

AZTAR CORP
Form 10-Q
November 05, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 2, 2003

OR

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 1-5440

AZTAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

86-0636534
(I.R.S. Employer
Identification No.)

2390 East Camelback Road, Suite 400, Phoenix, Arizona 85016

(Address of principal executive offices)

(Zip Code)

(602) 381-4100

(Registrant's telephone number, including area code)

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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

At October 30, 2003, the registrant had outstanding 34,167,802 shares of its common stock, \$.01 par value.

AZTAR CORPORATION AND SUBSIDIARIES

FORM 10-Q

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AZTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share data)

| | <u>October 2,</u> <u>2003</u> | <u>January 2,</u> <u>2003</u> |
|--|----------------------------------|----------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 39,889 | \$ 52,896 |
| Accounts receivable, net | 17,826 | 18,812 |
| Refundable income taxes | -- | 4,593 |
| Inventories | 7,491 | 7,532 |
| Prepaid expenses | 10,486 | 8,708 |
| Deferred income taxes | <u>16,648</u> | <u>16,731</u> |
| Total current assets | 92,340 | 109,272 |
| Investments | 19,111 | 17,420 |
| Property and equipment: | | |
| Buildings, riverboats and equipment, net | 732,240 | 740,352 |
| Land | 215,304 | 214,794 |
| Construction in progress | 152,634 | 69,809 |
| Leased under capital leases, net | <u>54</u> | <u>104</u> |
| | 1,100,232 | 1,025,059 |
| Intangible assets | 60,985 | 53,625 |

| | | |
|--------------|---------------|--------------|
| Other assets | <u>11,771</u> | <u>5,306</u> |
| | \$1,284,439 | \$1,210,682 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements.

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(in thousands, except share data)

| | October 2, <u>2003</u> | January 2, <u>2003</u> |
|--|---------------------------|---------------------------|
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable and accruals | \$ 68,086 | \$ 64,780 |
| Accrued payroll and employee benefits | 25,063 | 29,741 |
| Accrued interest payable | 10,665 | 9,134 |
| Accrued rent | 10,816 | 10,081 |
| Income taxes payable | 1,028 | -- |
| Current portion of long-term debt | 17,007 | 5,015 |
| Current portion of other long-term liabilities | <u>982</u> | <u>870</u> |
| Total current liabilities | 133,647 | 119,621 |
| Long-term debt | 573,314 | 524,066 |
| Other long-term liabilities | 18,112 | 17,480 |
| Deferred income taxes | 32,111 | 28,560 |
| Contingencies and commitments | | |
| Series B convertible preferred stock (redemption value \$11,506 and \$10,025) | 5,352 | 5,601 |
| Shareholders' equity: | | |
| Common stock, \$.01 par value (34,112,469 and 37,026,379 shares outstanding) | 524 | 524 |
| Paid-in capital | 439,372 | 439,275 |
| Retained earnings | 280,116 | 231,420 |
| Accumulated other comprehensive loss | (612) | (612) |
| Less: Treasury stock | <u>(197,497)</u> | <u>(155,253)</u> |
| Total shareholders' equity | <u>521,903</u> | <u>515,354</u> |
| | \$1,284,439 | \$1,210,682 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements.

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AZTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
For the periods ended October 2, 2003 and October 3, 2002
(in thousands, except per share data)

Third Quarter

Nine Months

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| | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> |
|---|-----------------|-----------------|-----------------|-----------------|
| Revenues | | | | |
| Casino | | | | |
| Rooms | | | | |
| Food and beverage | \$164,748 | \$175,137 | \$496,084 | \$504,777 |
| Other | 20,885 | 18,432 | 58,580 | 57,463 |
| | 13,845 | 14,099 | 42,872 | 42,700 |
| Costs and expenses | <u>10,789</u> | <u>10,438</u> | <u>30,266</u> | <u>30,261</u> |
| Casino | 210,267 | 218,106 | 627,802 | 635,201 |
| Rooms | | | | |
| Food and beverage | 70,224 | 73,370 | 211,399 | 211,660 |
| Other | 10,570 | 9,796 | 30,039 | 29,548 |
| Marketing | 13,124 | 13,421 | 40,562 | 40,442 |
| General and administrative | 7,699 | 8,436 | 22,925 | 24,585 |
| Utilities | 18,809 | 21,782 | 57,613 | 61,393 |
| Repairs and maintenance | 19,596 | 19,090 | 57,231 | 57,200 |
| Provision for doubtful accounts | 5,650 | 5,231 | 13,873 | 12,987 |
| Property taxes and insurance | 6,168 | 6,153 | 18,607 | 18,910 |
| Rent | 435 | 492 | 1,186 | 1,860 |
| Depreciation and amortization | 7,299 | 7,600 | 22,255 | 20,169 |
| | 2,111 | 2,949 | 6,385 | 9,749 |
| | <u>12,971</u> | <u>12,854</u> | <u>38,473</u> | <u>38,061</u> |
| Operating income | <u>174,656</u> | <u>181,174</u> | <u>520,548</u> | <u>526,564</u> |
| Interest income | 35,611 | 36,932 | 107,254 | 108,637 |
| Interest expense | | | | |
| Equity in unconsolidated partnership's loss | 153 | 219 | 549 | 860 |
| | (8,774) | (10,349) | (27,540) | (31,439) |
| Income before income taxes | --- | --- | --- | <u>(458)</u> |
| Income taxes | 26,990 | 26,802 | 80,263 | 77,600 |
| | <u>(10,088)</u> | <u>(10,233)</u> | <u>(31,025)</u> | <u>(30,794)</u> |
| Net income | | | | |
| | \$ 16,902 | \$ 16,569 | \$ 49,238 | \$ 46,806 |
| Net income per common share | ===== | ===== | ===== | ===== |
| Net income per common share assuming dilution | \$.48 | \$.44 | \$ 1.38 | \$ 1.24 |
| Weighted-average common shares applicable to: | \$.46 | \$.43 | \$ 1.33 | \$ 1.19 |
| Net income per common share | | | | |
| Net income per common share assuming dilution | 34,620 | 37,310 | 35,275 | 37,163 |
| | 36,321 | 38,726 | 36,745 | 38,944 |

The accompanying notes are an integral part of these financial statements.

