Proposal for Cherokee and Crawford County

My Function in this review process is to:

1) Evaluate financial stability based on current corporate structure
2) Evaluate financial stability based on :
    a. Financial liquidity
    b. Financial solvency
    c. Future commitments

Any financial analysis needs a comparative peer group base for the evaluation process. All current gaming jurisdictions provide analysis on a property basis, size or gaming revenues. Evaluation on a corporate level does not provide the same segmentation. There are a wider range of sizes and industry segments. It is more difficult to define peer groups.

Peer group composite

Different investment bankers and analysts create different peer groups. Casino type businesses could fall into the service industry, the entertainment industry, or the hospitality industry. Within these groups can be different sub-groups. One of the common groups used by gaming analysts is the "service industry" with a "Casino and Gaming" subgroup.

This subgroup currently consists of 60 different companies.[1] The top 20 of these corporations have market capitalization of $100 million or more[2]. The top corporations include several corporations who have submitted proposals: (June 11, 2008)

		Millions
1.	Las Vegas Sands Corp. (LVS)	$19,111
2.	MGM Mirage (MGM)	11,797
3.	Wynn Resorts, Limited (WYNN)	9,898
4.	International Gaming Technology (IGT)	9,712
5.	Melco PBL (MPEL)	4,359
6.	Penn National Gaming (PENN)	3,729
13.	Pinnacle Entertainment, Inc (PNK)	736

One of the largest casino companies in the world, Harrah's, is missing because it has been bought out by a private group of Investors (Hamlet Holdings) for a sum over $29 billion. Before the takeover by Hamlet Holdings, Harrah's spent the last five years, buying up other well known major casino properties such as Bally's, Caesars, The Flamingo, Harvey's, Imperial Palace, Rio, and Showboat. It currently has over 51 properties around the world with the majority of them in the United States and England.

[1] I use information provided by Reuters Research, which is based on this composite of 60 firms. It also appears that Standard & Poor's also uses this composite. Note that these composites can be different for other financial research.
[2] Market capitalization represents the current market price times the total number of shares outstanding. The Casino and Gaming market price has decreased by 41% compared to S&P 1500 which declined by 13%.

The MGM Mirage is considered Harrah's major competitor. They have 23 wholly owned casino properties plus 3 other joint ventures. Included in the group of properties are the casinos once owned by Wynn and Circus Circus.

The composition of this group includes International Gaming Technology (IGT) ($7.9 b), a company that does not own one single casino. Other companies include Great American Financial Corp. and Medical Institutional Services Corporation. Great American Financial Corp., formerly known as Interactive Gaming and Communications Corp., is a holding company that conducts business in the gaming industry through Intersphere Communications, Ltd. (PA), a software development, marketing and Internet communications company specializing in the Internet market. Medical Institutional Services Corp, formerly Go Call, Inc., together with its wholly owned subsidiaries, Go Cash, Ltd. and Go Call Canada, Inc.($290,000), is principally a provider of services to businesses engaged in electronic commerce on the Internet (e-commerce).

A analysis of corporations who have submitted Kansas proposals provide a sense of the diversity of the corporations and the problem with using any type of industry norms for comparative analysis.

Comparative Financial Information
In 000's

	Harrah's	Sands	Penn	Pinnacle	Butler Nat. Co.
Total Assets	23,357,700	11,466,517	4,967,032	2,193,544	20,444
Total Equity	6,626,900	2,260,274	1,120,962	1,052,359	10,648
Total Cltd + ltd	12,440,400	7,572,330	2,974,922	841,301	6,971
Market Capitalization 7-14		14,280,900	2,117,000	562,370	25,850
Sales	10,825,200	2,950,567	2,565,737	1,068,790	14,681
Net income before Taxes	892,500	138,279	292,240	(1,851)	717
Return on Income	8.24%	4.69%	11.39%	-0.17%	4.88%
Return on Assets	3.82%	1.21%	5.88%	-0.08%	3.51%
Return on Equity	13.47%	6.12%	26.07%	-0.18%	6.73%
Current Ratio	93.01%	92.35%	61.29%	132.77%	203.12%
Debt/Equity	187.73%	335.02%	265.39%	79.94%	65.47%

As shown from the above table, the proposals have come from Harrah's, the giant in the industry with total assets exceeding $23 billion, compared to Butler national with only $20 million in assets. Comparison of other financial strengths shows complete disparity in all categories of corporations. A substantial amount of the growth in the industry has been financed by way of debt.[3] The industry norm is sitting at 2.4 times. As can be seen, many of the current proposals come from companies that are highly leveraged. In the current economic environment, this could be a real deal breaker.

