PENN NATIONAL GAMING INC
Form 10-Q
November 09, 2009
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2009**

**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**<br>(State or other jurisdiction of<br>incorporation or organization) | **23-2234473**<br>(I.R.S. Employer<br>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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

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

| **Title** | **Outstanding as of October 28, 2009** |
|---|---|
| Common Stock, par value $.01 per share | 78,644,526 (includes 325,500 shares of restricted stock) |

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This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although Penn National Gaming, Inc. and its subsidiaries (collectively, the Company ) believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors that could cause actual results to differ from expectations include, but are not limited to, risks related to the following: our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; the passage of state, federal or local legislation or referenda that would expand, restrict, further tax, prevent or negatively impact operations (such as a smoking ban at any of our facilities) in or adjacent to the jurisdictions in which we do business; the activities of our competitors and the emergence of new competitors; increases in the effective rate of taxation at any of our properties or at the corporate level; delays or changes to, or cancellations of, planned capital projects at our gaming and pari-mutuel facilities or an inability to achieve the expected returns from such projects; construction factors, including delays and the cost of labor and materials; the ability to recover proceeds on significant insurance claims (such as claims related to the fire at Empress Casino Hotel); 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; the availability and cost of financing; the maintenance of agreements with our horsemen, pari-mutuel clerks and other organized labor groups; the outcome of legal proceedings instituted against the Company in connection with the termination of the previously announced acquisition of the Company by certain affiliates of Fortress Investment Group LLC and Centerbridge Partners, L.P.; 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; changes in accounting standards; our dependence on key personnel; the impact of terrorism and other international hostilities; the impact of weather on our operations; and other factors as discussed in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, subsequent Quarterly Reports on Form 10-Q and Current Reports on Form 8-K as filed with the SEC. The Company does not intend to update publicly any forward-looking statements except as required by law.

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

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

**Consolidated Balance Sheets**

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

| | September 30, 2009 (unaudited) | December 31, 2008 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 764,409 | $ 746,278 |
| Receivables, net of allowance for doubtful accounts of $3,771 and $3,797 at September 30, 2009 and December 31, 2008, respectively | 49,074 | 43,574 |
| Insurance receivable | 36,359 | |
| Prepaid expenses and other current assets | 96,514 | 95,386 |
| Deferred income taxes | 22,900 | 21,065 |
| Total current assets | 969,256 | 906,303 |
| **Property and equipment, net** | 1,820,391 | 1,812,131 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliate | 26,237 | 14,419 |
| Goodwill | 1,595,875 | 1,598,571 |
| Other intangible assets | 685,843 | 693,764 |
| Deferred financing fees, net of accumulated amortization of $39,774 and $38,914 at September 30, 2009 and December 31, 2008, respectively | 44,837 | 34,910 |
| Other assets | 108,800 | 129,578 |
| Total other assets | 2,461,592 | 2,471,242 |
| **Total assets** | $ 5,251,239 | $ 5,189,676 |
| | | |
| **Liabilities** | | |
| **Current liabilities** | | |
| Current maturities of long-term debt | $ 1,221 | $ 105,281 |
| Accounts payable | 15,438 | 35,540 |
| Accrued expenses | 101,522 | 106,769 |
| Accrued interest | 60,751 | 80,190 |
| Accrued salaries and wages | 67,535 | 55,380 |
| Gaming, pari-mutuel, property, and other taxes | 50,781 | 44,503 |
| Income taxes | 1,956 | |
| Insurance financing | 8,099 | 8,093 |
| Other current liabilities | 38,739 | 34,730 |
| Total current liabilities | 346,042 | 470,486 |
| | | |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 2,380,384 | 2,324,899 |
| Deferred income taxes | 261,758 | 265,610 |
| Noncurrent tax liabilities | 61,756 | 68,632 |
| Other noncurrent liabilities | 7,169 | 2,776 |

| | | | | |
|---|---|---|---|---|
| Total long-term liabilities | | 2,711,067 | | 2,661,917 |
| | | | | |
| **Shareholders equity** | | | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,500 issued and outstanding at September 30, 2009 and December 31, 2008) | | | | |
| Common stock ($.01 par value, 200,000,000 shares authorized, 78,621,526 and 78,148,488 shares issued at September 30, 2009 and December 31, 2008, respectively) | | 785 | | 782 |
| Additional paid-in capital | | 1,472,066 | | 1,442,829 |
| Retained earnings | | 752,847 | | 662,355 |
| Accumulated other comprehensive loss | | (31,568) | | (48,693) |
| Total shareholders equity | | 2,194,130 | | 2,057,273 |
| **Total liabilities and shareholders equity** | $ | 5,251,239 | $ | 5,189,676 |

See accompanying notes to the consolidated financial statements.