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AZTAR CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
For the periods ended October 2, 2003 and October 3, 2002
 (in thousands)

| | <u>Nine Months</u> | |
|---|--------------------|--------------|
| | <u>2003</u> | <u>2002</u> |
| Cash Flows from Operating Activities | | |
| Net income | | |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | \$ 49,238 | \$ 46,806 |
| Depreciation and amortization | | |
| Provision for losses on accounts receivable | | |
| Loss (gain) on reinvestment obligation | 39,608 | 39,152 |
| Rent expense | 1,186 | 1,860 |
| Distribution less than equity in income of partnership | 138 | (2,709) |
| Deferred income taxes | 344 | (171) |
| Change in assets and liabilities: | -- | (414) |
| (Increase) decrease in accounts receivable | 3,634 | 7,490 |
| (Increase) decrease in refundable income taxes | | |
| (Increase) decrease in inventories and prepaid expenses | (200) | (808) |
| Increase (decrease) in accounts payable, accrued expenses and income taxes payable | 4,593 | -- |
| Other items, net | (2,056) | 1,253 |
| | (9,058) | (65) |
| Net cash provided by (used in) operating activities | <u>981</u> | <u>4,268</u> |

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| | | |
|--|--------------------|--------------------|
| Cash Flows from Investing Activities | <u>88,408</u> | <u>96,662</u> |
| Reduction in investments | | |
| Purchases of property and equipment | | |
| Acquisition of Tropicana Enterprises partnership interests | 1,855 (103,126) | 12,869 (46,561) |
| Additions to other long-term assets | -- | (117,500) |
| Net cash provided by (used in) investing activities | <u>(18,278)</u> | <u>(5,826)</u> |
| Cash Flows from Financing Activities | <u>(119,549)</u> | <u>(157,018)</u> |
| Proceeds from issuance of long-term debt | | |
| Proceeds from issuance of common stock | | |
| Principal payments on long-term debt | 274,900 | 106,600 |
| Principal payments on other long-term liabilities | 65 | 4,499 |
| Repurchase of common stock | (213,660) | (90,123) |
| Preferred stock dividend | (23) | (27) |
| Redemption of preferred stock | (42,244) (435) | -- (461) |
| Net cash provided by (used in) financing activities | <u>(469)</u> | <u>(627)</u> |
| Net increase (decrease) in cash and cash equivalents | <u>18,134</u> | <u>19,861</u> |
| Cash and cash equivalents at beginning of period | (13,007) | (40,495) |
| Cash and cash equivalents at end of period | <u>52,896</u> | <u>92,122</u> |
| | \$ 39,889 | \$ 51,627 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements.

AZTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)(continued)
For the periods ended October 2, 2003 and October 3, 2002
(in thousands)

| | <u>Nine Months</u> | |
|--|--------------------|-------------|
| | <u>2003</u> | <u>2002</u> |
| Supplemental Cash Flow Disclosures | | |
| Acquisition of Tropicana Enterprises partnership interests: | | |
| Investments in and advances to unconsolidated partnership | | |
| Buildings, net | | |
| Land | \$ -- | \$ 6,828 |
| Intangible assets | -- | (41,411) |
| Other assets | -- | (109,979) |
| Current portion of long-term debt | -- | (15,331) |
| Current portion of other long-term liabilities | -- | 1,000 |
| Long-term debt | -- | 4,148 |
| Other long-term liabilities | -- | (847) |
| | -- | 44,773 |
| Net cash used in acquisition | -- | (6,681) |
| Summary of non-cash investing and financing activities: | \$ -- | \$(117,500) |
| Current liabilities incurred for intangible assets | | |
| Exchange of common stock in lieu of cash payments in connection with the exercise of stock options | \$ 1,919 | \$ -- |
| Cash flow during the period for the following: | -- | 5 |
| Interest paid, net of amount capitalized | | |
| Income taxes paid | \$ 24,874 | \$ 29,528 |
| | 21,738 | 19,074 |

The accompanying notes are an integral part of these financial statements.

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AZTAR CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
For the periods ended October 2, 2003 and October 3, 2002
 (in thousands, except number of shares)

| | <u>Nine Months</u> | |
|--|--------------------|-------------|
| | <u>2003</u> | <u>2002</u> |
| Common stock: | | |
| Beginning balance | | |
| Stock options exercised for 8,666 and 665,034 shares | | |
| | \$ 524 | \$ 517 |
| Ending balance | <u>—</u> | <u>7</u> |
| Paid-in capital: | <u>524</u> | <u>524</u> |

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| | | |
|---|------------------|------------------|
| Beginning balance | | |
| Stock options exercised | | |
| Tax benefit from stock options exercised | 439,275 | 431,455 |
| | 65 | 4,497 |
| Ending balance | <u>32</u> | <u>3,323</u> |
| Retained earnings: | <u>439,372</u> | <u>439,275</u> |
| Beginning balance | | |
| Preferred stock dividend and losses on redemption | | |
| Net income | 231,420 | 173,409 |
| | (542) | (681) |
| Ending balance | <u>49,238</u> | <u>46,806</u> |
| Accumulated other comprehensive loss: | <u>280,116</u> | <u>219,534</u> |
| Beginning and ending balance | | |
| Treasury stock: | <u>(612)</u> | <u>(353)</u> |
| Beginning balance | | |
| Repurchase of 2,922,576 shares of common stock at cost in 2003 | (155,253) | (151,187) |
| Repurchase of 222 shares of common stock, at cost, in connection with stock options exercised in 2002 | (42,244) | -- |
| Ending balance | <u>--</u> | <u>(5)</u> |
| | <u>(197,497)</u> | <u>(151,192)</u> |
| | \$ 521,903 | \$ 507,788 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements.

AZTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Note 1: General

The consolidated financial statements reflect all adjustments, such adjustments being normal recurring accruals, which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented; interim results, however, may not be indicative of the results for the full year.

The notes to the interim consolidated financial statements are presented to enhance the understanding of the financial statements and do not necessarily represent complete disclosures required by generally accepted accounting principles. The interest that was capitalized during the third quarter and nine months ended 2003 was \$2,372,000 and \$5,725,000, respectively; it was \$789,000 and \$1,866,000 during the third quarter and nine months ended 2002. Capitalized costs related to various development projects, included in intangible assets, were \$8,869,000 and \$2,159,000 at October 2, 2003 and January 2, 2003, respectively. For additional information regarding significant accounting policies, long-term debt, lease obligations, stock options, and other matters applicable to the Company, reference should be made to the Company's Annual Report to Shareholders for the year ended January 2, 2003.

Equity Instruments

The fair-value-based method of accounting is used for equity instruments issued to nonemployees for goods or services. The intrinsic-value-based method of accounting is used for stock-based employee compensation plans. The Company has elected to follow Accounting Principles Board Opinion No. 25 entitled "Accounting for Stock Issued to Employees" and related Interpretations in accounting for its stock-based employee compensation arrangements because the alternative fair-value-based method of accounting provided for under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 entitled "Accounting for Stock-Based Compensation" requires use of option valuation models that were not developed for use in valuing employee stock options.

Under APB 25, because the exercise price of the Company's stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Stock options that were granted during the third quarter and nine months ended 2003 were 25,000 and 633,000, respectively; they were 735,000 during the nine months ended 2002. There were no stock options granted during the third quarter ended 2002.

