PENN NATIONAL GAMING INC
Form 10-Q
November 04, 2011
Table of Contents

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, 2011

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 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 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:

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 issuer s classes of common stock, as of the latest practicable date.

Title	Outstanding as of October 27, 2011
Common Stock, par value $.01 per share	78,233,972 (includes 431,017 shares of restricted stock)

Table of Contents

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although Penn National Gaming, Inc. and its subsidiaries (collectively, the Company) believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors that could cause actual results to differ from expectations include, but are not limited to, risks related to the following: our ability to receive, or delays in obtaining, the regulatory approvals required to own, develop and/or operate our facilities, or other delays or impediments to completing our planned acquisitions or projects, including favorable resolution of any related litigation; 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; 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 business (such as a smoking ban at any of our facilities) or in jurisdictions where we seek to do business; the effects of local and national economic, credit, capital market, housing, and energy conditions on the economy in general and on the gaming and lodging industries in particular; the activities of our competitors and the emergence of new competitors; increases in the effective rate of taxation at any of our properties or at the corporate level; our ability to recover proceeds on significant insurance claims; 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 maintenance of agreements with our horsemen, pari-mutuel clerks and other organized labor groups; 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, 2010, 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

PART I.	FINANCIAL INFORMATION	4
ITEM 1.	FINANCIAL STATEMENTS	4
	Condensed Consolidated Balance Sheets September 30, 2011 and December 31, 2010	4
	Condensed Consolidated Statements of Income Three and Nine Months Ended September 30, 2011 and 2010	5
	Condensed Consolidated Statements of Changes in Shareholders Equity Nine Months Ended September 30, 2011 and 2010	6
	Condensed Consolidated Statements of Cash Flows Nine Months Ended September 30, 2011 and 2010	7
	Notes to the Condensed Consolidated Financial Statements	8
ITEM 2.	MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	29
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	43
ITEM 4.	CONTROLS AND PROCEDURES	44
PART II.	OTHER INFORMATION	44
ITEM 1.	LEGAL PROCEEDINGS	44
ITEM 1A.	RISK FACTORS	44
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	44
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	45
ITEM 4.	(Removed and Reserved)	45
ITEM 5.	OTHER INFORMATION	45
ITEM 6.	EXHIBITS	46
SIGNATURES		47
EXHIBIT INDEX		48

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)

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets		
Cash and cash equivalents	$ 207,821	$ 246,385
Receivables, net of allowance for doubtful accounts of $3,241 and $3,332 at September 30, 2011 and December 31, 2010, respectively	41,812	44,463
Insurance receivable	953	
Prepaid expenses	38,834	72,393
Deferred income taxes	28,833	25,206
Other current assets	52,079	77,506
Total current assets	370,332	465,953
Property and equipment, net	2,221,467	1,965,774
Other assets		
Investment in and advances to unconsolidated affiliates	153,762	64,120
Goodwill	1,181,708	1,185,756
Other intangible assets	421,117	415,152
Debt issuance costs, net of accumulated amortization of $3,313 and $45,234 at September 30, 2011 and December 31, 2010, respectively	34,478	27,742
Loan receivable		230,500
Other assets	101,397	107,882
Total other assets	1,892,462	2,031,152
Total assets	$ 4,484,261	$ 4,462,879
Liabilities		
Current liabilities		
Current maturities of long-term debt	$ 45,581	$ 357,927
Accounts payable	23,221	17,312
Accrued expenses	102,088	101,447
Accrued interest	12,339	36,597
Accrued salaries and wages	72,869	73,432
Gaming, pari-mutuel, property, and other taxes	51,879	46,449
Insurance financing	2,399	11,602
Other current liabilities	53,294	46,763
Total current liabilities	363,670	691,529
Long-term liabilities		
Long-term debt, net of current maturities	1,922,192	1,813,196
Deferred income taxes	167,408	134,572
Noncurrent tax liabilities	31,755	36,846

Other noncurrent liabilities		8,321		8,970
Total long-term liabilities		2,129,676		1,993,584
Shareholders equity				
Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,275 shares issued and outstanding at September 30, 2011 and December 31, 2010)				
Common stock ($.01 par value, 200,000,000 shares authorized, 78,216,509 and 78,414,022 shares issued at September 30, 2011 and December 31, 2010, respectively)		776		779
Additional paid-in capital		1,450,937		1,446,932
Retained earnings		539,171		337,940
Accumulated other comprehensive loss		31		(7,885)
Total shareholders equity		1,990,915		1,777,766
Total liabilities and shareholders equity	$	4,484,261	$	4,462,879

See accompanying notes to the consolidated financial statements.

Table of Contents

Penn National Gaming, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues				
Gaming	$ 636,389	$ 582,307	$ 1,868,373	$ 1,668,870
Food, beverage and other	109,681	85,787	289,361	250,971
Management service fee	4,476	4,363	11,830	11,569
Revenues	750,546	672,457	2,169,564	1,931,410
Less promotional allowances	(39,641)	(34,201)	(103,757)	(102,520)
Net revenues	710,905	638,256	2,065,807	1,828,890
Operating expenses				
Gaming	331,496	309,991	979,285	890,473
Food, beverage and other	87,952	66,857	231,801	196,705
General and administrative	108,897	102,164	314,695	303,633
Depreciation and amortization	52,195	53,842	159,583	157,675
Impairment losses		816		31,542
Insurance deductible charges, net of recoveries	30	(5,876)	(13,219)	(5,662)
Total operating expenses	580,570	527,794	1,672,145	1,574,366
Income from operations	130,335	110,462	393,662	254,524
Other income (expenses)				
Interest expense	(23,514)	(32,412)	(78,649)	(99,615)
Interest income	68	398	217	1,739
Gain (loss) from unconsolidated affiliates	17,293	(3,925)	15,370	(5,762)
Loss on early extinguishment of debt	(17,838)		(17,838)	(519)
Other	2,737	8,259	393	8,245
Total other expenses	(21,254)	(27,680)	(80,507)	(95,912)
Income from operations before income taxes	109,081	82,782	313,155	158,612
Taxes on income	38,278	34,437	114,835	67,140
Net income including noncontrolling interests	70,803	48,345	198,320	91,472
Less: Net loss attributable to noncontrolling interests				(2,193)
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	$ 70,803	$ 48,345	$ 198,320	$ 93,665
Earnings per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:				
Basic earnings per common share	$ 0.73	$ 0.51	$ 2.05	$ 0.97
Diluted earnings per common share	$ 0.66	$ 0.46	$ 1.85	$ 0.88

See accompanying notes to the 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)

	Penn National Gaming, Inc. shareholders									
	Preferred Stock		Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	Noncontrolling	Total Shareholders	Comprehensive
	Shares	Amount	Shares	Amount	Capital	Earnings	(Loss) Income	Interests	Equity	Income (Loss)
Balance, December 31, 2009	12,500	$	78,972,256	$ 786	$ 1,480,476	$ 397,407	$ (26,028)	$ (565)	1,852,076	
Repurchase of preferred stock	(225)				(11,200)				(11,200)	$
Repurchase of noncontrolling interest					(27,758)			2,758	(25,000)	
Stock option activity, including tax benefit of $402			315,609	3	20,203				20,206	
Share activity			(1,526,400)	(15)	(35,843)				(35,858)	
Restricted stock activity			145,110		4,454				4,454	
Change in fair value of interest rate swap contracts, net of income taxes of $6,732							11,588		11,588	11,588
Change in fair value of corporate debt securities							780		780	780
Foreign currency translation adjustment							274		274	274
Net income (loss)						93,665		(2,193)	91,472	91,472
Balance, September 30, 2010	12,275	$	77,906,575	$ 774	$ 1,430,332	$ 491,072	$ (13,386)	$	$ 1,908,792	$ 104,114
Balance, December 31, 2010	12,275	$	78,414,022	$ 779	$ 1,446,932	$ 337,940	$ (7,885)	$	$ 1,777,766	
Stock option activity, including tax benefit of $2,317			462,009	5	27,714				27,719	$
Share activity			(755,517)	(8)	(27,028)				(27,036)	
Restricted stock activity			95,995		3,319				3,319	
Change in fair value of interest rate swap contracts, net of income taxes of $4,600							8,162		8,162	8,162
Change in fair value of corporate debt securities							364		364	364
Foreign currency translation adjustment							(610)		(610)	(610)

Cumulative-effect of adoption of amendments to ASC 924 regarding jackpot liabilities, net of income taxes of $1,068					2,911			2,911	
Net income					198,320			198,320	198,320
Balance, September 30, 2011	12,275	$ 78,216,509	$ 776	$ 1,450,937	$ 539,171	$ 31	$	$ 1,990,915	$ 206,236

See accompanying notes to the consolidated financial statements.

