2008	2007
Operating activities		
Net income	$ 225,250	$ 127,830
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	129,198	110,221
Amortization of items charged to interest expense	9,489	9,777
Amortization of items charged to interest income	(38)	
Loss on sale of fixed assets	999	1,366
Loss (earnings) from joint venture	1,050	(243)
Deferred income taxes	2,936	11,928
Charge for stock compensation	18,519	19,184
Decrease (increase), net of businesses acquired		
Accounts receivable	1,868	3,608
Insurance receivable		100,000
Prepaid expenses and other current assets	(30,414)	5,568
Other assets	(10,567)	(18,594)
(Decrease) increase, net of businesses acquired		
Accounts payable	(2,106)	(27,325)
Accrued expenses	(17,958)	(21,484)
Accrued interest	(8,203)	1,009
Accrued salaries and wages	6,539	3,417
Gaming, pari-mutuel, property and other taxes	17,298	15,626
Income taxes payable	23,992	(4,356)
Other current and noncurrent liabilities	5,358	4,507
Other noncurrent tax liabilities	(2,465)	4,096
Net cash provided by operating activities	370,745	346,135
Investing activities		
Expenditures for property and equipment	(272,951)	(232,061)
Proceeds from sale of property and equipment	882	14,251
Investment in corporate debt securities	(5,110)	
Acquisition of businesses and licenses, net of cash acquired	(382)	(253,078)
Net cash used in investing activities	(277,561)	(470,888)
Financing activities		
Proceeds from exercise of options	1,942	21,390
Repurchases of common stock	(31,627)	
Proceeds from issuance of long-term debt	215,937	327,000
Principal payments on long-term debt	(798,164)	(231,831)
Deposit on preferred stock, net of related expenses	471,400	
Proceeds on insurance financing	22,255	25,978
Payments on insurance financing	(24,608)	(24,059)
Tax benefit from stock options exercised	965	16,897
Net cash (used in) provided by financing activities	(141,900)	135,375
Net (decrease) increase in cash and cash equivalents	(48,716)	10,622
Cash and cash equivalents at beginning of year	174,372	168,515
Cash and cash equivalents at end of period	$ 125,656	$ 179,137

Supplemental disclosure

Interest expense paid	$	139,310	$	147,732
Income taxes paid	$	135,598	$	85,475

See accompanying notes to the consolidated financial statements.

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Penn National Gaming, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Penn National Gaming, Inc. (Penn) and its subsidiaries (collectively, 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 notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2007 should be read in conjunction with these consolidated financial statements. For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation. Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

2. Merger Announcement and Termination

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

The Merger Agreement provided that, upon termination under specified circumstances generally related to a competing acquisition proposal, the Company would have been required to pay a termination fee of up to $200 million to Parent and, under certain circumstances if the Company s shareholders had not approved the Merger, the Company would have been required to reimburse Parent for an aggregate amount not to exceed $17.5 million for transaction expenses incurred by Parent and its affiliates. Since the shareholder vote was obtained, the Company was unable to solicit, or terminate the Merger Agreement to accept, any third-party acquisition proposals. The Company s reimbursement of Parent s expenses would have reduced the amount of any required termination fee that became payable by the Company. The Merger Agreement further provided that, upon termination under specified circumstances related to, among other things, Parent s breach of the Merger Agreement, the failure to obtain financing or failure to obtain regulatory approval, Parent would have been required to pay the Company a termination fee of $200 million. Affiliates of the Funds had agreed to fund Parent in the amount of the termination fee in the event it became payable.

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee (the Cash Termination Fee) and a $1.25 billion, zero coupon, preferred equity investment. Pursuant to the terms of the preferred equity purchase agreement, the purchasers made a nonrefundable $475 million payment (the Initial Investment) to the Company on July 3, 2008, in addition to the payment of the Cash Termination Fee. Under the terms of the purchase agreement, the purchasers deposited the remaining preferred equity investment purchase consideration with an escrow agent. The funds will be released from escrow upon the issuance of the preferred stock, which is subject to the receipt of required regulatory approvals and the satisfaction of certain other conditions. The Company is in the process of seeking the required regulatory approvals and expects to satisfy all conditions to funding and the related issuance of the preferred stock in the fourth quarter of 2008. The Company primarily used the net proceeds from the Initial Investment and the after-tax proceeds of the Cash Termination Fee to repay some of its existing debt and for repurchases of its common stock. The repurchase of up to $200 million of the Company s common stock over the twenty-four month period ending July 2010 was authorized by the Company s Board of Directors in July 2008. See Note 13 for information regarding the receipt of the remaining preferred equity investment purchase consideration and the issuance of the preferred stock in the fourth quarter of 2008.