Pro forma information regarding net income and earnings per share is required by SFAS 123, and has been determined as if the Company had accounted for its stock option plans under the fair-value-based method of that Statement. The fair value for these options was estimated at the date of grant or modification using a Black-Scholes option pricing

model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting or trading restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

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AZTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The pro forma information for the periods ended October 2, 2003 and October 3, 2002 is as follows (in thousands, except for net income per common share information):

| | <u>Third Quarter</u> | | <u>Nine Months</u> | |
|---|----------------------|--------------|--------------------|----------------|
| | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> |
| Net income, as reported | | | | |
| Deduct: Total stock-based employee compensation expense determined under the fair-value-based method of accounting, net of income tax benefit | \$ 16,902 | \$ 16,569 | \$ 49,238 | \$ 46,806 |
| Pro forma net income | <u>(819)</u> | <u>(839)</u> | <u>(2,376)</u> | <u>(2,738)</u> |

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| | | | | |
|--------------------------------------|-----------|-----------|-----------|-----------|
| Net income per common share: | \$ 16,083 | \$ 15,730 | \$ 46,862 | \$ 44,068 |
| As reported | ===== | ===== | ===== | ===== |
| Pro forma | | | | |
| | \$.48 | \$.44 | \$ 1.38 | \$ 1.24 |
| Net income per common share assuming | \$.46 | \$.42 | \$ 1.31 | \$ 1.17 |
| dilution: | | | | |
| As reported | | | | |
| Pro forma | | | | |
| | \$.46 | \$.43 | \$ 1.33 | \$ 1.19 |
| | \$.44 | \$.41 | \$ 1.28 | \$ 1.13 |

Note 2: Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." The objective of FIN 46 is to improve financial reporting by enterprises involved with variable interest entities. FIN 46 establishes requirements for which and when business enterprises should consolidate variable interest entities. An entity subject to the consolidation requirements of FIN 46 is referred to as a variable interest entity. Consolidation is required under FIN 46 when either of the following conditions is present: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties or (2) the equity investors (as a group) do not hold a controlling financial interest in the entity. A variable interest entity formed subsequent to January 31, 2003 is immediately subject to FIN 46. For variable interest entities formed prior to February 1, 2003, the effective date for public companies was delayed until the first reporting period ending after December 15, 2003. Based on a preliminary review, the Company expects FIN 46 to have no impact on its consolidated financial position, results of operations or cash flows.

Note 3: Acquisition and Prior Investments in and Advances to Unconsolidated Partnership

The Company's prior investment in unconsolidated partnership was a noncontrolling partnership interest of 50% in Tropicana Enterprises, a Nevada general partnership that owned the real property that the Company leased in the operation of the Las Vegas Tropicana. The Company used the equity method of accounting for this investment. On February 28, 2002, the Company purchased the 50% partnership interest in Tropicana Enterprises that it did not own. After credits, the Company paid \$117,500,000. The source of funds for this purchase was cash on hand of \$47,500,000 and \$70,000,000 in borrowings under its revolving credit facility ("Revolver"). In addition, the Company assumed \$48,921,000 of partnership debt ("Tropicana Enterprises Loan") that the Company was servicing through its rent payments. This purchase eliminates, after February 28, 2002, the Company's real

AZTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

estate rent expense at the Las Vegas Tropicana, which was \$1,361,000 net of intercompany eliminations in the nine months ended 2002, and its equity in unconsolidated partnership's loss, which was \$458,000 in the nine months ended 2002. However, it increases depreciation and interest expenses and decreases interest income after February 28, 2002. As part of the acquisition, the Company acquired the 50% interest in the Tropicana trademark, an intangible asset with an indefinite life, that it did not already own as part of its interest in the partnership, at an allocated cost of \$22,172,000 based upon an appraisal report.

Summarized operating results, prior to the acquisition, for the unconsolidated partnership for the period ended October 3, 2002 is as follows (in thousands):

| | Nine Months 2002 |
|--------------------|---------------------|
| Revenues | \$ 2,722 |
| Operating expenses | (473) |
| Operating income | 2,249 |
| Interest expense | (253) |
| Net income | \$ 1,996 |

The Company's share of the above operating results, after intercompany eliminations, is as follows (in thousands):

| | Nine Months 2002 |
|---|---------------------|
| Equity in unconsolidated partnership's loss | \$ (458) |

Note 4: Las Vegas Tropicana Development

The Company's master plan for a potential development of its Las Vegas Tropicana site envisions the creation of two separate but essentially equal and inter-connected sites. The north site would be developed by the Company. The south site would be held for future Company development, joint venture development, or sale for development by another party.

For development of a potential project on the north site, the Company plans to complete a detailed design development effort with construction documents and estimated construction costs by the end of the first quarter of 2004. The Company will decide by the end of the first quarter of 2005 whether to proceed, whether to delay, or whether not to proceed at all with development of a project on the north site. The amount and timing of any future expenditure, and the extent of any impact on existing operations, will depend on the nature and timing of the development we ultimately undertake, if any. If we decide to abandon any facilities in the development process, we

would have to conduct a review for impairment with a possible write-down and review their useful lives with a possible adjustment to depreciation and amortization expense. These reviews could result in adjustments that have a material adverse effect on our consolidated results of operations.

The net book value of the property and equipment used in the operation of the Las Vegas Tropicana, excluding land at a cost of \$109,979,000, was \$60,544,000 at October 2, 2003. The net book value of accounts receivable, inventories and prepaid expenses at the Las Vegas Tropicana was \$8,463,000 at October 2, 2003. It is reasonably possible that the carrying value of some or all of these assets may change.

AZTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

Note 5: Long-term Debt

Long-term debt consists of the following (in thousands):

| | October 2, <u>2003</u> | January 2, <u>2003</u> |
|--|---------------------------|---------------------------|
| 8 7/8% Senior Subordinated Notes Due 2007 | \$235,000 | \$235,000 |
| 9% Senior Subordinated Notes Due 2011 | 175,000 | 175,000 |
| Revolver; floating rate, 3.2% at October 2, 2003; matures June 30, 2005 | 90,000 | 25,000 |
| Term loan ("Term Loan"); floating rate, 3.7% at October 2, 2003; matures June 30, 2005 | 47,875 | 48,250 |
| Tropicana Enterprises Loan; floating rate, 2.9% at October 2, 2003; matures June 30, 2005 | 42,213 | 45,504 |
| Obligations under capital leases | <u>233</u> | <u>327</u> |
| | 590,321 | 529,081 |
| Less current portion | <u>(17,007)</u> | <u>(5,015)</u> |
| | \$573,314 | \$524,066 |
| | ===== | ===== |

Note 6: Other Long-term Liabilities

Other long-term liabilities consist of the following (in thousands):

| | October 2, <u>2003</u> | January 2, <u>2003</u> |
|--|---------------------------|---------------------------|
| Deferred compensation and retirement plans | \$ 16,175 | \$ 15,219 |
| Deferred income | 2,594 | 2,783 |
| Las Vegas Boulevard beautification assessment | <u>325</u> | <u>348</u> |
| | 19,094 | 18,350 |
| Less current portion | <u>(982)</u> | <u>(870)</u> |
| | \$ 18,112 | \$ 17,480 |
| | ===== | ===== |

Note 7: Income Taxes

The Internal Revenue Service ("IRS") is examining the Company's income tax returns for the years 1994 through 2002. For the years 1994 through 1999, the IRS has settled for all but two issues. The two issues involve the deductibility of certain complimentary services provided to customers and the deductibility of a portion of payments on certain liabilities related to the restructuring of Ramada Inc. (the "Restructuring"). In the fourth quarter of 2002, the Company settled these same two issues with the IRS for the years 1992 and 1993, resulting in a tax benefit of \$1,041,000. The Company has estimated and provided for income taxes and interest in accordance with the IRS position. It is reasonably possible that these two issues for 1994 through 1999 could be favorably settled in the near term. The New Jersey Division of Taxation is examining the New Jersey income tax returns for the years 1995 through 1998. Management believes that adequate provision for income taxes and interest has been made in the financial statements.