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

**Consolidated Statements of Income**

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

**(unaudited)**

| | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Gaming | $ 565,483 | $ 558,424 | $ 1,651,776 | $ 1,685,455 |
| Management service fee | 4,239 | 4,898 | 10,946 | 13,577 |
| Food, beverage and other | 87,404 | 88,670 | 258,273 | 252,040 |
| Gross revenues | 657,126 | 651,992 | 1,920,995 | 1,951,072 |
| Less promotional allowances | (36,700) | (34,105) | (107,526) | (99,105) |
| Net revenues | 620,426 | 617,887 | 1,813,469 | 1,851,967 |
| | | | | |
| **Operating expenses** | | | | |
| Gaming | 303,420 | 301,944 | 887,602 | 903,489 |
| Food, beverage and other | 69,100 | 67,274 | 199,158 | 195,164 |
| General and administrative | 110,116 | 108,068 | 302,587 | 295,589 |
| Impairment loss for replaced Lawrenceburg vessel | 120 | | 11,809 | |
| Empress Casino Hotel fire | 211 | | 5,942 | |
| Depreciation and amortization | 50,055 | 44,224 | 141,427 | 129,198 |
| Total operating expenses | 533,022 | 521,510 | 1,548,525 | 1,523,440 |
| Income from operations | 87,404 | 96,377 | 264,944 | 328,527 |
| | | | | |
| **Other income (expenses)** | | | | |
| Interest expense | (36,785) | (37,880) | (97,874) | (129,631) |
| Interest income | 956 | 720 | 5,650 | 1,956 |
| Loss from joint venture | (36) | (139) | (755) | (1,050) |
| Merger termination settlement fees, net of related expenses | | 195,471 | | 195,471 |
| Loss on early extinguishment of debt | (3,599) | | (3,599) | |
| Other | (2,560) | 636 | 2,419 | 1,520 |
| Total other (expenses) income | (42,024) | 158,808 | (94,159) | 68,266 |
| | | | | |
| **Income from operations before income taxes** | 45,380 | 255,185 | 170,785 | 396,793 |
| Taxes on income | 24,029 | 107,694 | 80,293 | 171,543 |
| **Net income** | $ 21,351 | $ 147,491 | $ 90,492 | $ 225,250 |
| | | | | |
| **Basic earnings per common share** | $ 0.22 | $ 1.72 | $ 0.94 | $ 2.61 |
| **Diluted earnings per common share** | $ 0.20 | $ 1.69 | $ 0.85 | $ 2.55 |

See accompanying notes to the consolidated financial statements.

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

**Consolidated Statements of Changes in Shareholders Equity**

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

| | Preferred Stock | | Common Stock | | Treasury | Additional Paid-In | Retained | Accumulated Other Comprehensive (Loss) | Total Shareholders | Comprehensive Income |
|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Stock | Capital | Earnings | Income | Equity | (loss) |
| Balance, December 31, 2007 | | $ | 88,579,070 | $ 887 | $ (2,379) | $ 322,760 | $ 815,678 | $ (15,984) | $ 1,120,962 | |
| Stock option activity, including tax benefit of $965 | | | 150,196 | 2 | | 17,511 | | | 17,513 | $ |
| Share activity | | | (2,848,400) | (30) | 2,379 | (33,988) | | | (31,639) | |
| Restricted stock | | | | | | 1,476 | | | 1,476 | |
| Change in fair value of interest rate swap contracts, net of income taxes of $801 | | | | | | | | 1,410 | 1,410 | 1,410 |
| Change in fair value of corporate debt securities | | | | | | | | (420) | (420) | (420) |
| Foreign currency translation adjustment | | | | | | | | (461) | (461) | (461) |
| Net income | | | | | | | 225,250 | | 225,250 | 225,250 |
| Balance, September 30, 2008 | | $ | 85,880,866 | $ 859 | $ | $ 307,759 | $ 1,040,928 | $ (15,455) | $ 1,334,091 | $ 225,779 |
| | | | | | | | | | | |
| Balance, December 31, 2008 | 12,500 | $ | 78,148,488 | $ 782 | $ | $ 1,442,829 | $ 662,355 | $ (48,693) | $ 2,057,273 | |
| Stock option activity, including tax benefit of $1,885 | | | 367,538 | 3 | | 27,499 | | | 27,502 | $ |
| Restricted stock | | | 105,500 | | | 1,738 | | | 1,738 | |
| Change in fair value of interest rate swap contracts, net of income taxes of $5,451 | | | | | | | | 9,681 | 9,681 | 9,681 |
| Change in fair value of corporate debt securities | | | | | | | | 6,537 | 6,537 | 6,537 |
| Foreign currency translation adjustment | | | | | | | | 907 | 907 | 907 |
| Net income | | | | | | | 90,492 | | 90,492 | 90,492 |
| Balance, September 30, 2009 | 12,500 | $ | 78,621,526 | $ 785 | $ | $ 1,472,066 | $ 752,847 | $ (31,568) | $ 2,194,130 | $ 107,617 |

See accompanying notes to the consolidated financial statements.