On December 26, 2007, the Company entered into a Change in Control Payment Acknowledgement and Agreement (the Acknowledgement and Agreement) with certain members of its management team. Pursuant to the Acknowledgement and Agreement, a portion of the payment due on a change in control to such executives was accelerated and paid on or before December 31, 2007. The Acknowledgement and Agreements were entered into as part of actions taken to reduce the amount

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of gross-up payments pertaining to federal excise taxes that may have otherwise been owed to such executives under the terms of their existing employment agreements in connection with the change in control payments due upon the consummation of the Merger. The accelerated change in control payments were subject to a clawback right in the event the Merger was terminated pursuant to the terms of the Merger Agreement or the closing of the Merger otherwise failed to occur or if the executive s employment with the Company was terminated prior to the effective date of the Merger under circumstances where the executive was not entitled to receive the remainder of his change in control payment under the terms of his employment agreement. In July 2008, the Company exercised its clawback right for the accelerated change in control payments in accordance with the Acknowledgement and Agreement, and advised the affected executives of the amounts to be repaid and the due date. The Company has received the net amount from each executive, and is working with each executive to recover the applicable taxes.

3. Summary of Significant Accounting Policies

Revenue Recognition and Promotional Allowances

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

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

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.

Revenues are recognized net of certain sales incentives in accordance with the Emerging Issues Task Force (EITF) consensus on Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products) (EITF 01-9). The consensus in EITF 01-9 requires that sales incentives and points earned in point-loyalty programs be recorded as a reduction of revenue. The Company recognizes incentives related to gaming play and points earned in point-loyalty programs as a direct reduction of gaming 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 nine months ended September 30, 2008 and 2007 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**

	(in thousands)		(in thousands)	
Rooms	$ 4,568	$ 4,164	$ 12,835	$ 11,402
Food and beverage	26,249	26,037	76,317	76,955
Other	3,288	2,701	9,953	6,896
Total promotional allowances	$ 34,105	$ 32,902	$ 99,105	$ 95,253

The estimated cost of providing such complimentary services for the three and nine months ended September 30, 2008 and 2007 are as follows:

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	Three Months Ended September 30, 2008	2007	Nine Months Ended September 30, 2008	2007
	(in thousands)		(in thousands)	
Rooms	$ 1,824	$ 1,580	$ 5,151	$ 4,833
Food and beverage	18,786	18,274	54,513	53,280
Other	1,602	1,462	4,402	3,833
Total cost of complimentary services	$ 22,212	$ 21,316	$ 64,066	$ 61,946

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options.

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. Options to purchase 4,939,838 and 1,567,760 shares were outstanding during the three and nine months ended September 30, 2008, respectively, but were not included in the computation of diluted EPS because they are antidilutive. Options to purchase 66,736 and 1,445,057 shares were outstanding during the three and nine months ended September 30, 2007, respectively, but were not included in the computation of diluted EPS because they are antidilutive.

	Three Months Ended September 30, 2008	2007	Nine Months Ended September 30, 2008	2007
	(in thousands)		(in thousands)	
Determination of shares:				
Weighted-average common shares outstanding	85,785	85,931	86,288	85,336
Assumed conversion of dilutive stock options	1,445	2,882	1,940	2,803
Diluted weighted-average common shares outstanding	87,230	88,813	88,228	88,139

The repurchase of up to $200 million of the Company s common stock over the twenty-four month period ending July 2010 was authorized by the Company s Board of Directors in July 2008. During the three months ended September 30, 2008, the Company repurchased 1,149,600 shares of its common stock in open market transactions for approximately $31.7 million, at an average price of $27.52. See Note 13 for information regarding the Company s repurchase of shares of its common stock in open market transactions during the month ended October 31, 2008.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), issued by the Financial Accounting Standards Board (FASB). SFAS 123(R) requires the Company to expense the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This expense must be recognized ratably over the requisite service period following the date of grant.

The Company elected the modified prospective application method for adoption, which results in the recognition of compensation expense using the provisions of SFAS 123(R) for all share-based awards granted or modified after December 31, 2005, and the recognition of compensation expense using the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, with the exception of the method of recognizing forfeitures, for all unvested awards outstanding at the date of adoption.