The Company has received proposed assessments from the Indiana Department of Revenue ("IDR") in connection with the examination of the Company's Indiana income tax returns for the years 1996 through 2000. Those assessments are based on the IDR's position that the Company's gaming taxes that are based on gaming revenue are not deductible for Indiana income tax purposes. The Company filed a petition in Indiana Tax Court for the 1996 and 1997 tax years and oral arguments were heard in April 2001. The Company has filed a formal protest for the years 1998 through 2000. The

Company believes that it has meritorious legal defense to those assessments and has not recorded an accrual for payment. It is reasonably possible that the Company's estimate may change in the near term. The amount involved, including the Company's estimate of interest, net of a federal income tax benefit assuming continuation through October 2, 2003, was approximately \$10,800,000 at October 2, 2003.

Note 8: Earnings Per Share

Net income per common share excludes dilution and is computed by dividing income applicable to common shareholders by the weighted-average number of common shares outstanding. Net income per common share, assuming dilution, is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options and the assumed conversion of the preferred stock at the stated rate.

The computations of net income per common share and net income per common share, assuming dilution, for the periods ended October 2, 2003 and October 3, 2002, are as follows (in thousands, except per share data):

| | <u>Third Quarter</u> | | <u>Nine Months</u> | |
|---|----------------------|--------------------|--------------------|--------------------|
| | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> |
| Net income | | | | |
| Less: preferred stock dividends and losses on redemption | \$ 16,902 | \$ 16,569 | \$ 49,238 | \$ 46,806 |
| Income available to common shareholders | <u>(194)</u> | <u>(174)</u> | <u>(542)</u> | <u>(681)</u> |
| Plus: income impact of assumed conversion of dilutive preferred stock | 16,708 | 16,395 | 48,696 | 46,125 |
| Income available to common shareholders plus dilutive potential common shares | <u>107</u> | <u>114</u> | <u>321</u> | <u>340</u> |
| Weighted-average common shares applicable to net income per common share | \$ 16,815 ===== | \$ 16,509 ===== | \$ 49,017 ===== | \$ 46,465 ===== |
| Effect of dilutive securities: | 34,620 | 37,310 | 35,275 | 37,163 |
| Stock option incremental shares | | | | |
| Assumed conversion of preferred stock | 1,135 | 816 | 904 | 1,181 |
| Dilutive potential common shares | <u>566</u> | <u>600</u> | <u>566</u> | <u>600</u> |
| Weighted-average common shares applicable to net income per | <u>1,701</u> | <u>1,416</u> | <u>1,470</u> | <u>1,781</u> |

common share assuming dilution

| | | | | |
|--|--------|--------|---------|---------|
| | 36,321 | 38,726 | 36,745 | 38,944 |
| Net income per common share | ===== | ===== | ===== | ===== |
| Net income per common share assuming dilution | \$.48 | \$.44 | \$ 1.38 | \$ 1.24 |
| | ===== | ===== | ===== | ===== |
| | \$.46 | \$.43 | \$ 1.33 | \$ 1.19 |
| | ===== | ===== | ===== | ===== |

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AZTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

Note 9: Contingencies and Commitments

The Company agreed to indemnify Ramada Inc. ("Ramada") against all monetary judgments in lawsuits pending against Ramada and its subsidiaries as of the conclusion of the Restructuring on December 20, 1989, as well as all related attorneys' fees and expenses not paid at that time, except for any judgments, fees or expenses accrued on the hotel business balance sheet and except for any unaccrued and unreserved aggregate amount up to \$5,000,000 of judgments, fees or expenses related exclusively to the hotel business. Aztar is entitled to the benefit of any crossclaims or counterclaims related to such lawsuits and of any insurance proceeds received. There is no limit to the term or the maximum potential future payment under this indemnification. In addition, the Company agreed to indemnify Ramada for certain lease guarantees made by Ramada. The lease terms potentially extend through 2015 and Ramada guaranteed all obligations under these leases. The Company has recourse against a subsequent purchaser of the operations covered by these leases. The estimated maximum potential amount of future payments the Company could be required to make under these indemnifications is \$8,100,000 at October 2, 2003. In connection with these matters, the Company's accrued liability was \$3,833,000 at both October 2, 2003 and January 2, 2003.

The Casino Reinvestment Development Authority ("CRDA") has issued bonds that are being serviced by its parking fee revenue. A series of these bonds are collateralized by a portion, \$977,000 at October 2, 2003, of the Company's CRDA deposits. The portion that serves as collateral is a varying percentage of a portion of CRDA deposits that satisfy the Company's investment obligation based upon its New Jersey casino revenues. In the event that the CRDA's parking fees are insufficient to service its bonds, these deposits can be used for that purpose. To the extent the

Company's CRDA deposits are used to service these bonds, the Company would receive credit against future investment obligations. The Company's CRDA deposits serve as collateral for a one-year period, after which they become available for eligible investments. This arrangement continues through 2013. The Company received a fee for this arrangement that is being amortized on a straight-line basis through 2013. The Company's estimate of the maximum potential deposits that could be used to service CRDA bonds is \$20,000,000 at October 2, 2003.

The Company is a party to various other claims, legal actions and complaints arising in the ordinary course of business or asserted by way of defense or counterclaim in actions filed by the Company. Management believes that its defenses are substantial in each of these matters and that the Company's legal posture can be successfully defended without material adverse effect on its consolidated financial position, results of operations or cash flows.

The Company has severance agreements with certain of its senior executives. Severance benefits range from a lump-sum cash payment equal to three times the sum of the executive's annual base salary and the average of the executive's annual bonuses awarded in the preceding three years plus payment of the value in the executive's outstanding stock options and vesting and distribution of any restricted stock to a lump-sum cash payment equal to one half of the executive's annual base salary. In certain agreements, the termination must be as a result of a change in control of the Company. Based upon salary levels and stock options at October 2, 2003, the aggregate commitment under the severance agreements should all these executives be terminated was approximately \$40,000,000 at October 2, 2003.

At October 2, 2003, the Company had commitments of approximately \$97,000,000 for the Atlantic City Tropicana expansion project.

Note 10: Subsequent Event

An accident occurred on the site of the construction of the parking-garage component of the expansion of the Atlantic City Tropicana on Thursday, October 30. The accident resulted in four fatalities and serious injuries to over 20 workers, as

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well as extensive damage to the facilities under construction. Access to the property was limited during the subsequent days because some of the streets surrounding the property were closed. In addition, the Tropicana's operations have been disrupted by the temporary closure of one of the property's three hotel towers (the West Tower, containing 600 rooms) and the parking garages that are part of the existing property. While most points of access were largely restored as of November 2, the West Tower, the parking garages, the bus terminal and the pedestrian bridge over Pacific Avenue are not available for use as of November 4 while measures are taken to make the area safe and permit

removal of debris. The Company is awaiting the results of an investigation to determine the extent of damages and the effects of the accident on the operation of the property and the construction of the expansion and the timing of its opening. The Company has insurance coverage, including business interruption insurance.