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

**Consolidated Statements of Cash Flows**

**(in thousands) (unaudited)**

| **Nine Months Ended September 30,** | **2009** | **2008** |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 90,492 | $ 225,250 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 141,427 | 129,198 |
| Amortization of items charged to interest expense | 8,746 | 9,489 |
| Amortization of items charged to interest income | (1,408) | (38) |
| (Gain) loss on sale of fixed assets | (340) | 999 |
| Loss from joint venture | 755 | 1,050 |
| Loss on early extinguishment of debt | 3,599 | |
| Empress Casino Hotel fire | 5,064 | |
| Gain on accelerated payment of other long-term obligations | (1,305) | |
| Gain on sale of investment in corporate debt securities | (6,598) | |
| Deferred income taxes | (13,091) | 2,936 |
| Charge for stock compensation | 21,904 | 18,519 |
| Impairment loss for replaced Lawrenceburg vessel | 11,689 | |
| (Increase) decrease, net of businesses acquired | | |
| Accounts receivable | (18,331) | 1,868 |
| Prepaid expenses and other current assets | (1,520) | (30,414) |
| Other assets | 2,645 | (10,567) |
| (Decrease) increase, net of businesses acquired | | |
| Accounts payable | (2,648) | (2,106) |
| Accrued expenses | (4,065) | (17,958) |
| Accrued interest | (4,307) | (8,203) |
| Accrued salaries and wages | 12,155 | 6,539 |
| Gaming, pari-mutuel, property and other taxes | 6,278 | 17,298 |
| Income taxes payable | 13,184 | 23,992 |
| Other current and noncurrent liabilities | 8,402 | 5,358 |
| Other noncurrent tax liabilities | 4,109 | (2,465) |
| Net cash provided by operating activities | 276,836 | 370,745 |
| **Investing activities** | | |
| Expenditures for property and equipment | (227,575) | (272,951) |
| Proceeds from sale of property and equipment | 2,120 | 882 |
| Investment in corporate debt securities | | (5,110) |
| Proceeds from sale of investment in corporate debt securities | 50,602 | |
| Proceeds from Empress Casino Hotel fire | 17,000 | |
| Investment in Kansas Entertainment | (12,500) | |
| Increase in cash in escrow | (25,000) | |
| Acquisition of businesses and licenses, net of cash acquired | | (382) |
| Net cash used in investing activities | (195,353) | (277,561) |
| **Financing activities** | | |
| Proceeds from exercise of options | 4,299 | 1,942 |
| Repurchases of common stock | | (31,627) |
| Proceeds from issuance of long-term debt | 650,214 | 215,937 |
| Principal payments on long-term debt | (697,650) | (798,164) |
| Deposit on preferred stock, net of related expenses | | 471,400 |
| Proceeds from insurance financing | 12,727 | 22,255 |

| | | | | |
|---|---|---|---|---|
| Payments on insurance financing | | (12,721) | | (24,608) |
| Increase in deferred financing fees | | (22,106) | | |
| Tax benefit from stock options exercised | | 1,885 | | 965 |
| Net cash used in financing activities | | (63,352) | | (141,900) |
| **Net increase (decrease) in cash and cash equivalents** | | 18,131 | | (48,716) |
| Cash and cash equivalents at beginning of year | | 746,278 | | 174,372 |
| Cash and cash equivalents at end of period | $ | 764,409 | $ | 125,656 |
| | | | | |
| **Supplemental disclosure** | | | | |
| Interest expense paid | $ | 99,692 | $ | 139,310 |
| Income taxes paid | $ | 58,741 | $ | 135,598 |

See accompanying notes to the consolidated financial statements.

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

**Notes to the Consolidated Financial Statements**

## 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Penn National Gaming, Inc. ( Penn ) and its subsidiaries (collectively, the Company ) have been prepared in accordance with United States ( U.S. ) generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2008 should be read in conjunction with these consolidated financial statements. For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation. Operating results for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

## 2. Merger Announcement and Termination

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

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee (the Cash Termination Fee ) and a $1.25 billion, zero coupon, preferred equity investment (the Investment ). On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of Series B Redeemable Preferred Stock (the Preferred Stock ).