Needless to say, with all the mergers and takeovers, and developments within the industry, there are many highly leveraged corporations that are susceptible to the current downturn of the economy. Current headlines include the following.

1) NEW YORK, June 10 (AP) - Shares of Las Vegas Sands Corp. fell to its lowest point in two years Tuesday after two analysts raised concerns about the health of the casino operators' key markets, Las Vegas and Macau.

2) CHICAGO, June 16 (Market Watch) Airfare hikes, capacity cuts start to pinch Las Vegas. Soaring fuel prices are starting to hit home in Las Vegas as cash-strapped airlines hike fares and cut capacity at McCarran International Airport - Sin City's tourism lifeline - leading to pressure on room rates and lower spending levels by visitors.

3) NEW YORK, June 17 (Reuters) - Harrah's Entertainment Inc's debt may weaken from already distressed levels as heavy capital spending and interest payments absorb cash flows at a time when the casino operator is also facing declining gambling revenues.

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3 Debt-Laden Casinos Squeezed by Slowdown By TAMARA AUDI and JEFFREY MCCRACKEN
July 1, 2008; Page A1: Wall Street Journal

Corporate Structure

Gaming Zone:	Southeast
County:	Cherokee and Crawford County
Property Name:	Hollywood Casino
Company Name:	Kansas Penn Gaming LLC
Parent Company:	Penn National Gaming, Inc.
Ownership Interest:	100%

Overview of Penn National Gaming, Inc.

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and operator of gaming and pari-mutuel properties. Penn is the successor to several businesses that have operated as Penn National Race Course since 1972. Penn was incorporated in Pennsylvania in 1982 as PNRC Corp. and adopted its current name in 1994, when the Company became a public company. In 1997, the Company began its transition from a pari-mutuel company to a diversified gaming company with the acquisition of the Charles Town property and the introduction of video lottery terminals in West Virginia. Since 1997, the Company has continued to expand its gaming operations through strategic acquisitions, including the acquisitions of Hollywood Casino Corporation in March 2003, Argosy Gaming Company ("Argosy") in October 2005, Black Gold Casino at Zia Park in April 2007, and Sanford-Orlando Kennel Club in October 2007.

Penn National Gaming is one of the leading companies in the Casino and Gaming sub-industry of the service industry. It represents one of 60 companies in the casino and gaming sector. Based on market capitalization, the Las Vegas Sands ($23.5 billion) is ranked number one with the MGM Mirage ($13.1 billion) in second place. Penn National follows in sixth place with a market capitalization of $3.9 B. (It has currently dropped to $2.67 B.)

The Company now owns or operates nineteen facilities in fifteen jurisdictions, including Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Mississippi, Missouri, New Jersey, New Mexico, Ohio, Pennsylvania, West Virginia, and Ontario.

Financial Position at 12/31/2007 and 3/31/2008

Penn National Gaming Corporate Earnings

The financial strength of any corporation is the ability to generate positive earnings and cash flows to meet its current and long term obligations. Exhibit 1 shows that Penn has been able to generate a steady growth in revenues for all years including the first quarter of this year despite the downturn of the economy. Exhibit 1 shows that Penn has had an average revenue growth rate of 28% per year between 2004 and 2007. Penn acknowledges that most of the properties operate in mature competitive markets and as a result, they expect future growth to come from prudent acquisitions of gaming properties, jurisdictional expansions (such as in Pennsylvania, Maine and Kansas) and property expansion in under-penetrated markets (Lawrenceburg property).

A higher cost of goods along with an increase in interest expenses has resulted in decreased earnings in 2007 and the first quarter of 2008. Compared with the casino and gaming industry average pre-tax return on revenues of 7.9%, Penn National has been able to maintain an 11% return since 2004.