Item 2. Management's Discussion and Analysis

Financial Condition

In April 2002, we commenced construction on a major expansion of our Tropicana Atlantic City. The cost of the expansion is targeted to be \$225 million; we also anticipate providing \$20 million of tenant allowances. Funds for the expansion will come in part from public sector subsidies, tax rebates and other credits, the present value of which could be up to \$60 million. We are planning that the costs to be borne by us would be funded largely from our operating cash flow, with additional needs met by our revolving credit facility. During the nine months of 2003, our purchases of property and equipment on an accrual basis, including capitalized interest of \$5.7 million, were \$81.3 million for this project, and our expenditures for tenant allowances were \$0.8 million.

During the 2003 nine-month period, we repurchased 2,922,576 shares of common stock at an average price of \$14.43 per share under a 4.0 million stock repurchase program authorized by our Board of Directors in 2002. At October 2, 2003, there remained authority to repurchase 794,224 shares of common stock under this program. Purchases under our stock repurchase program are made from time to time in the open market or privately negotiated transactions, depending upon market prices and other business factors.

Effective January 3, 2003, we established the Aztar Corporation Nonqualified Retirement Plan Trust for the benefit of employees covered by one of our nonqualified defined benefit pension plans. We contributed \$6.2 million to this trust on January 9, 2003. The funds in the trust continue to be assets of Aztar and are included in other assets.

Effective January 3, 2003, our Board of Directors authorized the establishment of the Aztar Corporation Nonqualified Retirement Plan for Selected Senior Executives. This plan is unfunded. Our accrued liability for this plan was immaterial at October 2, 2003.

During the 2003 nine-month period, the outstanding balance on our revolving credit facility increased to \$90 million from \$25 million at January 2, 2003, leaving \$174 million available at October 2, 2003, for future borrowing.

Our master plan for a potential development of our Las Vegas site envisions the creation of two separate but essentially equal and inter-connected 17-acre development sites. The north site would be developed by us. The south site would be held for our future development, joint venture development, or sale for development by another party. For development of a potential project on the north site, we plan to complete a detailed design development effort with construction documents and estimated construction costs by the end of the first quarter of 2004. During the nine months of 2003, we capitalized \$6.2 million for design development costs included in intangible assets. We will decide by the end of the first quarter of 2005 whether to proceed, whether to delay, or whether not to proceed at all with development of a project on the north site. The amount and timing of any future

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expenditure, and the extent of any impact on existing operations, will depend on the nature and timing of the development we ultimately undertake, if any. If we decide to abandon any facilities in the development process, we would have to conduct a review for impairment with a possible write-down and review their useful lives with a possible adjustment to depreciation and amortization expense. These reviews could result in adjustments that have a material adverse effect on our results of operations.

We have received proposed assessments from the Indiana Department of Revenue in connection with the examination of our Indiana income tax returns for the years 1996 through 2000. Those assessments are based on the IDR's position that our gaming taxes that are based on gaming revenue are not deductible for Indiana income tax purposes. We filed a petition in Indiana Tax Court for the 1996 and 1997 tax years and oral arguments were heard in April 2001. We have filed a formal protest for the years 1998 through 2000. We believe that we have meritorious legal defense to those assessments and have not recorded an accrual for payment. It is reasonably possible that our estimate may change in the near term. The amount involved, including our estimate of interest, net of a federal income tax benefit assuming continuation through October 2, 2003, was approximately \$10.8 million at October 2, 2003.

We have severance agreements with certain of our senior executives. Severance benefits range from a lump-sum cash payment equal to three times the sum of the executive's annual base salary and the average of the executive's annual bonuses awarded in the preceding three years plus payment of the value in the executive's outstanding stock options and vesting and distribution of any restricted stock to a lump-sum cash payment equal to one half of the executive's annual base salary. In certain agreements, the termination must be as a result of a change in control of Aztar. Based upon salary levels and stock options at October 2, 2003, the aggregate commitment under the severance agreements should all these executives be terminated was approximately \$40 million at October 2, 2003.

At October 2, 2003, we had commitments of approximately \$97 million for the Tropicana Atlantic City expansion project.

Results of Operations

Nine Months Ended October 2, 2003 Compared to Nine Months Ended October 3, 2002

Our consolidated revenues in the 2003 nine-month period were \$627.8 million, down slightly from \$635.2 million in the 2002 nine-month period.

Consolidated operating income was \$107.3 million in the nine months of 2003 compared with \$108.6 million in the nine months of 2002. Consolidated property taxes and insurance were \$2.1 million or 10% higher in the 2003 versus 2002 nine-month period. Effective June 30, 2002, we renewed our property insurance and effective November 1, 2002, we renewed our excess general liability insurance. As a result of conditions in the insurance markets, our insurance costs increased substantially, reflecting increases at all properties. Property taxes increased at Tropicana Atlantic City.

Consolidated rent expense was \$3.4 million or 35% lower in the 2003 versus 2002 nine-month period primarily due to decreased rent at Casino Aztar Evansville and Tropicana Las Vegas. As a result of our acquisition of the partnership interest in Tropicana Enterprises, we have eliminated, after February 28, 2002, our real estate rent expense at the Las Vegas Tropicana, which was \$1.4 million prior to the acquisition, net of intercompany eliminations. In addition, the acquisition eliminated, after February 28, 2002, our equity in unconsolidated partnership's loss. Rent expense at

Casino Aztar Evansville decreased \$2.0 million in the 2003 versus 2002 nine-month period primarily due to a decrease in rent relating to our riverboat landing lease. On December 27, 2002, we amended our riverboat landing lease agreement with the City of Evansville. We agreed to change a portion of our contingent rent into a fixed stated amount and to make it available to the City at its request. The City agreed to provide us with \$1 of credit against our rent for each \$2.50 of development capital expenditures that we make. Therefore, we are preparing plans for development in Evansville.

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Consolidated interest expense was \$27.5 million in the nine months of 2003 compared with \$31.4 million in the nine months of 2002. The decrease in interest expense was primarily a result of an increase in capitalized interest relating to the Atlantic City Tropicana expansion. Capitalized interest was \$3.9 million higher in the 2003 versus 2002 nine-month period.

TROPICANA ATLANTIC CITY Total revenues at Tropicana Atlantic City were \$331.7 million in the 2003 nine-month period, down 5% from \$347.4 million in the 2002 nine-month period. Casino revenue was \$15.5 million or 5% lower in the 2003 versus 2002 nine-month period, primarily reflecting decreases in slot revenue and games revenue of 4% and 6%, respectively. The decline in both slot revenue and games revenue was attributable to a decrease in the volume of play. The reduced volume of play was a function of additional competition in Atlantic City due to the July 3, 2003 opening of the Borgata Hotel, Casino and Spa.

Operating income was \$68.2 million in the 2003 nine-month period, down 7% from \$73.1 million in the 2002 nine-month period. Casino costs decreased \$7.9 million, or 6% from \$128.6 million in the nine months of 2002. The decrease in casino costs is consistent with the overall decrease in casino revenue during the 2003 nine-month period. Marketing costs were \$4.3 million, or 10% lower in the nine months of 2003 compared to the nine months of 2002. The decrease in marketing costs is primarily related to a decrease in promotional expenses. Operating income is after depreciation and amortization of \$22.6 million in the 2003 nine-month period compared with \$21.6 million in the 2002 nine-month period.