6

Table of Contents

Penn National Gaming, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands) (unaudited)

Nine Months Ended September 30,	**2011**	**2010**
Operating activities		
Net income including noncontrolling interests	$ 198,320	$ 91,472
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	159,583	157,675
Amortization of items charged to interest expense and interest income	7,964	9,520
(Gain) loss on sale of fixed assets	(89)	923
(Gain) loss from unconsolidated affiliates	(15,370)	5,762
Loss on early extinguishment of debt	12,212	519
Loss on police services contract termination at Hollywood Casino Aurora		6,624
Deferred income taxes	38,906	(5,631)
Charge for stock-based compensation	18,456	19,757
Impairment losses		31,542
Decrease (increase), net of businesses acquired		
Accounts receivable	6,522	(447)
Insurance receivable	(955)	28,674
Prepaid expenses and other current assets	25,430	31,665
Other assets	(1,646)	11,894
Increase (decrease), net of businesses acquired		
Accounts payable	3,599	2,606
Accrued expenses	(3,229)	(21,345)
Accrued interest	(11,496)	(11,058)
Accrued salaries and wages	(3,455)	605
Gaming, pari-mutuel, property and other taxes	4,367	13,002
Other current and noncurrent liabilities	2,493	2,749
Other noncurrent tax liabilities	(3,540)	(6,802)
Net cash provided by operating activities	438,072	369,706
Investing activities		
Expenditures for property and equipment	(203,509)	(285,284)
Proceeds from sale of property and equipment	11,643	1,425
Insurance proceeds related to damaged property and equipment	3,862	4,821
Investment in joint ventures, net of proceeds received	(74,198)	(50,266)
Decrease (increase) in cash in escrow	29,900	(30,264)
Cash acquired, net of acquisitions of businesses and licenses	9,585	(55,895)
Net cash used in investing activities	(222,717)	(415,463)
Financing activities		
Proceeds from exercise of options	10,265	3,989
Repurchase of common stock	(27,036)	(35,858)
Repurchase of preferred stock		(11,200)
Proceeds from issuance of long-term debt, net of issuance costs	1,651,610	56,733
Principal payments on long-term debt	(1,881,872)	(297,466)
Proceeds from insurance financing	892	6,222
Payments on insurance financing	(10,095)	(9,741)
Repurchase of noncontrolling interest		(25,000)
Tax benefit from stock options exercised	2,317	402
Net cash used in financing activities	(253,919)	(311,919)

Net decrease in cash and cash equivalents		(38,564)		(357,676)
Cash and cash equivalents at beginning of year		246,385		713,118
Cash and cash equivalents at end of period	$	207,821	$	355,442
Supplemental disclosure				
Interest expense paid	$	85,381	$	104,969
Income taxes paid	$	70,386	$	50,357

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

See accompanying notes to the consolidated financial statements.

Table of Contents

Penn National Gaming, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

1. Organization and Basis of Presentation

Penn National Gaming, Inc. (Penn) and its subsidiaries (collectively, the Company) is a diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of September 30, 2011, the Company owns, manages, or has ownership interests in twenty-five facilities in the following eighteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

The accompanying unaudited 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 consolidated financial statements include the accounts of Penn and its subsidiaries. Investment in and advances to unconsolidated affiliates that are 50% or less owned are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates. For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

Operating results for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2010 should be read in conjunction with these consolidated financial statements.

2. Summary of Significant Accounting Policies

Revenue Recognition and Promotional Allowances

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

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

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

Revenues are recognized net of certain sales incentives in accordance with Financial Accounting Standards Board (the FASB) Accounting Standards Codification (ASC) 605-50, Revenue Recognition Customer Payments and Incentives. The Company records certain sales incentives and points earned in point-loyalty programs as a reduction of revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the three and nine months ended September 30, 2011 and 2010 are as follows:

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Rooms	$ 7,231	$ 6,253	$ 17,970	$ 18,213
Food and beverage	29,586	25,541	78,275	76,576
Other	2,824	2,407	7,512	7,731
Total promotional allowances	$ 39,641	$ 34,201	$ 103,757	$ 102,520

The estimated cost of providing such complimentary services for the three and nine months ended September 30, 2011 and 2010 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Rooms	$ 2,615	$ 2,378	$ 6,639	$ 6,981
Food and beverage	20,383	19,137	56,647	57,332
Other	1,792	1,401	4,586	4,872
Total cost of complimentary services	$ 24,790	$ 22,916	$ 67,872	$ 69,185

Earnings Per Share

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

At September 30, 2011, the Company had outstanding 12,275 shares of Series B Redeemable Preferred Stock (the Preferred Stock), which the Company determined qualified as a participating security as defined in ASC 260. Under ASC 260, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with ASC 260, a company is required to use the two-class method when computing EPS when a company has a security that qualifies as a participating security. The two-class method is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company s Common Stock is computed by dividing net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS for the Company s Common Stock is computed using the more dilutive of the two-class method or the if-converted method.

The following table sets forth the allocation of net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries for the three and nine months ended September 30, 2011 and 2010 under the two-class method:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
	$ 70,803	$ 48,345	$ 198,320	$ 93,665

Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries								
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to preferred stock		13,433		9,252		37,619		17,853
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock	$	57,370	$	39,093	$	160,701	$	75,812

Table of Contents

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Determination of shares:				
Weighted-average common shares outstanding	78,242	77,414	78,264	78,228
Assumed conversion of dilutive employee stock-based awards	1,929	817	1,787	796
Assumed conversion of preferred stock	27,278	27,278	27,278	27,428
Diluted weighted-average common shares outstanding	107,449	105,509	107,329	106,452

Reflecting the issuance of the Preferred Stock and the repurchase of 225 shares of Preferred Stock during the year ended December 31, 2010, the Company is required to adjust its diluted weighted-average common shares outstanding for the purpose of calculating diluted EPS as follows: 1) when the price of the Company s Common Stock is less than $45, the diluted weighted-average common shares outstanding is increased by 27,277,778 shares (regardless of how much the stock price is below $45); 2) when the price of the Company s Common Stock is between $45 and $67, the diluted weighted-average common shares outstanding is increased by an amount which can be calculated by dividing $1.23 billion (face value) by the current price per share of the Company s Common Stock, which will result in an increase in the diluted weighted-average common shares outstanding of between 18,320,896 shares and 27,277,778 shares; and 3) when the price of the Company s Common Stock is above $67, the diluted weighted-average common shares outstanding is increased by 18,320,896 shares (regardless of how much the stock price exceeds $67).

Options to purchase 2,786,303 shares and 2,855,652 shares were outstanding during the three and nine months ended September 30, 2011, respectively, but were not included in the computation of diluted EPS because they were antidilutive. Options to purchase 8,517,332 shares and 8,453,582 shares were outstanding during the three and nine months ended September 30, 2010, respectively, but were not included in the computation of diluted EPS because they were antidilutive.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Calculation of basic EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:				
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock	$ 57,370	$ 39,093	$ 160,701	$ 75,812
Weighted-average common shares outstanding	78,242	77,414	78,264	78,228
Basic EPS	$ 0.73	$ 0.51	$ 2.05	$ 0.97
Calculation of diluted EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:				

Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	$	70,803	$	48,345	$	198,320	$	93,665
Diluted weighted-average common shares outstanding		107,449		105,509		107,329		106,452
Diluted EPS	$	0.66	$	0.46	$	1.85	$	0.88

Stock-Based Compensation

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

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the 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 5.77 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable

future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company s employees. Forfeitures are estimated at the date of grant based on historical experience. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at September 30, 2011 and 2010:

Nine Months Ended September 30,	**2011**	**2010**
Risk-free interest rate	2.04%	2.00%
Expected volatility	47.24%	49.18%
Dividend yield		
Weighted-average expected life (years)	5.77	5.68
Forfeiture rate	5.00%	5.00%

Beginning in the fourth quarter of 2010, the Company issued cash-settled phantom stock unit awards, which vest over a period up to five years. Cash-settled phantom stock unit awards entitle employees and directors to receive cash based on the fair value of the Company s Common Stock on the vesting date. These phantom stock unit awards are accounted for as liability awards and are re-measured at fair value each reporting period until they become vested with compensation expense being recognized over the requisite service period in accordance with ASC 718-30 Compensation Stock Compensation, Awards Classified as Liabilities. As of September 30, 2011, there was $5.8 million of total unrecognized compensation cost that will be recognized over the grants remaining vesting period. For the three and nine months ended September 30, 2011, the Company recognized $0.5 million and $1.5 million, respectively, of compensation expense associated with these awards.

Additionally, the Company has issued stock appreciation rights to certain employees, which vest over a period of four years. The Company s stock appreciation rights are accounted for as liability awards since they will be settled in cash. The fair value of these awards is calculated during each reporting period and estimated using the Black-Scholes option pricing model based on the various inputs discussed previously. As of September 30, 2011, there was $4.7 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period. For the three and nine months ended September 30, 2011, the Company recognized $0.3 million and $1.0 million, respectively, of compensation expense associated with these awards.

Accounting for Derivatives and Hedging Activities

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

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

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

Currently, the Company has a number of interest rate swap contracts in place. These contracts serve to mitigate income volatility for a portion of its variable-rate funding. In effect, these interest rate swap contracts synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company receives cash flows from the swap contract counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts fixed rates. These two respective obligations are net-settled periodically. The fair value of the Company s interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the

LIBOR-based yield curve s implied discount rates. The credit adjustment reflects the Company s best estimate as to the Company s credit quality at September 30, 2011. The interest rate swap contract liabilities are included in accrued interest within the consolidated balance sheets at September 30, 2011 and December 31, 2010.