Exhibit 1: Revenues	1st Q 2008	1st Q 2007	2007	2006	2005	2004
Revenues	646,146	626,337	2,565,737	2,351,463	1,486,406	1,205,515
Income before Tax	72,726	77,121	292,240	369,932	141,770	137,628
Before Tax Return %	.11	.12	.11	.16	.10	.11

But, all is not rosy with Penn National. A closer look at the properties shows that many of them are having declines in revenue. This has been offset by the new acquisitions and new openings of properties. Exhibit 2 shows that while net revenues increased $17.2 million (from $596 m to $613 m), or 2.9%, for the three months ended March 31, 2008, as compared to the three months ended March 31, 2007, it was primarily due to the opening of the casino at Hollywood Casino at Penn National Race Course, the acquisition of Black Gold Casino at Zia Park and Sanford-Orlando Kennel Club, and the opening of the Argosy Casino Riverside hotel. These increases were offset by decreases in net revenues at 8 of the 13 older properties. This included big declines at Empress Casino Hotel, Hollywood Casino Aurora and Argosy Casino Alton. Penn suggests that the decreases were due to competitive pressures and the impact of the Illinois smoking ban that became effective on January 1, 2008. The firm also believes that the current economic conditions also played a role. Income from operations was even worse as 12 properties showed reduced earnings.

Exhibit 2: The results of operations by property for the three months ended March 31, 2008 and 2007

Three Months Ended March 31,	Net Revenues 2008	Net Revenues 2007	Income (loss) from Operations 2008	Income (loss) from Operations 2007
	(in thousands)			
Charles Town Entertainment Complex	$ 122,512	$ 119,596	$ 29,645	$ 30,723
Argosy Casino Lawrenceburg	118,244	121,858	34,889	37,414
Hollywood Casino Aurora	53,626	64,500	14,072	18,332
Empress Casino Hotel	44,644	59,613	6,380	10,601
Argosy Casino Riverside	46,801	41,715	12,353	10,007
Hollywood Casino Baton Rouge	34,766	34,881	11,986	12,587
Argosy Casino Alton	22,697	30,863	3,607	6,756
Hollywood Casino Tunica	24,562	26,596	4,556	5,004
Hollywood Casino Bay St. Louis	25,441	23,484	2,161	1,239
Argosy Casino Sioux City	14,271	14,117	3,736	3,522
Boomtown Biloxi	20,648	24,067	4,090	5,558
Hollywood Slots at Bangor	10,700	10,976	1,774	2,058
Bullwhackers	5,744	7,131	(459)	136
Black Gold Casino at Zia Park (1)	21,915	—	7,129	—
Casino Rama management service contract	3,985	3,474	3,595	3,188
Hollywood Casino at Penn National Race Course (2)	39,449	11,854	(1,379)	(2,115)
Raceway Park	1,587	1,533	(303)	(247)
Sanford-Orlando Kennel Club (3)	1,902	—	91	—
Earnings from Pennwood Racing, Inc.	—	—	—	—
Corporate overhead	—	—	(19,364)	(19,983)
Total	$ 613,494	$ 596,258	$ 118,559	$ 124,780

Financial Viability

An analysis of the balance sheet and the cash flow statement provides evidence of possible trends and the ability to maintain a going concern. Liquidity ratios are used to measure the firm's ability to meet current obligations whereas solvency ratios tend to provide an indication of possible future cash flow problems.

Liquidity

The most common measure of a firm's ability to meet its current commitments is the current ratio. It compares current assets to current liabilities. The casino and gaming industry current ratio norm is 1.6. A look at Exhibit 3 shows that Penn National is way below the norm at 0.61 and that this ratio has been decreasing over the last four years. A closer look at the balance sheet shows that current assets as a percentage of total assets have been declining while at the same time current liabilities have been increasing.

On the other hand, the cash flow statement provides evidence that Penn National has been able to meet its current operational needs and have plenty of cash left over to meet other commitments. Exhibit 3 provides evidence that Penn National has doubled its cash flows from operations (CFO) between 2004 and 2007. Yet, the cash flow from operations needs watching after showing a major decline for the first quarter of 2008.

Exhibit 3 also provides information on the cash interest charge ratio. It indicates the number of times that CFO can meet current interest expenses. Once again, Penn National is below the industry norm of 3.6.

Exhibit 3 **Liquidity Ratios**	1stQt2008	1stqt2007	2007	2006	2005	2004
Current Ratio	0.61	0.79	0.61	0.97	0.90	1.04
CFO	86,632	168,739	431,219	281,809	150,475	197,164
CFO/NI	1.19	2.19	1.48	0.76	1.06	1.43
CFO/ CL	0.18	0.47	0.87	0.68	0.44	1.18
Cash Interest Charge	2.56	2.62	2.51	2.92	2.66	2.87

Solvency Ratios

Exhibit 4 provides a series of ratios that address the firm's ability to maintain financial flexibility in the future. An increasing amount of debt by a firm results in higher risk of not meeting future commitments when the economy turns sour. It also means that a firm has less flexibility in financing choices. In the long run, a firm must be able to generate enough excess cash to not only run its operations but to also meet investment and financing commitments. The debt/equity Casino and Gaming industry norm is 2.4 whereas the norm for the service industry is only 1.2 and that for the S&P 500 is 0.8. This vast difference in norms would indicate that the casino industry has grown by way of financing its acquisitions with debt instead of equity and that they are highly leveraged. Penn National's ratio of 2.65 for 2007 provides evidence they have also taken this road to growth. It has a debt to assets ratio of .60. Analysts note that companies with debt/assets greater than 0.60 are also risky.