TROPICANA LAS VEGAS At Tropicana Las Vegas, total revenues were \$116.3 million in the nine months of 2003, up 3% from \$112.6 million in the nine months of 2002. Operating income was \$14.8 million in the nine months of 2003, a 15% improvement over \$12.9 million in the nine months of 2002. Rent expense was \$0.5 million in the 2003 nine-month period compared to \$1.9 million in the 2002 nine-month period. As a result of our acquisition of the partnership interest in Tropicana Enterprises, we have eliminated, after February 28, 2002, our real estate rent expense at the Las Vegas Tropicana, which was \$1.4 million prior to the acquisition, net of intercompany eliminations. Operating income is after depreciation and amortization of \$5.0 million in the 2003 nine-month period compared with \$5.1 million in the 2002 nine-month period.

RAMADA EXPRESS At Ramada Express, total revenues were \$68.0 million in the 2003 nine-month period, down

3% from \$70.2 million in the 2002 nine-month period. Operating income was \$11.2 million in the 2003 nine-month period, a 13% decrease from \$12.9 million in the 2002 nine-month period. Operating income is after depreciation and amortization of \$4.7 million in the nine months ended 2003 compared with \$4.5 million in the nine months ended 2002.

CASINO AZTAR EVANSVILLE Total revenues at Casino Aztar Evansville were \$94.1 million in the 2003 nine-month period, up 9% from \$86.3 million in the 2002 nine-month period. Casino Aztar Evansville benefited from a change in the State of Indiana rules of operation permitting open boarding of casino patrons that went into effect August 1, 2002. Dockside gaming increased accessibility to our casino riverboat by eliminating cruising schedules. Casino revenue was \$7.6 million or 10% higher in the 2003 nine-month period compared to the 2002 nine-month period. The increase in casino revenue was primarily attributable to an increase in slot revenue.

Operating income was \$23.2 million in the 2003 nine-month period, a 27% increase from \$18.3 million in the 2002 nine-month period. Casino costs were \$6.2 million or 23% higher in the 2003 versus 2002 nine-month period. Casino costs were higher due to the institution of a graduated gaming tax structure by the state of Indiana and an increase in payroll costs. Gaming taxes were \$4.5 million higher in the 2003 versus 2002 nine-month period, which included \$1.3 million recorded in the second quarter of 2003 as a result of an Indiana legislation change requiring casino operators to retroactively apply the dockside graduated tax rates effective July 1, 2002 versus August 1, 2002, the date dockside gaming came into effect. Other costs were \$1.5 million lower in the 2003 versus 2002 nine-month period due to a decrease

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in our admission tax. Our admission tax decreased as a result of dockside gaming. With dockside gaming, effective August 1, 2002, our admission tax became \$3 per entry versus \$3 per person per cruise. Rent expense was \$3.4 million in the nine months of 2003 compared with \$5.4 million in the nine months of 2002. Rent expense decreased primarily as a result of a decrease in rent relating to our riverboat landing lease. On December 27, 2002, we amended our riverboat landing lease agreement with the City of Evansville. We agreed to change a portion of our contingent rent into a fixed stated amount and to make it available to the City at its request. The City agreed to provide us with \$1 of credit against our rent for each \$2.50 of development capital expenditures that we make. Therefore, we are preparing plans for development in Evansville. Operating income is after depreciation and amortization of \$4.1 million in the 2003 nine-month period compared with \$4.7 million in the 2002 nine-month period.

CASINO AZTAR CARUTHERSVILLE Total revenues at Casino Aztar Caruthersville were \$17.7 million in the 2003 nine-month period compared with \$18.7 million in the 2002 nine-month period. Casino Aztar Caruthersville had operating income of \$1.3 million in the 2003 nine-month period compared to \$1.4 million in the 2002 nine-month period. Operating income is after depreciation and amortization of \$2.0 million in the 2003 nine-month period compared with \$2.1 million in the 2002 nine-month period.

Quarter Ended October 2, 2003 Compared to Quarter Ended October 3, 2002

The Company's consolidated revenues in the 2003 third quarter were \$210.3 million, a 4% decrease from \$218.1 million in the 2002 third quarter. Consolidated rooms revenue was \$2.5 million or 13% higher in the 2003 versus 2002 third quarter. This improvement relates to an increase in occupied rooms on a non-complimentary basis at Tropicana Atlantic City and Tropicana Las Vegas of 9% and 5%, respectively, combined with an increase in average daily rates at both properties.

Consolidated operating income was \$35.6 million in the third quarter of 2003, down 4% from \$36.9 million in the third quarter of 2002. Consolidated rooms costs were \$0.8 million higher in the 2003 versus 2002 third quarter. The increase in rooms costs consists primarily of an increase at Tropicana Atlantic City and Tropicana Las Vegas due to an increase in occupied rooms on a non-complimentary basis. Consolidated marketing costs were \$3.0 million, or 14% lower in the 2003 versus 2002 third quarter primarily due to a reduction in promotional expenses at Tropicana Atlantic City. Consolidated interest expense was \$8.8 million in the third quarter of 2003 compared with \$10.3 million in the third quarter of 2002. The decrease in interest expense was primarily a result of an increase in capitalized interest relating to the Atlantic City Tropicana expansion. Capitalized interest was \$1.6 million higher in the 2003 versus the 2002 third quarter.

Consolidated rent expense was \$0.8 million or 28% lower in the 2003 versus 2002 third quarter. This decrease was related primarily to a \$0.7 million reduction in rent expense at Casino Aztar Evansville. On December 27, 2002, we amended our riverboat landing lease with the City of Evansville. We agreed to change a portion of our contingent rent into a fixed stated amount and make it available to the City at its request. The City agreed to provide us with \$1 of credit against our rent for each \$2.50 of development capital expenditures that we make. Therefore, we are preparing plans for development in Evansville.

TROPICANA ATLANTIC CITY Total revenues at Tropicana Atlantic City were \$111.9 million in the 2003 third quarter, a 9% decrease from \$122.6 million in the 2002 third quarter. Casino revenue was \$11.5 million or 11% lower in the 2003 versus 2002 third quarter, primarily reflecting decreases in slot revenue and games revenue of 8% and 17%, respectively. The decline in both slot revenue and games revenue was primarily attributable to a decrease in the volume of play. The reduced volume of play was a function of additional competition in Atlantic City due to the July 3, 2003 opening of the Borgata Hotel, Casino and Spa combined with severe weather conditions along the Atlantic coastline during the third quarter of 2003. Rooms revenue was \$1.1 million higher in the 2003 third quarter compared with the 2002 third quarter due to a 9% increase in occupied rooms on a non-complimentary basis combined with an average daily rate increase of 7%.

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Operating income was \$23.9 million in the third quarter of 2003, an 11% decline from \$26.8 million in the third quarter of 2002. Casino costs were \$40.4 million in the third quarter of 2003, a 9% reduction from \$44.5 million in the

third quarter of 2002. The reduction in casino costs is related to the decrease in casino revenue.

Rooms costs were \$3.7 million in the third quarter of 2003, a 9% increase from \$3.4 million in the third quarter of 2002. The increase in rooms costs was consistent with the increase in occupied rooms on a non-complimentary basis. Marketing costs were \$2.9 million lower in the 2003 versus 2002 third quarter as previously discussed. Operating income is after depreciation and amortization of \$7.6 million in the third quarter of 2003 compared with \$7.3 million in the third quarter of 2002.