Effective July 1, 2011, the Company de-designated its interest rate swap contracts that historically qualified for cash flow hedge accounting. This was due to the new $2.15 billion senior secured credit facility that the Company entered into in July 2011. As a result, the loss in OCI related to these swaps of $4.7 million will be amortized to interest expense over the swaps remaining lives. The total notional value of these swaps at September 30, 2011 was $440 million, with $200 expiring in October 2011 and the remainder maturing in December 2011. Subsequent to the de-designation date of July 1, 2011, the Company has accounted for changes in the fair value of these derivatives in earnings as a component of interest expense in the consolidated statements of income.

In addition, the Company had certain other derivative instruments that were not designated to qualify for hedge accounting, which expired in May 2011. The periodic change in the mark-to-market of these derivative instruments had been recorded in current period earnings in interest expense in the consolidated statements of income.

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

See Note 8 for additional information related to the Company s derivatives.

3. New Accounting Pronouncements

In September 2011, the FASB issued amendments to simplify how entities test goodwill for impairment. Under the updated guidance, an entity now has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If the assessment of qualitative factors leads to a determination that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then the entity is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing it against its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of impairment loss, if any. Under the new guidance, an entity can elect to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted.

In June 2011, the FASB issued amendments to guidance regarding the presentation of comprehensive income. The amendments eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments require that comprehensive income be presented in either a single continuous statement or in two separate but consecutive statements. In a single continuous statement, the entity would present the components of net income and total net income, the components of other comprehensive income and a total of other comprehensive income, along with the total of comprehensive income in that statement. In the

two-statement approach, the entity would present components of net income and total net income in the statement of net income and a statement of other comprehensive income would immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. The amendments also require the entity to present on the face of the financial statements any reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments do not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassed to net income or the option to present components of other comprehensive income either net of related tax effects or before related tax effects. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. In October 2011, the FASB decided to defer the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income. The Company is currently evaluating its options on how it will present comprehensive income upon adoption of these amendments.

In May 2011, the FASB issued amendments to existing fair value measurement guidance in order to achieve common requirements for measuring fair value and disclosures in accordance with GAAP and International Financial Reporting Standards. The guidance clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks, addresses the concept of valuation premise and highest and best use, extends the prohibition on blockage factors to all three levels of the fair value hierarchy and requires additional disclosures. The amendments are to be applied

prospectively and are effective during interim and annual periods beginning after December 15, 2011. The Company does not anticipate that these amendments will have a material impact on the consolidated financial statements.

In April 2010, the FASB issued guidance on accruing for jackpot liabilities. The guidance clarifies that an entity should not accrue jackpot liabilities (or portions thereof) before a jackpot is won if the entity can legally avoid paying that jackpot (for example, by removing the gaming machine from the casino floor). Jackpots should be accrued and charged to revenue when an entity has the obligation to pay the jackpot. This guidance applies to both base jackpots and the incremental portion of progressive jackpots. However, the guidance only affected the accounting for base jackpots, as the guidance uses the same principle that is applied by the Company to the incremental portion of progressive jackpots. The guidance was effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. This guidance was applied by recording a cumulative-effect adjustment to opening retained earnings in the period of adoption. The Company adopted the guidance as of January 1, 2011, and as such, recorded a cumulative-effect adjustment, which increased retained earnings by $2.9 million.

4. Acquisition and Other Recent Business Ventures

M Resort Transaction

On June 1, 2011, following the purchase of all of the outstanding debt of The M Resorts LLC (the M Resort) for $230.5 million and the receipt of requisite regulatory approvals, the Company acquired the business in exchange for the debt. The Company purchased all of the outstanding bank and subordinated debt of the M Resort in October 2010 at which time the Company also secured the right to acquire the business of the M Resort in exchange for the property s outstanding debt obligations. At December 31, 2010, the $230.5 million loan was recorded as a loan receivable within total other assets on the consolidated balance sheet. This non-cash transaction resulted in the removal of the Company s loan receivable and the preliminary purchase price allocation resulted in an increase to property and equipment, net, total current assets, total other assets, and total current liabilities, by $203.7 million, $13.7 million, $2.4 million, and $17.3 million, respectively based on their estimated fair values as of June 1, 2011.

Opened in March 2009, the M Resort, located approximately ten miles from the Las Vegas strip in Henderson, Nevada, is situated on over 90 acres on the southeast corner of Las Vegas Boulevard and St. Rose Parkway. The resort features over 92,000 square feet of gaming space. M Resort also offers 390 guest rooms and suites, nine restaurants and five destination bars, more than 60,000 square feet of meeting and conference space, a 4,700 space parking facility, a spa and fitness center and a 100,000 square foot events piazza.

Acquisition of Texas Joint Venture Interest

On April 8, 2011, the Company established a joint venture that owns and operates racetracks in Texas. See Note 5 for further discussion.

Sale of Maryland Jockey Club Interest

In July 2011, the Company sold its joint venture interest in the Maryland Jockey Club. See Note 5 for further discussion.

Rosecroft Acquisition

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

5. Investment In and Advances to Unconsolidated Affiliates

As of September 30, 2011, investment in and advances to unconsolidated affiliates primarily includes the Company s 50% interest in Freehold Raceway, its 50% investment in Kansas Entertainment, LLC (Kansas Entertainment), which is a joint venture with International Speedway Corporation (International Speedway), and its 50% joint venture with Maxxam, Inc. (Maxxam) that owns and operates racetracks in Texas which is more fully described below.

Table of Contents

Texas Joint Venture

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

Sam Houston Race Park, opened in April 1994, is located in Northwest Houston along Beltway 8 near the intersection of Highway 249. Sam Houston Race Park hosts thoroughbred and quarter horse racing and offers daily simulcast operations, as well as hosts various special events, private parties and meetings, concerts and national touring festivals throughout the year. Valley Race Park, which was opened in 1990 and acquired by Sam Houston Race Park in 2000, is a 91,000 square foot dog racing and simulcasting facility located in Harlingen, Texas.

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

The Company determined that the joint venture did not qualify as a variable interest entity (VIE) at September 30, 2011. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the joint venture at, and for the three and nine months ended September 30, 2011, primarily as it did not have the ability to direct the activities of the joint venture that most significantly impacted the joint venture s economic performance without the input of Maxxam. Therefore, the Company did not consolidate its investment in the joint venture at, and for the three and nine months ended September 30, 2011.

Kansas Entertainment

Kansas Entertainment is proceeding with its construction of its planned $411 million facility, inclusive of licensing fees, which is expected to feature a 95,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment facilities. The Company and International Speedway share equally the cost of developing and constructing the proposed facility. The Company estimates that its share of the project will be approximately $155 million. During the three and nine months ended September 30, 2011, the Company funded $22.8 million and $44.2 million, respectively, for capital expenditures and other operating expenses.

Sale of Maryland Jockey Club Interest

In July 2011, the Company sold its joint venture interest in Maryland RE & R LLC, a joint venture with MI Developments, Inc. that owns and operates the Maryland Jockey Club. This transaction resulted in a gain of $20.2 million which is included in gain (loss) from unconsolidated affiliates within the consolidated statements of income for the three and nine months ended September 30, 2011.

Table of Contents

6. Property and Equipment

Property and equipment, net, consists of the following:

	September 30, 2011	December 31, 2010
	(in thousands)	
Land and improvements	$ 375,377	$ 298,482
Building and improvements	1,729,986	1,534,117
Furniture, fixtures, and equipment	1,004,362	938,443
Leasehold improvements	16,909	17,089
Construction in progress	161,373	106,963
Total property and equipment	3,288,007	2,895,094
Less accumulated depreciation	(1,066,540)	(929,320)
Property and equipment, net	$ 2,221,467	$ 1,965,774

Total property and equipment increased by $392.9 million primarily due to the M Resort transaction that closed on June 1, 2011, as well as expenditures for the facilities under construction in Ohio.

Depreciation expense, for property and equipment, totaled $51.8 million and $157.6 million for the three and nine months ended September 30, 2011, respectively, as compared to $52.3 million and $152.7 million for the three and nine months ended September 30, 2010, respectively. Interest capitalized in connection with major construction projects was $1.7 million and $3.5 million for the three and nine months ended September 30, 2011, respectively, as compared to $1.6 million and $4.4 million for the three and nine months ended September 30, 2010, respectively.

7. Goodwill and Other Intangible Assets

In accordance with ASC 350, Intangibles-Goodwill and Other, the Company does not amortize goodwill, rather it is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value in step 1 of the impairment test, then step 2 of the impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value of goodwill is less than the goodwill allocated for that reporting unit, an impairment loss is recognized. Additionally, the Company considers its gaming licenses, racing permits and the majority of its trademark intangible assets as indefinite-life intangible assets that do not require amortization based on the Company s future expectations to operate its gaming facilities indefinitely as well as the Company s historical experience in renewing these intangible assets at minimal cost with various state gaming and racing commissions.

