



Mossberg's Investor Digest

Idea Profile

Penn National Gaming (Nasdaq: PENN)

DESCRIPTION:

Penn National Gaming owns and operates 19 casinos and other gaming facilities in 15 of the 16 legalized gambling jurisdictions (all but Las Vegas) in the United States.

KEY INVESTMENT CONSIDERATIONS:

After its terminated takeover, PENN is now flush with liquidity and in excellent position to acquire properties at fire sale prices.

Terminated deal – In June '07, just prior to the credit crises last year, PENN agreed to be purchased for \$67 per share. At the beginning of July, PENN reached an agreement to terminate the acquisition and accept \$1.475 billion in cash proceeds for issuing \$1.25 billion in non-interest bearing 7-year redeemable preferred equity and accepting the \$225 million cash termination fee.

The preferred equity is unique and may be causing some confusion – PENN pays no interest or coupon on the instrument. It is redeemable in 2015, only by the company, for stock with a floor price of \$45 and a ceiling of \$67 (18.7M to 27.8M shares). It will be reported as equity on the balance sheet and the diluted share count will increase by 27.8 million shares (as long as the stock trades under \$45). Effectively, the company has issued \$1.25 billion in stock at a price that is 1.7x to 2.5x greater than current levels.

Many attractive properties may be up for sale – At a time when the whole gaming industry is on its rear, many casino operators have expended all of their dry powder with slackening demand and significantly diminished access to capital. PENN, now flush with liquidity is in a position to act like a vulture over the next few years and pick up some attractive properties at fire sale prices. The company states that the \$1.3 billion (after tax) in cash proceeds can be re-deployed to purchase \$430 million to \$650 million in incremental EBITDA, nearly 2x what it has produced in the past 12 months.

Strong Insider Ownership – About 10% of the stock is owned by the CEO, who thinks like an owner and has made investments in the right areas in the past.

Secular growth in gaming industry is likely in the coming years – State and Local governments are in desperate financial condition and revenue from legalized gambling makes an attractive alternative to raising taxes. No matter who wins the next presidential election, it's likely that federal taxes will increase. With increased tax payments at the federal level, combined with the weak economy and difficulties in the credit market, it is likely that state and local government entities will have fiscal difficulties and/or have a difficult time funding new projects. The recent vote of the City of Vallejo, CA to declare bankruptcy and the looming bankruptcy of Jefferson County, AL, which could be the largest in U.S. history, illustrate the point.

KEY RISKS:

Property Concentration – Approximately 40% to 50% of PENN's revenue and net income is derived from two properties. A disruption at one of these properties could have a significant adverse affect on the company's earnings.

VALUATION:

With an enterprise value of \$4.8 billion (calculated conservatively by converting the preferred at the lower end of the conversion rate), the current EV to EBITDA valuation is approximately 7.6x. This is an attractive value, considering PENN's TTM ROE was 13% and it has the potential to double its EBITDA by redeploying its excess liquidity in the next couple of years.

(Nasdaq: PENN)	
Investment Data (as of 8/5/08)	
Recent Price	\$29.74
52-Week Range	21.72 - 62.30
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	86.9 MM
Average Trading Volume (3 mos)	1.6 MM
Market Capitalization	2.6 B
Cash	167.9 MM
Long Term Debt	3.0 B
Enterprise Value (EV)	5.5 B
LT Debt/ Equity	2.6
Tangible BV/ Share	N/A
TTM Revenue	2.4 B
P/ Revenue	1.1x
TTM EPS	1.76
P/ EPS	16.9x
TTM EBITDA	631.3 MM
EV/ TTM EBITDA	8.7x

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