TROPICANA LAS VEGAS At Tropicana Las Vegas, total revenues were \$39.5 million in the 2003 third quarter, a 6% increase from \$37.3 million in the 2002 third quarter. Rooms revenue was \$1.4 million higher in the 2003 third quarter compared with the 2002 third quarter as a result of a 5% increase in occupied rooms on a non-complimentary basis combined with an average daily rate increase of 11%.

Operating income was \$5.3 million in the third quarter of 2003 compared with \$3.8 million in the third quarter of 2002. Rooms costs were \$0.3 million higher in the 2003 versus 2002 third quarter as a result of an increase in occupied rooms on a non-complimentary basis. Operating income is after depreciation and amortization of \$1.7 million in both periods.

RAMADA EXPRESS At Ramada Express, total revenues were \$20.8 million in the 2003 third quarter, down 2% from \$21.2 million in the 2002 third quarter. Operating income was \$1.8 million in the third quarter of 2003 compared with \$2.4 million in the third quarter of 2002. Operating income is after depreciation and amortization of \$1.5 million in both periods.

CASINO AZTAR EVANSVILLE Total revenues at Casino Aztar Evansville were \$32.3 million in the 2003 third quarter, up 4% from \$31.0 million in the 2002 third quarter. Casino Aztar Evansville benefited from a change in the State of Indiana rules of operation permitting open boarding of casino patrons that went into effect August 1, 2002. Dockside gaming increased accessibility to our casino riverboat by eliminating cruising schedules. Casino revenue was \$1.3 million or 5% higher in the 2003 versus 2002 third quarter primarily due to an increase in slot revenue.

Operating income was \$7.9 million in the 2003 third quarter, an 18% increase from \$6.7 million in the 2002 third quarter. Casino costs were \$1.1 million or 11% higher in the 2003 versus 2002 third quarter. Casino costs were higher due to an increase in gaming taxes that are based on casino revenue and an increase in payroll costs. Other costs totaled \$1.2 million in the 2003 third quarter compared with \$1.4 million in the 2002 third quarter. As previously discussed, the reduction in other costs is related to a decrease in the admissions tax which resulted from the dockside gaming rules, which became effective August 1, 2002. Rent expense was \$1.1 million in the 2003 third quarter compared with \$1.9 million in the 2002 third quarter. Rent expense decreased primarily as a result of a decrease in rent relating to our riverboat landing lease. On December 27, 2002, we amended our riverboat landing lease agreement with the City of Evansville. We agreed to change a portion of our contingent rent into a fixed stated amount and to make it available to the City at its request. The City agreed to provide us with \$1 of credit against our rent for each \$2.50 of development capital expenditures that we make. Therefore, we are preparing plans for development in Evansville. Operating income is after depreciation and amortization of \$1.5 million in the 2003 third quarter compared with \$1.7 million in the 2002 third quarter.

CASINO AZTAR CARUTHERSVILLE Total revenues at Casino Aztar Caruthersville were \$5.8 million in the 2003 third quarter, a slight decrease from \$6.0 million in the 2002 third quarter. Casino Aztar Caruthersville had operating income of \$0.4 million in the third quarter of 2003, which remained unchanged from the third quarter of 2002. Operating income is after depreciation and amortization of \$0.7 million in both periods.

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Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America that require us to make estimates and assumptions about the effects of matters that are inherently uncertain. These estimates and assumptions affect the reported amounts and disclosures in our consolidated financial statements. Of our accounting estimates, we believe the following may involve a higher degree of judgment and complexity.

Property and equipment - At October 2, 2003, our property and equipment of \$1.1 billion, represented 86% of our total assets. We depreciate the property and equipment on a straight-line basis over their estimated useful lives. The estimated useful lives are based on the nature of the assets as well as our current operating strategy. Future events, such as property expansions, property developments, new competition, new regulations and new taxes, could result in a change in the manner in which we are using certain assets requiring a change in the estimated useful lives of such assets. In assessing the recoverability of the carrying value of property and equipment if events and circumstance warrant such an assessment, we must make assumptions regarding estimated future cash flows and other factors. If these estimates or the related assumptions change, we may be required to record an impairment loss for these assets. Such an impairment loss would be recognized as a non-cash component of operating income. See the earlier discussion under "Financial Condition". The carrying value of the property and equipment used in the operation of the Tropicana Las Vegas, excluding land at \$110 million, was \$60.5 million at October 2, 2003.

Income tax liabilities - The Internal Revenue Service is examining the Company's income tax returns for the years 1994 through 2002. For the years 1994 through 1999 the IRS has settled for all but two issues. The two issues involve the deductibility of certain complimentary services provided to customers and the deductibility of a portion of payments on certain liabilities related to the Restructuring. In the fourth quarter of 2002, we settled these same two issues with the IRS for the years 1992 and 1993, resulting in a tax benefit of \$1.0 million. We have estimated and provided for income taxes and interest in accordance with the IRS position. It is reasonably possible that these two issues for 1994 through 1999 could be favorably settled in the near term. On July 2, 2002, the State of New Jersey enacted the Business Tax Reform Act, which was retroactive to the beginning of 2002. We have provided for New Jersey income taxes based on our best estimate of the effect of this new law. Certain provisions of the Act are subject to future rules and regulations and the discretion of the Director. We have received proposed assessments from the Indiana Department of Revenue in connection with the examination of the Company's Indiana income tax returns for the years 1996 through 2000. See the earlier discussion under "Financial Condition".

Ramada indemnification - We have agreed to indemnify Ramada against all monetary judgments in lawsuits pending against Ramada and its subsidiaries as of the conclusion of the Restructuring on December 20, 1989, as well as all related attorneys' fees and expenses not paid at that time, except for any judgments, fees or expenses accrued on the hotel business balance sheet and except for any unaccrued and unreserved aggregate amount up to \$5.0 million of judgments, fees or expenses related exclusively to the hotel business. Aztar is entitled to the benefit of any crossclaims or counterclaims related to such lawsuits and of any insurance proceeds received. There is no limit to the term or the

maximum potential future payment under this indemnification. In addition, we agreed to indemnify Ramada for certain lease guarantees made by Ramada. The lease terms potentially extend through 2015 and Ramada guaranteed all obligations under these leases. We have recourse against a subsequent purchaser of the operations covered by these leases. The estimated maximum potential amount of future payments we could be required to make under these indemnifications is \$8.1 million at October 2, 2003. In connection with these matters, our accrued liability was \$3.8 million at both October 2, 2003 and January 2, 2003.

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Stock Option Accounting

As permitted under generally accepted accounting principles, we have elected to follow Accounting Principles Board Opinion No. 25 entitled "Accounting for Stock Issued to Employees" and related Interpretations in accounting for our stock-based employee compensation arrangements because the alternative fair-value-based method of accounting provided for under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 entitled "Accounting for Stock-Based Compensation" requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of our stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Under SFAS 123, the estimated fair value of our stock options would be amortized to expense over their vesting period.