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

Balance at December 31, 2010:		
Goodwill	$	2,019,613
Accumulated goodwill impairment losses		(833,857)
Goodwill, net	$	1,185,756
Other		(4,048)
Balance at September 30, 2011:		
Goodwill	$	2,015,565
Accumulated goodwill impairment losses		(833,857)
Goodwill, net	$	1,181,708

Table of Contents

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of intangible asset at September 30, 2011 and December 31, 2010:

	September 30, 2011			December 31, 2010		
	(in thousands)					
	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
Indefinite-life intangible assets	$ 420,550	$	$ 420,550	$ 412,686	$	$ 412,686
Other intangible assets	49,667	49,100	567	49,600	47,134	2,466
Total	$ 470,217	$ 49,100	$ 421,117	$ 462,286	$ 47,134	$ 415,152

The Company s intangible asset amortization expense was $0.4 million and $2.0 million for the three and nine months ended September 30, 2011, respectively, as compared to $1.6 million and $5.0 million for the three and nine months ended September 30, 2010, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at September 30, 2011 (in thousands):

Remainder of 2011	$ 175
2012	245
2013	46
2014	46
2015	27
Thereafter	28
Total	$ 567

The Company s remaining goodwill and other intangible assets by reporting unit at September 30, 2011 is shown below (in thousands):

Reporting Unit	Remaining Goodwill and other intangible assets at September 30, 2011
Hollywood Casino Lawrenceburg	$ 362,491
Hollywood Casino Joliet	211,508
Hollywood Casino Aurora	207,207
Argosy Casino Riverside	159,296
Black Gold Casino at Zia Park	145,937
Argosy Casino Alton	135,511
Argosy Casino Sioux City	92,795
Hollywood Casino Baton Rouge	75,521
Others	212,559
Total	$ 1,602,825

Table of Contents

8. Long-term Debt and Derivatives

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

	September 30, 2011	December 31, 2010
	(in thousands)	
Senior secured credit facility	$ 1,639,375	$ 1,589,125
$250 million 6 ¾% senior subordinated notes due March 2015		250,000
$325 million 8 ¾% senior subordinated notes due August 2019	325,000	325,000
Other long-term obligations	1,919	3,782
Capital leases	3,289	3,216
	1,969,583	2,171,123
Less current maturities of long-term debt	(45,581)	(357,927)
Less discount on senior secured credit facility Term Loan B	(1,810)	
	$ 1,922,192	$ 1,813,196

The following is a schedule of future minimum repayments of long-term debt as of September 30, 2011 (in thousands):

Within one year	$ 45,581
1-3 years	111,435
3-5 years	775,215
Over 5 years	1,037,352
Total minimum payments	$ 1,969,583

Senior Secured Credit Facility

On July 14, 2011, the Company entered into a new $2.15 billion senior secured credit facility, which is comprised of a $700 million revolving credit facility that will mature in July 2016, a $700 million variable rate Term Loan A due in July 2016 and a $750 million variable rate Term Loan B due in July 2018. The interest rates payable on the facilities are based on the leverage ratios of the Company as defined in the debt agreements, however, based on current borrowing levels, the Company will pay LIBOR plus 150 basis points on the revolver and Term Loan A and LIBOR plus 275 basis points on Term Loan B (subject to a 1% LIBOR floor). The Company utilized the proceeds of the two term loan borrowings and cash on hand to retire its previous senior secured credit facility obligation of $1,518.1 million (which had significant principal repayments due at the end of 2011 and 2012) and pay transaction costs and accrued interest and fees on the retired debt. As a result of this refinancing, the Company incurred debt extinguishment charges of $10.2 million during the three months ended September 30, 2011.

The Company s senior secured credit facility had a gross outstanding balance of $1,639.4 million at September 30, 2011, consisting of $200.0 million drawn under the revolving credit facility, a $691.3 million Term Loan A facility, and a $748.1 million Term Loan B facility. Additionally, at September 30, 2011, the Company was contingently obligated under letters of credit issued pursuant to the $2.15 billion senior

secured credit facility with face amounts aggregating $25.0 million, resulting in $475.0 million of available borrowing capacity as of September 30, 2011 under the revolving credit facility.

6 3/4% Senior Subordinated Notes

In July 2011, the Company announced its intention to redeem all of its $250 million senior subordinated notes. The redemption price was $1,022.50 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in August 2011. The Company funded the redemption of its $250 million senior subordinated notes from its new revolving credit facility and available cash. The Company recorded a $7.6 million loss on early extinguishment of debt during the three months ended September 30, 2011 related to debt issuance costs write-offs and the call premium on the $250 million senior subordinated notes.

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%

Table of Contents

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 restricts corporate activities.

At September 30, 2011, the Company was in compliance with all required covenants.

Interest Rate Swap Contracts

In accordance with the terms of its previous senior secured credit facility, the Company was required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of the Company s consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the previous senior secured credit facility. This requirement was not included in the new senior secured credit facility. As discussed in Note 2, the Company de-designated its cash flow hedges on July 1, 2011 in connection with its new senior secured credit facility.

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

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

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

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

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

Table of Contents

The effect of derivative instruments on the consolidated statement of income for the three months ended September 30, 2010 was as follows (in thousands):

Derivatives in a Cash Flow Hedging Relationship	Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)
Interest rate swap contracts	$ (3,462)	Interest expense	$ (6,363)	None	$
Total	$ (3,462)		$ (6,363)		$

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Interest rate swap contracts	Interest expense	$ (18)
Total		$ (18)

The effect of derivative instruments on the consolidated statement of income for the nine months ended September 30, 2010 was as follows (in thousands):

Derivatives in a Cash Flow Hedging Relationship	Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)
Interest rate swap contracts	$ (13,640)	Interest expense	$ (19,222)	None	$
Total	$ (13,640)		$ (19,222)		$

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative
Interest rate swap contracts	Interest expense	$ (56)
Total		$ (56)

In addition, during the three and nine months ended September 30, 2011, the Company amortized $2.8 million and $5.3 million, respectively, in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, Derivatives and Hedging, as compared to $4.2 million and $12.7 million for the three and nine months ended September 30, 2010, respectively.

In the coming twelve months, the Company anticipates that losses of approximately $1.8 million will be reclassified from OCI to earnings, as part of interest expense.

Table of Contents

The following table sets forth the fair value of the interest rate swap contract liabilities included in accrued interest within the consolidated balance sheets at September 30, 2011 and December 31, 2010:

	September 30, 2011			December 31, 2010		
			(in thousands)			
	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivatives designated as hedging instruments						
Interest rate swap contracts	Accrued interest	$		Accrued interest	$	13,034
Total derivatives designated as hedging instruments		$			$	13,034
Derivatives not designated as hedging instruments						
Interest rate swap contracts	Accrued interest	$	1,437	Accrued interest	$	3,712
Total derivatives not designated as hedging instruments		$	1,437		$	3,712
Total derivatives		$	1,437		$	16,746

9. Income Taxes

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

		Noncurrent tax liabilities (in thousands)
Balance at January 1, 2011	$	36,846
Additions based on current year positions		3,920
Additions based on prior year positions		1,336
Decreases due to settlements and/or reduction in liabilities		(9,569)
Currency translation adjustments		(778)
Balance at September 30, 2011	$	31,755

The decrease in the Company s liability for unrecognized tax benefits during the nine months ended September 30, 2011 was primarily due to the reversal of previously recorded unrecognized tax benefit reserves in the second quarter of 2011 for years that either the statue of limitations has lapsed in 2011 or that have been favorably settled.

The Company s effective tax rate (income taxes as a percentage of income from operations before income taxes) decreased to 35.1% and 36.7% for the three and nine months ended September 30, 2011, respectively, as compared to 41.6% and 42.3% for the three and nine months ended September 30, 2010, respectively. The reason is primarily due to the reversal of previously recorded unrecognized tax benefit reserves in the second quarter of 2011 for years that either the statue of limitations has lapsed in 2011 or that have been favorably settled coupled with favorable

state income tax benefits received from the impact of certain subsidiary restructurings completed in the third quarter of 2011. Lastly, the Company also had an impairment charge in the second quarter of 2010 on the Company s Columbus property which had an unfavorable impact to the Company s effective rate by lowering income from operations before income taxes.

10. 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.

Table of Contents

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. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

The Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company s Hollywood Casino Joliet and Hollywood Casino Aurora, for a 3% surcharge to subsidize local horse racing interests. On May 30, 2006, Hollywood Casino Joliet and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah s Joliet and the Grand Victoria Casino in Elgin (collectively, the Four Casinos), and filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois (the Court), asking the Court to declare the law unconstitutional. Hollywood Casino Joliet and Hollywood Casino Aurora began paying the 3% surcharge into a protest fund which accrued interest during the pendency of the lawsuit. In two orders dated March 29, 2007 and April 20, 2007, the Court declared the law unconstitutional under the Uniformity Clause of the Illinois Constitution and enjoined the collection of this surcharge. The State of Illinois requested, and was granted, a stay of this ruling. As a result, Hollywood Casino Joliet and Hollywood Casino Aurora continued paying the 3% surcharge into the protest fund until May 25, 2008, when the 3% surcharge expired. The State of Illinois appealed the ruling to the Illinois Supreme Court. On June 5, 2008, the Illinois Supreme Court reversed the trial court s ruling and issued a decision upholding the constitutionality of the 3% surcharge. On January 21, 2009, the Four Casinos filed a petition for certiorari, requesting the U.S. Supreme Court to hear the case. Seven amicus curiae briefs supporting the plaintiffs request were also filed. On June 8, 2009, the U.S. Supreme Court decided not to hear the case. On June 10, 2009, the Four Casinos filed a petition with the Court to open the judgment based on new evidence that came to light during the investigation of former Illinois Governor Rod Blagojevich that the 2006 law was procured by corruption. On August 17, 2009, the Court dismissed the Four Casinos petition to reopen the case, and the Four Casinos decided not to pursue an appeal of the dismissal.