Exhibit 4 **Solvency Ratios**	1stQt2008	1stqt2007	2007	2006	2005	2004
Debt/Equity	2.62	2.90	2.65	3.07	5.10	2.16
Debt/Assets	0.60	0.62	0.60	0.63	0.66	0.53
CFO/LT Debt	0.03	0.06	0.14	0.10	0.05	0.23
CFO/Capital Expend	0.72	2.27	1.19	0.69	1.24	2.86
Free Cash Flow	-33,758	94,554	70,064	-127,074	29,340	128,207

When looking at the long term, can Penn generate enough cash to meet future commitments? The CFO/LT Debt ratio has been increasing but is still far from being able to pay off long term debt in the future. The CFO/Capital expenditure ratio indicates that the excess cash being generated can barely meet current investment needs, let alone the payment of long term debt. On the other hand, there was only one year that Penn was not able to cover its capital expenditures from operating cash flows (free cash flow).

Take-over Bid

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 result 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 provides, among other things, for Merger Sub to be merged with and into the Company (the "Merger"), as a result of which the Company will continue as the surviving corporation and will become a wholly-owned subsidiary of Parent. Parent is indirectly owned by certain funds (the "Funds") managed by affiliates of Fortress Investment Group LLC ("Fortress") and Centerbridge Partners, L.P. ("Centerbridge").

Termination of Takeover Bid[4]

More than a year later (July 3, 2008) , Penn announced that the $6.1 billion takeover bid by Fortress Investment Group and Centerbridge Partners has been terminated. The end of the takeover bid could be a blessing for Penn. Under the termination agreement, Penn will receive $1.475 billion in cash. It will consist of a break-up fee of $225 million and a seven-year interest fee loan of $1.25 billion from the combined group of Fortress, Centerbridge, Wachovia Corp. and Deutsche Bank.

The $1.25 billion debt will be classified as "redeemable preferred equity with a repurchase date in 2015. It can be paid off with cash, its own common stock, or a combination of the two. Preferred equity allows Penn to forgo any interest or dividend payments and if Penn uses the money to repay its debt, greatly reduces future required interest payments.

This infusion of cash will allow Penn to make a huge dent in its overleveraged debt structure of $2.97 billion. Penn has stated that it will use the $1.475 cash infusion to repay its existing debt and to acquire or develop additional gaming properties.

[4] http://www.reuters.com/articlePrint?articleId=USWNAS024420080703; **Penn National says takeover deal terminated** Thu Jul 3, 2008 12:15pm EDT

Change in Balance Sheet

At 7/15/2008	3/31/2008	Addition	Pay $1 b	Ending
New Cash from term.		1,475,000	1,000,000	475,000
cash	170,822	170,822		170,822
other current assets	115463	115,463		115,463
total current assets	286,285	1,761,285		761,285
total fixed assets	1404740	1,404,740		1,404,740
Total other Assets	2,818,794	2,818,794		2,818,794
Total Assets	4,509,819	5,984,819		4,984,819
Total current Liabilities	361,243	361,243		361,243
Total long term debt	2,737,012	2,737,012	1,000,000	1,737,012
Total other liabilities	447,193	447,193		447,193
Total liabilities	3,545,448	3,545,448	1,000,000	2,545,448
Equity Debt		1,275,000		1,275,000
Equity	964,371	1,164,371		1,164,371
Total Equity		2,439,371		2,439,371
Total liab & Equity	4,509,819	5,984,819		4,984,819

Change in Ratios

	Prior Bal 3/31/2008	Addition 7/14/2008	Debt payment 7/14/2008
Current Ratio	0.61	4.88	2.11
Debt/Equity	2.62	1.12	0.71

The above charts provide possible options available to Penn management. The options are to bank the cash and then use it for possible new projects or to pay down a large portion of the debt. Either approach provides the company with major improvements in its balance sheet. The payoff of debt would also help increase earnings with reductions of interest payments. The weighted average interest rate on Penn's current debt is around 4.71%, thus a payoff of $1 billion would reduce interest payments by $47 million.