Pro forma information regarding net income and earnings per share as if we had accounted for our stock options under the fair-value-based method of accounting for the periods ended October 2, 2003 and October 3, 2002 is as follows (in millions, except for net income per common share information):

| | <u>Third Quarter</u> | | <u>Nine Months</u> | |
|---|----------------------|-------------|--------------------|-------------|
| | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> |
| Net income, as reported | | | | |
| Deduct: Total stock-based employee compensation expense determined under the fair-value-based method of accounting, net of income tax benefit | \$ 16.9 | \$ 16.6 | \$ 49.2 | \$ 46.8 |

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| | | | | |
|--------------------------------------|--------------|--------------|--------------|--------------|
| Pro forma net income | <u>(0.8)</u> | <u>(0.9)</u> | <u>(2.3)</u> | <u>(2.7)</u> |
| Net income per common share: | \$ 16.1 | \$ 15.7 | \$ 46.9 | \$ 44.1 |
| As reported | ===== | ===== | ===== | ===== |
| Pro forma | \$.48 | \$.44 | \$ 1.38 | \$ 1.24 |
| Net income per common share assuming | \$.46 | \$.42 | \$ 1.31 | \$ 1.17 |
| dilution: | | | | |
| As reported | | | | |
| Pro forma | \$.46 | \$.43 | \$ 1.33 | \$ 1.19 |
| | \$.44 | \$.41 | \$ 1.28 | \$ 1.13 |

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." The objective of FIN 46 is to improve financial reporting by enterprises involved with variable interest entities. FIN 46 establishes requirements for which and when business enterprises should consolidate variable interest entities. An entity subject to the consolidation requirements of FIN 46 is referred to as a variable interest entity. Consolidation is required under FIN 46 when either of the following conditions is present: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties or (2) the equity investors (as a group) do not hold a controlling financial interest in the entity. A variable interest entity formed subsequent to January 31, 2003 is immediately subject to FIN 46. For variable interest entities formed prior to February 1, 2003, the effective date for public companies was delayed until the first reporting period ending after December 15, 2003. Based on a preliminary review, we expect FIN 46 to have no effect on our consolidated financial position, results of operations or cash flows.

Subsequent Event

An accident occurred on the site of the construction of the parking-garage component of the expansion of the Atlantic City Tropicana on Thursday, October 30. The accident resulted in four fatalities and serious injuries to over 20 workers, as

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well as extensive damage to the facilities under construction. Access to the property was limited during the subsequent days because some of the streets surrounding the property were closed. In addition, the Tropicana's operations have been disrupted by the temporary closure of one of the property's three hotel towers (the West Tower, containing 600 rooms) and the parking

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garages that are part of the existing property. While most points of access were largely restored as of November 2, the West Tower, the parking garages, the bus terminal and the pedestrian bridge over Pacific Avenue are not available for use as of November 4 while measures are taken to make the area safe and permit removal of debris. The Company is awaiting the results of an investigation to determine the extent of damages and the effects of the accident on the operation of the property and the construction of the expansion and the timing of its opening. The Company has insurance coverage, including business interruption insurance.

Private Securities Litigation Reform Act

Certain information included in Aztar's Form 10-K for the year ended January 2, 2003, this Form 10-Q and other materials filed or to be filed with, or furnished or to be furnished to the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by us including those made in Aztar's 2002 annual report) contains statements that are forward-looking. These include forward-looking statements relating to the following activities, among others: operation and expansion of existing properties, in particular the Atlantic City Tropicana, including future performance; development of the Las Vegas Tropicana and financing and/or concluding an arrangement with a partner for such development; other business development activities; stock repurchases; debt repayments; and use of derivatives. These forward-looking statements generally can be identified by phrases such as we "believe," "expect," "anticipate," "foresee," "forecast," "estimate," "target," or other words or phrases of similar import. Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals are also forward-looking statements. Such forward-looking information involves important risks and uncertainties that could significantly affect results in the future and, accordingly, such results may differ materially from those expressed in any forward-looking statements made by us or on our behalf. These risks and uncertainties include, but are not limited to, the following factors as well as other factors described from time to time in Aztar's reports filed with or furnished to the SEC: those factors relating to war and terrorist activities and other factors affecting discretionary consumer spending; business and economic conditions; the impact of new competition including the Borgata, which opened in Atlantic City in July 2003, and the effects of other competition, including locations of competitors and operating and marketing competition; our ability to complete the Tropicana Atlantic City expansion on budget and on time; the success of "The Quarter;" the ongoing benefit of dockside gaming in Indiana; our ability to execute our development plans in a timely and cost-effective manner; estimates of development costs and returns on development capital; construction and development factors, including zoning and other regulatory issues, environmental restrictions, soil conditions, weather, fire, flood and other natural hazards, site access matters, shortages of material and skilled labor, labor disputes and work stoppages, and engineering and equipment problems; factors affecting leverage and debt service, including sensitivity to fluctuation in interest rates; access to available and feasible financing; regulatory and licensing matters; third-party consents, approvals and representations, and relations with partners, owners, suppliers and other third parties; reliance on key personnel; the cyclical nature of the hotel business and the gaming business; the effects of weather; market prices of our common stock; litigation outcomes, judicial actions and legislative matters and referenda including the potential legalization of gaming in Maryland, New York and Pennsylvania, and taxation including potential tax increases in Indiana, Missouri, Nevada and New Jersey. Any forward-looking statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.

AZTAR CORPORATION AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For current information that affects information incorporated by reference in Item 7A of the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2003 see "Note 5: Long-term Debt" of the Notes to Consolidated Financial Statements included in this Form 10-Q under Item 1.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation as of October 2, 2003, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective to provide reasonable assurance that the desired control objectives were achieved.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting during the quarter ended October 2, 2003, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In connection with Case No. CV-S-94-1126-DAE(RJJ)-BASE FILE (the "Poulos/Ahearn Case"), Case No. CV-S-95-00923-DWH(RJJ) (the "Schreier Case") and Case No. CV-S-95-936-LDG(RLH) (the "Cruise Ship Case"), (collectively, the "Consolidated Cases" as Case No. CV-S-94-1126-RLH(RJJ)), as reported under Part I, Item 3 of the Company's Form 10-K for the year ended January 2, 2003, the parties are in the process of briefing the matter in the Ninth Circuit, as reported under Part II, Item 1 of the Company's Form 10-Q for the quarter ended April 3, 2003.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| | |
|------|--|
| 31.1 | Certification of CEO. |
| 31.2 | Certification of CFO. |
| 32 | Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

AZTAR CORPORATION AND SUBSIDIARIES

(b) Reports on Form 8-K

On October 15, 2003, the Company filed a report on Form 8-K under Items 7. and 9. to furnish news releases as Exhibit 99.1 and Exhibit 99.2 and related brochure as Exhibit 99.3 announcing release by the Company's Tropicana Casino and Resort in Atlantic City, New Jersey, of the names of the tenants in its The Quarter dining, entertainment, retail and spa complex scheduled to open March 2004.

On October 22, 2003, the Company filed a report on Form 8-K under Items 7. and 12. to furnish a press release as Exhibit 99 announcing the Company's financial results for its third quarter ended October 2, 2003.

AZTAR CORPORATION AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AZTAR CORPORATION

(Registrant)

Date: November 4, 2003

ROBERT M. HADDOCK

Robert M. Haddock

President and Chief Financial Officer

AZTAR CORPORATION AND SUBSIDIARIES

EXHIBIT INDEX

| <u>Exhibit Number</u> | <u>Description</u> |
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