On December 15, 2008, former Illinois Governor Rod Blagojevich signed Public Act No. 95-1008 requiring the Four Casinos to continue paying the 3% surcharge to subsidize Illinois horse racing interests. On January 8, 2009, the Four Casinos filed suit in the Court, asking it to declare the law unconstitutional. The 3% surcharge being paid pursuant to Public Act No. 95-1008 was paid into a protest fund where it accrued interest. The defendants filed a motion to dismiss, which was granted on August 17, 2009. The Four Casinos appealed the dismissal and filed motions to keep the payments in the protest fund while the appeal is being litigated. The motion to keep the monies in the protest fund was denied and the funds were released to the racetracks. On January 27, 2011, the Illinois appellate court affirmed the trial court s dismissal of this case. Hollywood Casino Joliet and Hollywood Casino Aurora asked the Illinois Supreme Court to hear an appeal of this dismissal and this request was denied. The monies paid into the protest fund have been transferred by the State of Illinois to the racetracks. The payment of the 3% surcharge under the 2008 statute ended on July 14, 2011 with the opening of the new casino in Des Plaines, Illinois.

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) (RICO), based on an illegal scheme to secure the enactment of the 3% surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos sought to impose a constructive trust over all funds paid under the surcharge, and therefore all of the Illinois racetracks were named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motions to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos appealed this dismissal to the Seventh Circuit Court of Appeals, which affirmed the dismissal in an en banc opinion. The Illinois racetracks are now free to use the monies that they received from the 3% surcharge. Since the passing of House Bill 1918 into law, Hollywood Casino Joliet and Hollywood Casino Aurora have recognized approximately $55.2 million in expense as a result of the 3% surcharge, including $0.4 million and $5.5 million during the three and nine months ended September 30, 2011, respectively. The 3% surcharge is included in gaming expense within the consolidated statements of income.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company s Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company s disclosure practices relative to the proposed transaction with Fortress Investment Group LLC and Centerbridge Partners, L.P. and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint was amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional

Table of Contents

defendants. The Company filed a motion to dismiss the complaint in November 2008, and the court granted the motion and dismissed the complaint with prejudice. The plaintiffs filed a motion for reconsideration, which was denied on October 21, 2009. The plaintiffs subsequently appealed the dismissal to the Fourth Circuit Court of Appeals and an oral argument was heard on October 26, 2010. On March 14, 2011, the Fourth Circuit Court of Appeals affirmed the decision of the lower court. The plaintiffs have requested the U.S. Supreme Court to consider an appeal of the decision. In October 2011, the U.S. Supreme Court denied the application for an appeal.

Amounts deducted and accumulated from participant compensation are used to purchase shares of our common stock at the end of each offering period. Unless otherwise provided by the administrator, the purchase price of the shares will be 85% of the lower of the fair market value of our common stock on the first trading day of the offering period or on the purchase date. Participants may end their participation at any time during an offering period and will receive a refund of their account balances not yet used to purchase shares. Participation ends automatically upon termination of employment with us.

Prior to the beginning of any offering period, the administrator may alter the maximum number of shares that may be purchased by any participant during the offering period or specify a maximum aggregate number of shares that may be purchased by all participants in the offering period. If insufficient shares remain available under

the plan to permit all participants to purchase the number of shares to which they would otherwise be entitled, the administrator will make a pro rata allocation of the available shares. Any amounts withheld from participants' compensation in excess of the amounts used to purchase shares will be refunded without interest.

A participant may not transfer rights granted under the ESPP other than by will, the laws of descent and distribution or as otherwise provided under the ESPP. In the event of a change in control, an acquiring or successor corporation may assume our rights and obligations under outstanding purchase rights or substitute substantially equivalent purchase rights. If the acquiring or successor corporation does not assume or substitute for outstanding purchase rights, then the purchase date of the offering periods then in progress will be accelerated to a date prior to the change in control. Our ESPP will continue in effect until terminated by the administrator. The Committee has the authority to amend, suspend or terminate our ESPP at any time.

Pension Benefits

We did not sponsor any defined benefit pension or other actuarial plan for our named executive officers during fiscal 2017.

Nonqualified Deferred Compensation

We did not maintain any nonqualified defined contribution or other deferred compensation plans or arrangements for our named executive officers during fiscal 2017.

Outstanding Equity Awards at June 30, 2017

The following table sets forth information regarding outstanding equity awards held by our named executive officers at June 30, 2017.

	Option Awards				Stock Awards			
Name	Number of securities underlying unexercised options exercisable (1)	Number of securities underlying unexercised options unexercisable (1)	Option exercise price	Option expiration date	Number of shares or units of stock that have not yet vested	Market value of shares or units of stock that have not yet vested	Equity incentive plan awards: number of unearned shares, units or other rights that have not yet vested	Equity incentive plan awards: market or payout value of unearned shares, units or other rights that have not vested
Steven R. Beauchamp	500,000	-	$ 4.88	8/21/2022	24,350 (7)	$ 1,100,133	11,700 (14)	$ 528,606
	16,666	-	$ 17.00	3/18/2024	52,500 (8)	$ 2,371,950	15,600 (15)	$ 704,808
	53,700 (2)	53,700 (2)	$ 24.80	8/18/2024	76,500 (9)	$ 3,456,270	-	-
	13,250 (3)	39,750 (3)	$ 35.28	8/17/2025	-	-	-	-
Peter J. McGrail	375,716	-	$ 1.31	6/21/2020	6,500 (10)	$ 293,670	6,600 (16)	$ 298,188
	83,333	-	$ 17.00	3/18/2024	29,250 (11)	$ 1,321,515	8,400 (17)	$ 379,512
	14,500 (4)	14,500 (4)	$ 24.80	8/18/2024	41,600 (12)	$ 1,879,488	-	-
	7,250 (5)	21,750 (5)	$ 35.28	8/17/2025	-	-	-	-
Michael R. Haske	300,000	-	$ 4.88	8/21/2022	5,500 (7)	$ 248,490	5,400 (14)	$ 243,972
	16,666	-	$ 17.00	3/18/2024	26,250 (8)	$ 1,185,975	6,600 (15)	$ 298,188
	12,000 (2)	12,000 (2)	$ 24.80	8/18/2024	34,000 (9)	$ 1,536,120	-	-
	6,500 (3)	19,500 (3)	$ 35.28	8/17/2025	-	-	-	-
Edward W. Gaty	81,499 (6)	45,834 (6)	$ 7.04	7/8/2023	3,500 (7)	$ 158,130	4,334 (14)	$ 195,810
	6,666	-	$ 17.00	3/18/2024	16,500 (8)	$ 745,470	4,080 (15)	$ 184,334
	7,500 (2)	7,500 (2)	$ 24.80	8/18/2024	20,500 (9)	$ 926,190	-	-
	4,000 (3)	12,000 (3)	$ 35.28	8/17/2025	-	-	-	-
Mark S. Kinsey	-	-	-	-	12,500 (13)	$ 564,750	3,000 (14)	$ 135,540
	-	-	-	-	17,000 (9)	$ 768,060	3,600 (15)	$ 162,648

(1) Shares of common stock.

(2) The option grant vests as to 1/4 of the total option grant on August 18, 2015, and thereafter as to 1/4 of the total option grant yearly.

(3) The option grant vests as to 1/4 of the total option grant on August 17, 2016, and thereafter as to 1/4 of the total option grant yearly.

(4) The option grant vests as to 1/4 of the total option grant on August 18, 2015, and thereafter as to 1/4 of the total option grant yearly as long as this former named executive officer remains an employee of the Company. Under the terms of this employee’s modified stock compensation arrangement, 100% of the option grant vested on August 3, 2017.

(5) The option grant vests as to 1/4 of the total option grant on August 17, 2016, and thereafter as to 1/4 of the total option grant yearly as long as this former named executive officer remains an employee of the Company. Under the terms of this employee’s modified stock compensation arrangement, 100% of the option grant vested on August 3, 2017.

(6) This option grant vests as to 1/4 of the total option grant on July 8, 2014, and thereafter as to 1/4 of the total option grant yearly.

(7) The RSUs will vest annually in four equal installments beginning on August 18, 2015.

(8) The RSUs will vest annually in four equal installments beginning on August 17, 2016.

(9) The RSUs will vest annually in four equal installments beginning on August 12, 2017.

(10) The RSUs will vest annually in four equal installments beginning on August 18, 2015 as long as this former named executive officer remains an employee of the Company. Under the terms of this employee’s modified stock compensation arrangement, 100% of the RSU grant vested on August 3, 2017.

(11) The RSUs will vest annually in four equal installments beginning on August 17, 2016 as long as this former named executive officer remains an employee of the Company. Under the terms of this employee's modified stock compensation arrangement, 100% of the RSU grant vested on August 3, 2017.

(12) The RSUs will vest annually in four equal installments beginning on August 12, 2017 as long as this former named executive officer remains an employee of the Company. Under the terms of this employee's modified stock compensation arrangement, 100% of the RSU grant vested on August 3, 2017.

(13) The RSUs will vest annually in four equal installments beginning on May 1, 2016.