Needless to say, from the perspective of the Kansas Lottery Gaming Facility Review Board, the Penn proposals should now be more favorably considered. Reducing the debt will result in favorable debt/equity ratios as well as reasonable interest charges ratios.

Penn National Proposal for Cherokee County

1. Cost of Project $150,000,000
2. Funding of project $150,000,000
3. Equity funding $ 37,500,000 parent contribution
4. Debt funding $112,500,000 Loan from Parent line of credit.

The Cherokee county proposal is for a 30,000 square foot casino that will have 900 slot machines and 30 gaming tables. Including the submission fee, the project has a cost of $150 million. Penn has put up the initial submission fee ($25 million) and expects to contribute an additional $12.5 million from Penn National cash flow. This equates to a 25% equity investment. The remainder $112.5 million is expected to come from Penn National (parent) line of credit. The Penn submitted Exhibit IV (F), suggests that Penn National expects that they will be capable of handling all the investment needs from cash flows coming from the parent company. Obviously, the infusion of the money from the failed merger provides the needed cash to cover the cost of the total Cherokee project, let alone the equity contribution.

Additional Considerations

Penn National currently has $3 billion in long term debt. It will have over $940 million that is due within 3 years. Given the new infusion of cash from its failed merger, it should not need to worry much about meeting these future commitments.

Exhibit 5: Long-term Debt

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

	March 31, 2008	December 31, 2007
	(in thousands)	
Senior secured credit facility	$ 2,531,250	$ 2,496,625
$200 million 6 $^7/_8$% senior subordinated notes	200,000	200,000
$250 million 6 ¾% senior subordinated notes	250,000	250,000
Other long-term obligations	20,158	19,810
Capital leases	8,155	8,487
	3,009,563	2,974,922
Less current maturities of long-term debt	(97,629)	(93,452)
	$ 2,911,934	$ 2,881,470

The following is a schedule of future minimum repayments of long-term debt as of March 31, 2008 (in thousands):

Within one year	$ 97,629
1-3 years	847,490
3-5 years	1,812,544
Over 5 years	251,900
Total minimum payments	$ 3,009,563

Possible write downs of goodwill and intangible assets.

An analysis of the asset side of the balance sheet shows that Penn National has assets in excess of $5 billion. A closer look finds that fixed assets total $1.7 billion (35% of total assets). Close to 59% of the assets are classified as goodwill ($2 billion) and intangible assets ($818 million).[5] If earnings continue to decline for certain properties, there is a good possibility that these goodwill and intangible assets would warrant possible write downs. Companies loaded with goodwill and intangible assets tend to raise red flags to the credit community. Creditors are looking for tangible assets that can be used as collateral. Penn National may have problems in the current economy in getting an increase in its lines of credit.

Additional Projects

The following table summarizes the expected capital project expenditures, other than capital maintenance expenditures and planned expenditures related to projects that have not yet been awarded, such as in Cherokee County and Sumner County, Kansas, by property for the year ended December 31, 2008, as well as the projects in their entirety:

Property	**December 31, 2008**	**Project Total**
	(in millions)	
Charles Town Entertainment Complex	$ 16.0	$ 23.0
Hollywood Casino at Penn National Race Course	87.0	326.0
Hollywood Slots at Bangor	87.0	139.0
Argosy Casino Lawrenceburg	102.0	328.0
Other	17.0	17.0
Totals	$ 309.0	$ 833.0

[5] Goodwill represents the excess value paid above the fair value of the purchased assets.

Concluding Points for Consideration

Positives

1. Healthy growth rate in revenues.
2. Healthy growth rate in earnings.
3. Healthy growth rate in cash flows from operations (CFO).
4. CFO has exceeded capital expenditures.
5. Failed merger generates $1.475 billion in cash.
6. The additional cash flow changes the financial flexibility of company.

Negatives

1. Maintains extremely low current ratio
2. Currently has high debt/equity ratio
3. First quarter cash flow significantly down
4. For current project, has not clearly defined its debt/equity financing approach.

Additional factors

1. One of the top Casino Corporations in America
2. Owns or operates nineteen facilities in fifteen jurisdictions
3. Has experience in running smaller properties
4. Has large number of employees and managers
5. After the failed merger, has the cash and or financing to close a deal for either of its projects.
6. Has cut back its original plans and is doing a two phase project. Taking a very conservative approach toward competition.