The Company used a portion of the net proceeds from the Investment and the after-tax proceeds of the Cash Termination Fee for the repayment of some of its existing debt, repurchases of its Common Stock, lobbying expenses for efforts in Ohio and investment in corporate debt securities, with the remainder being invested primarily in short-term securities. The repurchase of up to $200 million of the Company s Common Stock over the twenty-four month period ending July 2010 was authorized by the Company s Board of Directors in July 2008. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05. During the nine months ended September 30, 2009, the Company did not repurchase any shares of its Common Stock.

On December 26, 2007, the Company entered into a Change in Control Payment Acknowledgement and Agreement (the Acknowledgement and Agreement ) with certain members of its management team. Pursuant to the Acknowledgement and Agreement, a portion of the payment due on a change in control to such executives was accelerated and paid on or before December 31, 2007. The Acknowledgement and Agreements were entered into as part of actions taken to reduce the amount of gross-up payments pertaining to federal excise taxes that may have otherwise been owed to such executives under the terms of their existing employment agreements in connection with the change in control payments due upon the consummation of the Merger. The accelerated change in control payments were subject to a clawback right in the event the Merger was terminated pursuant to the terms of the Merger Agreement or the closing of the Merger otherwise failed to occur or if the executive s employment with the Company was terminated prior to the effective date of the Merger under circumstances where the executive was not entitled to receive the remainder of his change in control payment under the terms of his employment agreement. In July 2008, the Company exercised its clawback right for the accelerated change in control payments in accordance with the Acknowledgement and Agreement, and advised the affected executives of the amounts to be repaid and the due date. Each executive has repaid to the Company all after-tax cash received by such executive and filed all returns and other instruments necessary to effect the refund of all applicable taxes. Further, each executive has assigned his right to such tax refunds to the Company.

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### 3. Summary of Significant Accounting Policies

**Revenue Recognition and Promotional Allowances**

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

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

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

Revenues are recognized net of certain sales incentives in accordance with the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 605-50, Revenue Recognition-Customer Payments and Incentives ( ASC 605-50 ). The consensus in ASC 605-50 requires that sales incentives and points earned in point-loyalty programs be recorded as a reduction of revenue. The Company recognizes incentives related to gaming play and points earned in point-loyalty programs as a direct reduction of gaming revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the three and nine months ended September 30, 2009 and 2008 are as follows:

| | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Rooms | $ 6,050 | $ 4,568 | $ 16,874 | $ 12,835 |
| Food and beverage | 27,963 | 26,249 | 82,531 | 76,317 |
| Other | 2,687 | 3,288 | 8,121 | 9,953 |
| Total promotional allowances | $ 36,700 | $ 34,105 | $ 107,526 | $ 99,105 |

The estimated cost of providing such complimentary services for the three and nine months ended September 30, 2009 and 2008 are as follows:

| Three Months Ended September 30, | Nine Months Ended September 30, |
|---|---|

| | 2009 | 2008 | 2009 | 2008 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Rooms | $ 2,373 | $ 1,824 | $ 6,798 | $ 5,151 |
| Food and beverage | 20,809 | 18,786 | 58,193 | 54,513 |
| Other | 1,742 | 1,602 | 4,876 | 4,402 |
| Total cost of complimentary services | $ 24,924 | $ 22,212 | $ 69,867 | $ 64,066 |

**Earnings Per Share**

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

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In the fourth quarter of 2008, the Company issued 12,500 shares of the Company s Preferred Stock, which the Company determined qualified as a participating security as defined in ASC 260. Under ASC 260, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with ASC 260, a company is required to use the two-class method when computing EPS when a company has a security that qualifies as a participating security. The two-class method is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company s Common Stock is computed by dividing net income applicable to common stock by the weighted-average common shares outstanding during the period.

The following table sets forth the allocation of net income for the three and nine months ended September 30, 2009 and 2008 under the two-class method:

| | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Net income | $ 21,351 | $ 147,491 | $ 90,492 | $ 225,250 |
| Net income applicable to preferred stock | 4,098 | | 17,459 | |
| Net income applicable to common stock | $ 17,253 | $ 147,491 | $ 73,033 | $ 225,250 |

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, 2009 and 2008:

| | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Determination of shares: | | | | |
| Weighted-average common shares outstanding | 78,255 | 85,785 | 78,044 | 86,288 |
| Assumed conversion of dilutive stock options | 1,186 | 1,445 | 998 | 1,940 |
| Assumed conversion of preferred stock | 27,778 | | 27,778 | |
| Diluted weighted-average common shares outstanding | 107,219 | | | |