(14) The RSUs were granted on August 17, 2015. Up to 50% of the RSUs will vest based upon the Company's revenue for fiscal 2018, and up to 50% will vest based upon the Company's revenue for fiscal 2019. The amount included in the table is based on achievement of the threshold performance goal.

(15) The RSUs were granted on August 12, 2016 and will vest based upon the Company's revenue for fiscal 2018. The amount included in the table is based on achievement of the threshold performance goal.

(16) The RSUs were granted on August 17, 2015. Up to 50% of the RSUs will vest based upon the Company's revenue for fiscal 2018, and up to 50% will vest based upon the Company's revenue for fiscal 2019, with the former named executive officer receiving a pro rata share based on the number of days employed over the award's vesting period as described in "Compensation of Named Executive Officers—Potential Payments Upon Termination or Change in Control." The amount included in the table is based on achievement of the threshold performance goal.

(17) The RSUs were granted on August 12, 2016 and will vest based upon the Company's revenue for fiscal 2018, with the former named executive officer receiving a pro rata share based on the number of days employed over the award's vesting period as described in "Compensation of Named Executive Officers—Potential Payments Upon Termination or Change in Control." The amount included in the table is based on achievement of the threshold performance goal.

Option Exercises and Stock Vested in Fiscal 2017

The following table sets forth the number of shares of common stock acquired during fiscal 2017 by our named executive officers upon the exercise of stock options and the vesting of restricted stock unit awards and the value realized upon such exercise or vesting.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired Upon Exercise (#)	Value Realized on Exercise ($)(1)	Number of Shares Acquired Upon Vesting (#)	Value Realized on Vesting ($)(2)
Steven R. Beauchamp	—	$ —	29,675	$ 1,312,090
Peter J. McGrail	116,784	$ 5,228,443	13,000	$ 580,613
Michael R. Haske	—	$ —	11,500	$ 513,968

Edward W. Gaty	10,000	$ 276,400	7,250	$ 323,978
Mark S. Kinsey	—	$ —	6,250	$ 273,375

(1) Calculated by multiplying (i) the fair market value of common stock on the exercise date, which was determined using the closing price on Nasdaq of a share of common stock on the date prior to the day of exercise, or if such day is a holiday, on the immediately preceding trading day, or the disposition price if the shares are disposed of in a disqualified disposition, minus the exercise price, by (ii) the number of shares of common stock acquired upon exercise.

(2) Calculated by multiplying (i) the fair market value of common stock on the vesting date, which was determined using the closing price on Nasdaq of a share of common stock on the date prior to the day of vesting, or if such day is a holiday, on the immediately preceding trading day, by (ii) the number of shares of common stock acquired upon vesting.

Grants of Plan-Based Awards in Fiscal 2017

The following table sets forth information regarding grants of plan-based cash and equity awards made to our named executive officers during fiscal 2017.

	Grant	Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units	All Other Option Awards: Number of Securities Underlying	Grant Date Fair Value of Stock and Option
ame	Date	Threshold	Target	Maximum	Threshold	Target	Maximum	(#)(2)	Options (#)	Awards (3)
teven R. eauchamp	n/a	$ 237,500	$ 475,000	$ 712,500	—	—	—	—	—	—
	8/12/2016	—	—	—	—	—	—	76,500	—	$ 3,483,81
	8/12/2016	—	—	—	15,600	26,000	39,000	—	—	$ 1,184,04
eter J. IcGrail	n/a	$ 126,000	$ 252,000	$ 378,000	—	—	—	—	—	—
	8/12/2016	—	—	—	—	—	—	41,600	—	$ 1,894,46
	8/12/2016	—	—	—	8,400	14,000	21,000	—	—	$ 637,560
ichael R. Iaske	n/a	$ 133,000	$ 266,000	$ 399,000	—	—	—	—	—	—
	8/12/2016	—	—	—	—	—	—	34,000	—	$ 1,548,36
	8/12/2016	—	—	—	6,600	11,000	16,500	—	—	$ 500,940
dward W. aty	n/a	$ 72,500	$ 145,000	$ 217,500	—	—	—	—	—	—
	8/12/2016	—	—	—	—	—	—	20,500	—	$ 933,570
	8/12/2016	—	—	—	4,080	6,800	10,200	—	—	$ 309,672
ark S. insey	n/a	$ 66,250	$ 132,500	$ 198,750	—	—	—	—	—	—
	8/12/2016	—	—	—	—	—	—	17,000	—	$ 774,180
	8/12/2016	—	—	—	3,600	6,000	9,000	—	—	$ 273,240

(1) The amounts reported in this column represent amounts payable under our cash bonus plan for fiscal 2017. Actual bonuses received under the cash bonus plan by the named executive officers are reported in the Summary Compensation Table under the column entitled "Non-Equity Incentive Plan Compensation."

(2) Represents RSUs.

(3) Amounts represent the aggregate grant date fair value of stock options and RSUs granted during the year computed in accordance with ASC Topic 718. Assumptions used in calculating the amounts reported in this column are set forth in Note 13 "Benefit Plans" of the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

38

EQUITY COMPENSATION PLAN INFORMATION

We currently maintain three compensation plans that provide for the issuance of our Common Stock to officers and other employees, directors and consultants. These consist of the 2008 Equity Incentive Plan (the "2008 Plan"), the 2014 Equity Incentive Plan (the "2014 Plan") and the 2014 Employee Stock Purchase Plan (the "2014 Purchase Plan"), each of which has been approved by our stockholders. The following table sets forth information regarding outstanding options and shares reserved for future issuance under the foregoing plans as of June 30, 2017:

Plan Category	Number of shares to be issued upon exercise of outstanding options and rights (a)	Weighted-average exercise price of outstanding options and rights (b)	Number of shares remaining available for future issuance under equity compensation plans (excluding shares reflected in column (a)) (c)
Equity compensation plans approved by stockholders	4,206,505	$ 11.54 (1)	9,050,718 (2)
Equity compensation plans not approved by stockholders	—	—	—
Total	4,206,505	$ 11.54	9,050,718

(1) The weighted average exercise price is calculated based solely on outstanding stock options. It does not take into account the shares of our common stock underlying RSUs, which have no exercise price.

(2) Includes 8,226,403 shares of common stock available for issuance in connection with future awards under our 2014 Plan and 824,315 shares of common stock available for future issuance under the 2014 Purchase Plan. The 2014 Plan provides that the number of shares reserved for issuance under that plan will automatically increase on January 1, 2018 and each subsequent anniversary through 2024, by an amount equal to the lesser of (i) 4.5% of the number of shares of common stock issued and outstanding on the immediately preceding December 31, or (ii) an amount determined by the board. The 2014 Purchase Plan provides that the number of shares reserved for issuance under that plan will automatically increase on January 1, 2018 and each subsequent anniversary through 2024 equal to the lesser of (i) 400,000 shares, (ii) 0.75% of the issued and outstanding shares of our common stock on the immediately preceding December 31 or (iii) such other amount as may be determined by the board.

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Related Party Transaction Policy

We have a written policy on authorizations, the Related Party Transactions Policy, which includes specific provisions for related party transactions. Pursuant to the Related Party Transactions Policy, related party transactions include any transaction, arrangement or relationship, or series of such transactions, including any indebtedness or guarantees, in which the amount involved exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of any class of our voting securities, or any member of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest. In the event that a related party transaction is identified, such transaction must be reported to our Corporate Secretary and subsequently must be reviewed and approved or ratified by the chairman of our audit committee or our full audit committee, depending on the amount of the transaction. Any member of the audit committee who is one of the parties in the related party transaction and who has a direct material interest in the transaction may not participate in the approval of the transaction. The audit committee has pre-approved certain potential related party transactions in advance including employment of executive officers and director compensation.

Related Party Transactions

Since the beginning of fiscal 2017, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are a party in which the amount involved exceeded or exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of any class of our voting securities, or any member of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest, except for the compensation and other arrangements described in “Compensation of Named Executive Officers” and “Corporate Governance—Compensation of Directors” elsewhere in this Proxy Statement and the transactions described below.

Stock Options Granted to Executive Officers and Directors

We have granted stock options and restricted stock units to our executive officers. We have also granted restricted stock units to certain members of our board of directors. For more information regarding certain of these equity awards, see “Corporate Governance—Compensation of Directors,” “Compensation of Named Executive Officers—Summary Compensation Table” and elsewhere in this Proxy Statement.

Investors’ Rights Agreement

We are party to an amended and restated investors' rights agreement with certain holders of our stockholders. The amended and restated investors' rights agreement grants such stockholders certain registration rights, which include demand registration rights, piggyback registration rights and short-form registration rights, with respect to shares of our common stock.

Employment Agreements

We have entered into employment agreements with each of our executive officers. These employment agreements provide for severance payments upon termination of the executive in certain circumstances and acceleration of vesting of stock options and time-based restricted stock units upon the occurrence of a change in control. Please see "Compensation of Named Executive Officers—Potential Payments upon Termination or Change in Control" elsewhere in this Proxy Statement for a summary of the potential payments to our named executive officers upon the occurrence of termination or a change in control.