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 remaining term equal to the expected life assumed at the date of grant. Expected volatility at September 30, 2008 was estimated based on the historical volatility of the Company s stock price over a period of 4.72 years, in order to match the

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expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its common stock since its initial public offering in May 1994, and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical exercise behavior of the Company s employees. Forfeitures are estimated at the date of grant based on historical experience. Prior to the adoption of SFAS 123(R), the Company recorded forfeitures as they occurred for purposes of estimating pro forma compensation expense under SFAS 123. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at September 30, 2008 and 2007:

Nine Months Ended September 30,	**2008**	**2007**
Risk-free interest rate	3.28%	4.24%
Expected volatility	35.87%	37.68%
Dividend yield		
Weighted-average expected life (years)	4.72	4.73
Forfeiture rate	4.00%	4.00%

4. New Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP (the GAAP hierarchy). Any effect of applying the provisions of SFAS 162 shall be reported as a change in accounting principle in accordance with SFAS No. 154, Accounting Changes and Error Corrections. SFAS 162 is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not expect SFAS 162 to have an impact on its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the assets under SFAS No. 141 (revised), Business Combinations , and other GAAP. FSP FAS 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption of the standard is prohibited. The Company is currently determining the impact of FSP FAS 142-3 on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133 (SFAS 161), which requires enhanced disclosures about an entity s derivative and hedging activities. Specifically, entities are required to provide enhanced disclosures about: a) how and why an entity uses derivative instruments; b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations; and c) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently determining the impact of SFAS 161 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised), Business Combinations (SFAS 141(R)), which is intended to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. SFAS 141(R) requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, SFAS 141(R) modifies the accounting for transaction and restructuring costs. SFAS 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently determining the impact of SFAS 141(R) on its consolidated financial statements.

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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of SFAS No. 115 (SFAS 159), which permits an entity to choose to measure many financial instruments and certain other items at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective as of the beginning of each reporting entity s first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option for any financial assets or financial liabilities.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands the disclosure requirements about fair value measurements. In February 2008, the FASB amended SFAS 157 through the issuance of FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS 157-1) and FSP FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2). FSP FAS 157-1, which was effective upon the initial adoption of SFAS 157, amends SFAS 157 to exclude from its scope certain accounting pronouncements that address fair value measurements associated with leases. FSP FAS 157-2, which was effective upon issuance, delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS 157-3), which was effective upon issuance. FSP FAS 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted SFAS 157, as amended, and on a prospective basis, as of January 1, 2008. The January 1, 2008 adoption did not have a significant impact on the Company. The Company will apply SFAS 157, as amended, and on a prospective basis, as of January 1, 2009 to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company is currently determining the impact of applying SFAS 157, as amended, to these items. See Note 12 for further information regarding the adoption of SFAS 157.

5. Acquisitions

Sanford-Orlando Kennel Club

On October 17, 2007, pursuant to the Asset Purchase Agreement dated July 5, 2007, the Company completed the purchase of Sanford-Orlando Kennel Club in Longwood, Florida from Sanford-Orlando Kennel Club, Inc. and Collins and Collins. In connection with the purchase, the Company also secured a right of first refusal with respect to a majority stake in the Sarasota Kennel Club in Sarasota, Florida. The purchase price for the Sanford-Orlando Kennel Club provides for additional consideration to be paid by the Company based upon certain future regulatory developments. Located on approximately 26 acres in Longwood, Florida, the Sanford-Orlando Kennel Club features year-round greyhound racing, a simulcast wagering facility, a clubhouse lounge and two dining areas. The Company accounted for the acquisition in accordance with SFAS No. 141, Business Combinations (SFAS 141). The results of the Sanford-Orlando Kennel Club have been included in the Company s consolidated financial statements since the acquisition date.

Black Gold Casino at Zia Park

On April 16, 2007, pursuant to the Asset Purchase Agreement dated November 7, 2006 among Zia Partners, LLC (Zia), Zia Park LLC (the Buyer), a wholly-owned subsidiary of Penn, and (solely with respect to specified sections thereof which relate to the Company s guarantee of the Buyer s payment and performance) Penn, the Buyer completed the acquisition of Black Gold Casino at Zia Park and all related assets of Zia. Penn funded this purchase with additional borrowings under its existing $750 million revolving credit facility. The Company accounted for the acquisition in accordance with SFAS 141. As a result of the acquisition, the Company recorded goodwill of $144.2 million and other intangible assets of $3.7 million. The results of the Black Gold Casino at Zia Park have been included in the Company s consolidated financial statements since the acquisition date.