Indemnification of Officers and Directors

As permitted by Delaware law, our amended and restated certificate of incorporation provides that, to the fullest extent permitted by Delaware law, no director will be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director. Pursuant to Delaware law, such protection would be not available for liability:

- for any breach of a duty of loyalty to us or our stockholders;
- for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
- for any transaction from which the director derived an improper benefit; or
- for an act or omission for which the liability of a director is expressly provided by an applicable statute, including unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law.

Our amended and restated certificate of incorporation also provides that if Delaware law is amended after the approval by our stockholders of the amended and restated certificate of incorporation to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of our directors will be eliminated or limited to the fullest extent permitted by Delaware law. In addition, our amended and restated bylaws provide that we are required to advance expenses to our directors and officers as incurred in connection with legal proceedings against them for which they may be indemnified and that the rights conferred in the amended and restated bylaws are not exclusive.

We have entered into indemnity agreements with each of our directors and executive officers. These agreements, among other things, require us to indemnify each director and officer to the fullest extent permitted by Delaware law and our amended and restated certificate of incorporation and bylaws for expenses such as, among other things, attorneys' fees, judgments, fines and settlement amounts incurred by the director or executive officer in any action or proceeding, including any action by or in our right, arising out of the person's services as our director or executive officer or as the director or executive officer of any subsidiary of ours or any other company or enterprise to which the person provides services at our request. We also maintain directors' and officers' liability insurance.

Other Related Party Transactions

In June 2014, we entered into a Memorandum of Understanding (the "Memorandum"), with our chairman Steven I. Sarowitz and Blue Marble Payroll, LLC ("Blue Marble"), a separate legal entity owned by Mr. Sarowitz. Pursuant to the terms of the Memorandum, Mr. Sarowitz is entitled to devote his efforts to Blue Marble provided that such efforts do not interfere with his ability to fulfill his duties as our chairman. Mr. Sarowitz and Blue Marble each also agreed not to compete with us in the United States of America and not to solicit our employees. In the event that we enter a geographic market in which Mr. Sarowitz or Blue Marble has clients, we have an option to acquire Mr. Sarowitz' or Blue Marble's (as the case may be) operations in such market at fair market value. At our option, Mr. Sarowitz and Blue Marble will permit us to become a partner of Blue Marble in any international market that Mr. Sarowitz or Blue Marble enters, on terms no less favorable than those offered by Mr. Sarowitz or Blue Marble to its other partners in that market. Pursuant to the terms of the Memorandum, in the event of a sale of a material portion of the business or capital stock of Blue Marble, we have a right of first refusal to buy Blue Marble. Beginning on the third anniversary of the Memorandum, we also have an ongoing option to acquire Blue Marble at fair market value.

41

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table and footnotes set forth information with respect to the beneficial ownership of our common stock as of September 30, 2017 by the following:

- each stockholder, or group of affiliated stockholders, who we know beneficially owns more than 5% of the outstanding shares of our common stock;
- each of our named executive officers;
- each of our current directors; and
- all of our current directors and current executive officers as a group.

Beneficial ownership of shares is determined under the rules of the SEC and generally includes any shares over which a person exercises sole or shared voting or investment power.

Applicable percentage ownership in the following table is based on 52,074,797 shares of common stock outstanding as of September 30, 2017. Shares of common stock subject to options currently exercisable or exercisable within 60 days of September 30, 2017 as well as RSU awards that will vest within 60 days of September 30, 2017 are deemed to be outstanding for calculating the number and percentage of outstanding shares of the person holding such options and RSU awards, but are not deemed to be outstanding for calculating the percentage ownership of any other person. Beneficial ownership or voting power representing less than 1% is denoted with an asterisk (*).

Shares shown in the table below include shares held in the beneficial owner's name or jointly with others, or in the name of a bank, nominee or trustee for the beneficial owner's account. Unless otherwise indicated and subject to applicable community property laws, to our knowledge, each stockholder named in the following table possesses sole voting and investment power over the shares listed, except for those jointly owned with that person's spouse.

Unless otherwise noted below, the address of each person listed on the table is c/o Paylocity Holding Corporation, 3850 N. Wilke Road, Arlington Heights, Illinois 60004.

Name of Beneficial Owner	Number of Shares of Common Stock	Percentage of Common Stock Owned

5% Stockholders:			
Entities affiliated with Adams Street Partners (1)	3,762,020	7.2	%
Named Executive Officers and Directors:			
Jeffrey T. Diehl (1)	3,762,020	7.2	%
Steven I. Sarowitz (2)	16,636,562	31.9	%
Steven R. Beauchamp (3)	2,745,574	5.3	%
Michael R. Haske (4)	1,431,960	2.7	%
Peter J. McGrail (5)	600,905	1.2	%
Edward W. Gaty (6)	157,409	*	
Mark S. Kinsey (7)	11,340	*	
Mark H. Mishler (8)	32,158	*	
Ronald V. Waters III (9)	31,558	*	
Andres D. Reiner (10)	14,857	*	
Ellen Carnahan (11)	3,818	*	
All executive officers and directors as a group (11 persons) (12)	25,428,161	48.8	%

42

(1) Represents 903 shares issuable to Jeffrey T. Diehl upon the vesting of restricted stock units within 60 days of September 30, 2017, 725,242 shares held by Adams Street 2006 Direct Fund, L.P. (“AS 2006”), 818,997 shares held by Adams Street 2007 Direct Fund, L.P. (“AS 2007”), 1,171,246 shares held by Adams Street 2008 Direct Fund, L.P. (“AS 2008”), 242,781 shares held by Adams Street 2009 Direct Fund, L.P. (“AS 2009”), 137,913 shares held by Adams Street 2010 Direct Fund, L.P. (“AS 2010”), 110,800 shares held by Adams Street 2011 Direct Fund LP (“AS 2011”), 111,194 shares held by Adams Street 2012 Direct Fund LP (“AS 2012”), and 428,955 shares of common stock held by Adams Street Co-Investment Fund II, L.P. (“AS CIF”). The shares owned by AS 2006, AS 2007, AS 2008, AS 2009, AS 2010, AS 2011, AS 2012 and AS CIF may be deemed to be beneficially owned by Adams Street Partners, LLC (“ASP”), the managing member of the general partner of each of AS 2006, AS 2007, AS 2008, AS 2009, AS 2010, AS 2011, AS 2012 and AS CIF. Thomas S. Bremner, Jeffrey T. Diehl, Elisha P. Gould, Robin Murray, Fred Wang and Michael R. Zappert, each of whom is a partner of Adams Street Partners, LLC (or a subsidiary thereof) may be deemed to have shared voting and investment power over the shares. The address of each of AS 2006, AS 2007, AS 2008, AS 2009, AS 2010, AS 2011, AS 2012, AS CIF and ASP is One North Wacker Drive, Suite 2200, Chicago, Illinois 60606. Mr. Diehl is a member of our board of directors.

(2) Includes 903 shares issuable upon vesting of restricted stock units within 60 days of September 30, 2017 and 559,297 shares held by the Julian Grace Foundation, a private charitable foundation controlled by Mr. Sarowitz. Mr. Sarowitz is our Chairman.

(3) Includes 623,716 shares issuable upon the exercise of options exercisable within 60 days of September 30, 2017, 145,000 shares held by the IRIE Family Trust where Mr. Beauchamp’s spouse is the trustee and 20,000 shares held by IRIE Foundation, a private charitable foundation controlled by Mr. Beauchamp. Mr. Beauchamp is our Chief Executive Officer and is a director.

(4) Includes 347,666 shares issuable upon the exercise of options exercisable within 60 days of September 30, 2017. Mr. Haske is our President and Chief Operating Officer.

(5) Includes 517,049 shares issuable upon the exercise of options exercisable within 60 days of September 30, 2017. Mr. McGrail served as our Chief Financial Officer until June 6, 2017.

(6) Includes 141,999 shares issuable upon the exercise of options exercisable within 60 days of September 30, 2017. Mr. Gaty is our Senior Vice President of Product and Technology.

(7) Mr. Kinsey is our Senior Vice President of Operations.

(8) Includes 903 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017. Mr. Mishler is a member of our board of directors.

(9) Includes 903 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017. Mr. Waters is a member of our board of directors.

(10) Includes 903 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017. Mr. Reiner is a member of our board of directors.

(11) Includes 903 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017. Ms. Carnahan is a member of our board of directors.

(12) Includes 1,630,430 shares issuable upon the exercise of options exercisable and 5,418 shares issuable upon the vesting of restricted stock units, in each case within 60 days of September 30, 2017.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our executive officers and directors and persons who beneficially own more than 10% of our common stock to file initial reports of beneficial ownership and reports of changes in beneficial ownership with the SEC. Such persons are required by SEC regulations to furnish us with copies of all Section 16(a) forms filed by such person.

Based solely on our review of such forms furnished to us, and written representations from certain reporting persons, we believe that all filing requirements applicable to our executive officers, directors and greater-than-10% stockholders during the fiscal year ended June 30, 2017 were satisfied.

PROPOSAL NO. 3

ADVISORY VOTE TO APPROVE THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“the Dodd-Frank Act”), and Section 14A of the Exchange Act enable our stockholders to vote to approve, on an advisory or nonbinding basis, the compensation of our named executive officers as disclosed in this Proxy Statement in accordance with the SEC’s rules. We currently conduct advisory votes on executive compensation every one year, with the next vote to occur at the 2019 annual meeting.

Our compensation committee and the board of directors believe that our executive compensation program, as described in the section titled “Compensation Discussion and Analysis,” the compensation tables and the related narratives and other materials in this Proxy Statement reflects our philosophy of linking the compensation of our executive officers with our performance. Our compensation committee and the board believe that the executive compensation program is reasonable and effective in that it aligns the interests of our executive officers with both the short-term and long-term interests of our stockholders.

This proposal gives you as a stockholder the opportunity to endorse or not endorse our executive compensation program through the following resolution:

“RESOLVED, that the compensation of our named executive officers, as described in the section titled “Compensation Discussion and Analysis,” the compensation tables and the related narratives and other materials in this Proxy Statement are hereby approved.”

Because this vote is advisory, it will not be binding upon the board of directors or our compensation committee. However, our compensation committee will carefully consider the outcome of the vote when determining future executive compensation arrangements. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our named executive officers and the philosophy, policies and practices described in this Proxy Statement. For information on how our compensation committee considered the 2017 advisory vote on executive compensation, see “Compensation Discussion and Analysis - Response to the 2017 Advisory Vote on Executive Compensation and Future Advisory Vote”.

Vote Required and Board of Directors Recommendation

The affirmative vote of a majority of the voting power of the shares present in person or by proxy and entitled to vote on the matter at the annual meeting is required for approval of this proposal. Abstentions will have the effect of a vote “against” this proposal. Broker non-votes will have no effect on the outcome of the vote.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE “FOR” APPROVAL OF THE ADVISORY VOTE TO APPROVE THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS.

45

STOCKHOLDER PROPOSALS OR NOMINATIONS

TO BE PRESENTED AT NEXT ANNUAL MEETING

Pursuant to Rule 14a-8 under the Exchange Act of 1934, some stockholder proposals may be eligible for inclusion in our proxy statement for the 2019 annual meeting. These stockholder proposals must be submitted, along with proof of ownership of our stock in accordance with Rule 14a-8(b) (2), to the Corporate Secretary at our principal executive offices no later than the close of business on June 30, 2018 (120 days prior to the anniversary of this year's mailing date). Failure to deliver a proposal in accordance with these procedures may result in it not being deemed timely received.

Submitting a stockholder proposal does not guarantee that we will include it in our proxy statement. Our nominating and corporate governance committee reviews all stockholder proposals and makes recommendations to the board for actions on such proposals. For information on qualifications of director nominees considered by our nominating and corporate governance committee, see the "Corporate Governance—Director Nominations" section of this Proxy Statement.

In addition, our Bylaws provide that any stockholder intending to nominate a candidate for election to the board or to propose any business at our 2019 annual meeting, other than non-binding proposals presented pursuant to Rule 14a-8 under the Exchange Act, must give notice to the Corporate Secretary at our principal executive offices, not earlier than the close of business on the 120th day nor later than the close of business on the 90th day prior to the first anniversary of the date of the preceding year's annual meeting as first specified in the notice of meeting (without regard to any postponements or adjournments of such meeting after the notice was first given). The notice must include the information specified in our Bylaws, including information concerning the nominee or proposal, as the case may be, and information concerning the proposing or nominating stockholder's ownership of and agreements related to our stock. If the 2019 annual meeting is held more than 30 days before or after the first anniversary of the date of the 2018 annual meeting, the stockholder must submit notice of any such nomination and of any such proposal that is not made pursuant to Rule 14a-8 by the later of the 90th day prior to the 2019 annual meeting or the 10th day following the date on which public announcement of the date of such meeting is first made. We will not entertain any proposals or nominations at the meeting that do not meet the requirements set forth in our Bylaws. If the stockholder does not also comply with the requirements of Rule 14a-4(c)(2) under the Exchange Act, we may exercise discretionary voting under proxies that we solicit to vote in accordance with our best judgment on any stockholder proposal or nomination. To make a submission or request a copy of our Bylaws, stockholders should contact our Corporate Secretary. We strongly encourage stockholders to seek advice from knowledgeable counsel before submitting a proposal or a nomination.

TRANSACTION OF OTHER BUSINESS

At the date of this Proxy Statement, the board of directors knows of no other business that will be conducted at the 2018 annual meeting other than as described in this Proxy Statement. If any other matter or matters are properly brought before the meeting or any adjournment or postponement of the meeting, it is the intention of the persons named in the accompanying proxy to vote the proxy on such matters in accordance with their best judgment.

STOCKHOLDERS SHARING THE SAME LAST NAME AND ADDRESS

To reduce the expense of delivering duplicate proxy materials to stockholders who may have more than one account holding Paylocity stock but sharing the same address, we have adopted a procedure approved by the SEC called “householding.” Under this procedure, certain stockholders of record who have the same address and last name, and who do not participate in electronic delivery of proxy materials, will receive only one copy of our Proxy Statement and Annual Report and, as applicable, any additional proxy materials that are delivered until such time as one or more of these stockholders notifies us that they want to receive separate copies. This procedure reduces duplicate mailings and saves printing costs and postage fees, as well as natural resources. Stockholders who participate in householding will continue to have access to and utilize separate proxy voting instructions.

If you receive a single set of proxy materials as a result of householding, and you would like to have separate copies of our annual report and other proxy materials mailed to you, please submit a written request to our Corporate Secretary, Paylocity Holding Corporation, 3850 N. Wilke Road, Arlington Heights, Illinois 60004, or call our Investor Relations department at 415-430-2073, and we will promptly send you what you have requested. You can also contact our Corporate Secretary or Investor Relations department if you received multiple copies of the annual meeting materials and would prefer to receive a single copy in the future, or if you would like to opt out of householding for future mailings.

By order of the board of directors

Steven R. Beauchamp
Chief Executive Officer

October 24, 2017

If you would like to reduce the costs incurred by our company in mailing proxy 1234567 VOTE BY MAIL 123,456,789,012.12345 TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: KEEP THIS PORTION FOR YOUR RECORDS DETACH AND RETURN THIS PORTION ONLY THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED. For All Withhold All For All Except To withhold authority to vote for any individual nominee(s), mark "For All Except" and write the number(s) of the The Board of Directors recommends you vote FOR the following: nominee(s) on the line below. 0 0 0 1. Election of Directors Nominees 01 Steven I. Sarowitz 02 Ellen Carnahan 03 Jeffrey T. Diehl The Board of Directors recommends you vote FOR proposals 2 and 3. 2Ratification of the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2018. 3Advisory vote to approve compensation of named executive officers. For 0 0 Against 0 0 Abstain 0 0 NOTE: Such other business as may properly come before the meeting or any adjournment thereof. Investor Address Line 2 Investor Address Line 4 John Sample attorney, executor, administrator, or other fiduciary, please give full ANY CITY, ON A1A 1A1 partnership name, by authorized officer. Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date 02 0000000000 1 OF 1 1 2 0000346505_1 R1.0.1.17 YesNo Please indicate if you plan to attend this meeting00 Please sign exactly as your name(s) appear(s) hereon. When signing as title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or Investor Address Line 1 Investor Address Line 3 Investor Address Line 5 1234 ANYWHERE STREET SHARES CUSIP # JOB #SEQUENCE # VOTE BY INTERNET - www.proxyvote.com Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form. ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years. VOTE BY PHONE - 1-800-690-6903 Use any touch-tone telephone to transmit your voting instructions up until 11:59 John Sample 234567P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions. 1234567 Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717. NAME THE COMPANY NAME INC. - COMMON THE COMPANY NAME INC. - CLASS A THE COMPANY NAME INC. - CLASS B THE COMPANY NAME INC. - CLASS C THE COMPANY NAME INC. - CLASS D THE COMPANY NAME INC. - CLASS E THE COMPANY NAME INC. - CLASS F THE COMPA N Y NAME INC. - 401 K CONTROL # SHARES123,456,789,012.12345 123,456,789,012.12345 123,456,789,012.12345 123,456,789,012.12345 123,456,789,012.12345 123,456,789,012.12345 123,456,789,012.12345 x PAGE1 OF 2 PAYLOCITY HOLDING CORPORATION 3850 N. WILKE ROAD ARLINGTON HEIGHTS, IL 60004 Investor Address Line 1 Investor Address Line 2 Investor Address Line 3 Investor Address Line 4 Investor Address Line 5 8 8 8 1 1234 ANYWHERE STREET ANY CITY, ON A1A 1A1 234567 234567 234567 234567

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice & Proxy Statement, Annual Report is/ are available at www.proxyvote.com PAYLOCITY HOLDING CORPORATION Annual Meeting of Stockholders December 8, 2017 8:30 AM This proxy is solicited by the Board of Directors The stockholder(s) hereby appoint(s) Steven R. Beauchamp as proxy, with the power to appoint his substitute, and hereby authorize(s) him to represent and to vote, as designated on the reverse side of this ballot, all of the shares of Common Stock of PAYLOCITY HOLDING CORPORATION that the stockholder(s) is/are entitled to vote at the Annual Meeting of Stockholders to be held at 08:30 AM, CST on 12/8/2017, at Paylocity Headquarters 3850 N. Wilke Road, Arlington Heights, IL 60004, and any adjournment or postponement thereof. This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors' recommendations. Continued and to be signed on reverse side 0000346505_2 R1.0.1.17